

# **SIR Royalty Income Fund**

Consolidated Financial Statements  
(Unaudited)

**For the period from January 1, 2005  
to March 31, 2005**

# SIR Royalty Income Fund

## Consolidated Balance Sheet

(Unaudited)

|   | <b>March 31,<br/>2005</b> | <b>December 31,<br/>2004</b> |
|---|---------------------------|------------------------------|
|   | \$                        | \$<br>(restated –<br>note 2) |
| <b>Assets</b>   |                           |                              |
| <b>Current assets</b>   |                           |                              |
| Prepaid expenses and other assets                             | 76,859                    | 97,296                       |
| Amounts due from related parties (note 7)                     | 1,383,858                 | 742,540                      |
|   | <u>1,460,717</u>          | <u>839,836</u>               |
| <b>Loan receivable from SIR Corp.</b> (note 3)                | 40,000,000                | 40,000,000                   |
| <b>Investment in SIR Royalty Limited Partnership</b> (note 4) | 11,166,671                | 11,166,671                   |
|   | <u>52,627,388</u>         | <u>52,006,507</u>            |
| <b>Liabilities</b>  |                           |                              |
| <b>Current liabilities</b>                                    |                           |                              |
| Accounts payable and accrued liabilities                      | 133,523                   | 104,002                      |
| Amounts due to related parties (note 7)                       | 944,426                   | 228,771                      |
|   | <u>1,077,949</u>          | <u>332,773</u>               |
| <b>Unitholders' Equity</b> (note 5)                           | 51,549,439                | 51,673,734                   |
|   | <u>52,627,388</u>         | <u>52,006,507</u>            |

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

# **SIR Royalty Income Fund**

Consolidated Statement of Earnings

(Unaudited)

For the period from January 1, 2005 to March 31, 2005

---

|  | \$               |
|--|------------------|
| <b>Investment income</b>                                 |                  |
| Distribution income from Partnership (notes 4 and 7)     | 848,890          |
| Interest income (note 3)                                 | <u>750,000</u>   |
|  | 1,598,890        |
| <b>Expenses</b>  |                  |
| General and administrative                               | <u>116,185</u>   |
| <b>Net earnings for the period</b>                       | <u>1,482,705</u> |
| <b>Basic and diluted earnings per Fund unit</b> (note 6) | <u>\$0.28</u>    |

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

# **SIR Royalty Income Fund**

Consolidated Statement of Unitholders' Equity

(Unaudited)

**For the period from January 1, 2005 to March 31, 2005**

---

|                                  | \$                 |
|----------------------------------|--------------------|
| <b>Balance – January 1, 2005</b> | 51,673,734         |
| Net earnings for the period      | 1,482,705          |
| Distributions declared and paid  | <u>(1,607,000)</u> |
| <b>Balance – March 31, 2005</b>  | <u>51,549,439</u>  |

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

# **SIR Royalty Income Fund**

Consolidated Statement of Cash Flows

(Unaudited)

For the period from January 1, 2005 to March 31, 2005

---

|  | \$                 |
|--|--------------------|
| <b>Cash provided by (used in)</b>                      |                    |
| <b>Operating activities</b>                            |                    |
| Net earnings for the period                            | 1,482,705          |
| Net change in non-cash working capital items           | <u>124,295</u>     |
|  | 1,607,000          |
| <b>Financing activities</b>                            |                    |
| Distributions paid                                     | <u>(1,607,000)</u> |
| <b>Change in cash and cash equivalents</b>             | -                  |
| <b>Cash and cash equivalents – Beginning of period</b> | <u>-</u>           |
| <b>Cash and cash equivalents – End of period</b>       | <u><u>-</u></u>    |

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

# **SIR Royalty Income Fund**

Notes to Consolidated Financial Statements

(Unaudited)

**March 31, 2005**

---

## **1 The Fund**

SIR Royalty Income Fund is a trust established on August 23, 2004 under the laws of the Province of Ontario.

On October 1, 2004, SIR Royalty Income Fund (the "Fund") filed a final prospectus for a public offering of units of the Fund. The net proceeds of the offering to the Fund of \$51,166,670 were used by the Fund to acquire, directly, certain bank debt of SIR Corp. (the "SIR loan") and indirectly, through SIR Holdings Trust (the "Trust"), all of the Ordinary LP units of SIR Royalty Limited Partnership (the "Partnership"). The Partnership owns the Canadian trademarks (the "SIR Rights") formerly owned or licensed by SIR Corp. ("SIR") or its subsidiaries and used in connection with the operation of the majority of SIR's restaurants in Canada (the "SIR restaurants"). The Partnership has granted SIR a 99-year 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 the royalty pool (the "License and Royalty Agreement"). The Fund, indirectly, participates in the revenue generated under the License and Royalty Agreement through its investment in the Partnership (note 4).

## **2 Summary of significant accounting policies**

The accompanying interim consolidated financial statements of the Fund have been prepared in accordance with accounting principles generally accepted in Canada. In the opinion of management, all adjustments considered necessary for fair presentation have been included. All such adjustments are of a normal recurring nature. Operating results for the three months ended March 31, 2005 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2005. Independent chartered accountants have not audited the information presented in these interim consolidated financial statements.

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the Fund and its subsidiaries, namely the Trust and SIR GP Inc. All intercompany accounts and transactions have been eliminated.

### **Use of estimates**

The preparation of these 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.

# **SIR Royalty Income Fund**

Notes to Consolidated Financial Statements

(Unaudited)

**March 31, 2005**

---

## **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 revenue during SIR's fourth quarter (ending the last Sunday in August) when patios can be open. Additionally, certain holidays and observances also affect dining patterns both favourably and unfavourably. Accordingly, distribution income recognized by the Fund will vary in conjunction with the seasonality in revenue experienced by SIR.

## **Cash and cash equivalents**

Cash is defined as cash and short-term investments with original maturities of three months or less.

## **Earnings per Fund unit**

The earnings per Fund unit are based on the weighted average number of Fund units outstanding during the period. Diluted earnings per Fund unit are calculated to reflect the dilutive effect, if any, of SIR exercising its right to exchange its Class A GP units of the Partnership into Fund units at the beginning of the period.

## **Distributions**

Distributions to unitholders are intended to be made monthly in arrears and are recorded when declared by the Trustees of the Fund.

## **Financial instruments**

The Fund's financial instruments consist of cash and cash equivalents, loan receivable from SIR Corp., accounts payable and accrued liabilities and amounts due to and from related parties. Unless otherwise noted, it is management's opinion that the Fund is not exposed to significant interest or credit risks arising from these financial instruments. Management estimates that the fair values of these financial instruments approximate their carrying values, unless otherwise noted.

## **Income taxes**

The Fund is a unit trust for income tax purposes. As such, the Fund is only taxable on income not distributed to unitholders. As substantially all taxable income is allocated to unitholders, no provision for income taxes has been made for earnings of the Fund. The Fund's subsidiaries also are not required to pay tax, and accordingly, no provision for income taxes has been made for the earnings of the Fund's subsidiaries.

**SIR Royalty Income Fund**  
Notes to Consolidated Financial Statements  
(Unaudited)  
**March 31, 2005**

---

**Investment and loan receivable**

The investment in SIR Royalty Limited Partnership is recorded at cost and written down to its estimated realizable amount when there is evidence of an impairment. Distribution income from the Partnership is recorded when distributions are declared by the Partnership. To date, had the Fund used the equity method to account for the investment in the Partnership there would not have been any impact on net earnings for the period or the balance of the Fund's investment in the Partnership. The loan receivable from SIR Corp. is reviewed for impairment. If an impairment is identified the loan would be reduced to its estimated recoverable amount measured by expected future cash flows. The accrual of interest would be suspended if collection becomes doubtful. At December 31, 2004 and March 31, 2005 there is no impairment of the investment or loan receivable.

**Changes in accounting policy**

**Consolidation of Variable Interest Entities ("VIEs"), Accounting Guideline – 15**

Effective January 1, 2005, the Fund adopted Accounting Guideline – 15 ("AcG-15") of the Canadian Institute of Chartered Accountants ("CICA"), Consolidation of Variable Interest Entities ("VIEs") which requires the consolidation of VIEs by the primary beneficiary. A VIE is an entity where (a) its equity investment at risk is insufficient to permit the entity to finance its activities without additional subordinated support from others and/or where certain essential characteristics of a controlling financial interest are not met, and (b) it does not meet specified exemption criteria. The primary beneficiary is the enterprise that will absorb or receive the majority of the VIE's expected losses, expected residual returns, or both.

The Fund has determined that the Partnership is a VIE and that SIR, under AcG-15, is the primary beneficiary of the Partnership. Therefore the Fund will no longer consolidate the Partnership which it had done previously based on the former consolidation guidelines. The prior year results have been restated to exclude the balances and transactions of the Partnership and to record the Fund's investment in the Partnership at cost. The effect of this change in accounting policy on the consolidated balance sheet as at December 31, 2004 was as follows:

|   | <b>Balance as<br/>previously<br/>reported</b> | <b>Adjustment</b> | <b>Balance as<br/>restated</b> |
|---|---|-------------------|--------------------------------|
|   | \$  | \$                | \$                             |
| Current assets                                | 1,038,941                                     | (199,105)         | 839,836                        |
| Loan receivable from SIR Corp.                | 40,000,000                                    | -                 | 40,000,000                     |
| Intangible assets                             | 53,585,422                                    | (53,585,422)      | -                              |
| Investment in SIR Royalty Limited Partnership | -   | 11,166,671        | 11,166,671                     |
| Current liabilities                           | 531,865                                       | (199,092)         | 332,773                        |
| Non-controlling interest                      | 45,951,852                                    | (45,951,852)      | -                              |
| Unitholders' equity                           | 48,140,646                                    | 3,533,088         | 51,673,734                     |



# **SIR Royalty Income Fund**

Notes to Consolidated Financial Statements

(Unaudited)

**March 31, 2005**

---

The change in accounting policy has had no impact on the consolidated net earnings for the period from August 23, 2004 to December 31, 2004.

The Partnership agreed to pay \$3,533,088 of the cost of the public offering of the Fund and the issuance of the Ordinary LP units of the Partnership and accordingly, upon adoption of AcG-15, unitholders' equity increased by an equivalent amount.

## **Recently issued accounting pronouncements**

### **Financial Instruments – Recognition and Measurement, Handbook Section 3855**

Section 3855 prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the balance sheet and at what amount – in certain instances using fair value and in others using cost-based measures. It also specifies how financial instrument gains and losses are to be presented.

Section 3855 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year ending on or after December 31, 2004. The Fund plans to adopt this standard for its 2007 fiscal year. Transitional provisions for this Section are complex and vary based on the type of financial instrument under consideration.

The Fund is currently evaluating the effect of this standard.

### **Comprehensive Income, Handbook Section 1530**

Section 1530 introduces a new requirement to temporarily present certain gains and losses outside net income.

Section 1530 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year ending on or after December 31, 2004. The Fund plans to adopt this standard for its 2007 fiscal year. Financial statements of prior periods are required to be restated for certain comprehensive income items. In addition, an enterprise is encouraged, but not required, to present reclassification adjustments in comparative financial statements provided for earlier periods.

The Fund is currently evaluating the effect of this standard.

# **SIR Royalty Income Fund**

Notes to Consolidated Financial Statements  
(Unaudited)  
**March 31, 2005**

---

## **Hedges – Handbook Section 3865**

Section 3865 establishes standards for when and how hedge accounting may be applied. Hedge accounting is optional. This Section applies for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Retroactive application is not permitted. Earlier adoption is permitted only as of the beginning of a fiscal year that ends on or after December 31, 2004.

The Fund plans to adopt this standard for its 2007 fiscal year. The Fund has no arrangements for hedging, and the adoption of this standard is not expected to have any impact on the Fund at this time.

## **3 Loan receivable from SIR Corp.**

The SIR loan bears interest at 7.5% per annum, is due October 12, 2044 and is collateralized by a general security agreement covering substantially all of the assets of SIR and its subsidiaries in Canada. Interest income of \$750,000 was earned during the period from January 1, 2005 to March 31, 2005.

SIR has the right to require the Fund to, indirectly, purchase the 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.

## **4 Investment in SIR Royalty Limited Partnership**

On October 12, 2004, the Fund, indirectly through the Trust, acquired all of the Ordinary LP units of the Partnership. The holders of the Ordinary LP and Class A GP units are entitled to receive a pro rata share of distributions of the Partnership. The holder of the Ordinary LP units have the right to receive distributions in priority to the Class A GP units. The subordination on the distributions on the Class A GP units of the Partnership ends on the date that both of the following conditions have been satisfied:

- a) Revenue of the SIR restaurants subject to the License and Royalty Agreement has not been less than \$127.4 million for each of two consecutive years commencing with SIR's fiscal year ending August 28, 2005; and
- b) Average monthly distributions of \$0.10 per Fund unit have been paid by the Fund and average quarterly cash distributions of at least \$0.30 have been paid by the Partnership to the Class A GP unitholders, in each case for the immediately preceding twelve month period.

The distributions from the Partnership primarily comprise revenue earned by the Partnership under the License and Royalty Agreement (note 1) less certain general and administrative expenses. Distributions earned for the period from January 1, 2005 to March 31, 2005 amount to \$848,890.

# SIR Royalty Income Fund

Notes to Consolidated Financial Statements

(Unaudited)

March 31, 2005

---

## 5 Fund units

An unlimited number of Fund units may be issued pursuant to the declaration of trust. Fund units are redeemable by the holder at a price equal to the lesser of 90% of the market price of a unit during the 10 consecutive trading day period ending on the trading day immediately prior to the date on which the units were surrendered for redemption and an amount based on the closing price on the redemption date, subject to certain restrictions. Each holder of units of the Fund participates pro rata in any distributions from the Fund. Income tax obligations related to the distributions by the Fund are obligations of the unitholders. The Fund issued one unit on August 23, 2004 for cash proceeds of \$10. Upon completion of the initial public offering, the initial unit was redeemed for \$10.

On October 12, 2004, the Fund issued 5,356,667 units for cash proceeds of \$51,166,670, net of unit issuance costs of \$2,400,000. As at March 31, 2005 and December 31, 2004, there are 5,356,667 units issued and outstanding. Each unit is entitled to one vote at any meeting of unitholders.

During the period from January 1, 2005 to March 31, 2005, the Fund declared distributions of \$0.30 per unit. Subsequent to March 31, 2005, the Fund declared a distribution of \$0.10 per unit for the month of March 2005.

## 6 Earnings per Fund unit

Basic earnings per Fund unit is computed by dividing net earnings by the weighted average number of Fund units outstanding during the period.

Subject to the subordination provisions of the Class A GP units, SIR has the right to convert the Class A GP units of the Partnership into units of the Fund. Diluted earnings per Fund unit is calculated using the weighted average number of Fund units outstanding adjusted to include the effect of the conversion of the Class A GP units of the Partnership into Fund units.

The following table reconciles the basic and diluted weighted average number of Fund units outstanding and basic and diluted earnings per Fund unit:

|  | Basic<br>earnings per<br>Fund unit | Adjustments<br>for<br>conversion of<br>Class A GP<br>units | Diluted<br>earnings per<br>Fund unit |
|--|------------------------------------|--|--------------------------------------|
| Net earnings   | \$1,482,705                        | \$177,653  | \$1,660,358                          |
| Earnings per Fund unit                               | \$0.28                             |  | \$0.28                               |
| Weighted average number of Fund units<br>outstanding | 5,356,667                          | 595,185  | 5,951,852                            |

**SIR Royalty Income Fund**  
Notes to Consolidated Financial Statements  
(Unaudited)  
**March 31, 2005**

---

**7 Related party transactions**

During the period from January 1, 2005 to March 31, 2005, the Fund received distribution income of \$848,890 from the Partnership. The Fund, indirectly through the Trust, is entitled to receive a pro rata share of all residual distributions. The Fund's distribution income is dependent upon the revenue generated by SIR for the restaurants subject to 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 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 restaurants in the royalty pool is equal to or greater than 68 or following October 12, 2019, whichever occurs first. On January 1 of each year (the adjustment date), following December 31, 2005, the restaurants subject to the License and Royalty Agreement are adjusted for new restaurants opened in the previous fiscal year. At each adjustment date, SIR will be entitled to convert its Class B GP units of the Partnership to Class A GP units of the Partnership based on a conversion formula defined in the License and Royalty Agreement.

The Partnership has entered into an arrangement with the Fund and the Trust whereby the Partnership will provide or arrange for the provision of services required in the administration of the Fund and the Trust. The Partnership has arranged for these services to be provided by SIR GP Inc. in its capacity as the Managing General Partner, or SIR as General Partner, of the Partnership. SIR, on behalf of SIR GP Inc., also provides services to the Partnership for its administration. For the period January 1, 2005 to March 31, 2005, the Partnership provided these services to the Fund and the Trust for consideration of \$6,000, which was the amount of consideration agreed to by the related parties.

Amounts due from related parties consist of:

|   | <b>March 31,<br/>2005</b> | <b>December 31,<br/>2004</b> |
|---|---------------------------|------------------------------|
|   | \$                        | \$                           |
| Distribution receivable                                       | -                         | 810,458                      |
| Advances payable  | -                         | (67,918)                     |
|   | <hr/>                     | <hr/>                        |
| Amounts receivable from SIR Royalty Limited Partnership – net | -                         | 742,540                      |
| Advances to SIR Corp.   | 1,383,858                 | -                            |
|   | <hr/>                     | <hr/>                        |
|   | 1,383,858                 | 742,540                      |
|   | <hr/>                     | <hr/>                        |

**SIR Royalty Income Fund**  
Notes to Consolidated Financial Statements  
(Unaudited)  
**March 31, 2005**

---

Amounts due to related parties consist of:

|  | <b>March 31,<br/>2005</b> | <b>December 31,<br/>2004</b> |
|--|---------------------------|------------------------------|
|  | <b>\$</b>                 | <b>\$</b>                    |
| Distributions receivable                             | (271,669)                 | -                            |
| Advances payable                                     | 1,216,095                 | -                            |
|  | <hr/>                     | <hr/>                        |
| Amounts due to SIR Royalty Limited Partnership – net | 944,426                   | -                            |
| Advances payable to SIR Corp.                        | -                         | 228,771                      |
|  | <hr/>                     | <hr/>                        |
|  | <b>944,426</b>            | <b>228,771</b>               |
|  | <hr/>                     | <hr/>                        |

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

# **SIR Royalty Limited Partnership**

Financial Statements  
(Unaudited)

**For the period from January 1, 2005  
to March 31, 2005**

# SIR Royalty Limited Partnership

Balance Sheet

(Unaudited)

---

|   | <b>March 31,<br/>2005</b> | <b>December 31,<br/>2004</b> |
|---|---------------------------|------------------------------|
|   | \$                        | \$                           |
| <b>Assets</b>                             |                           |                              |
| <b>Current assets</b>                     |                           |                              |
| Cash and cash equivalents                 | 50,676                    | 893,794                      |
| Prepaid expenses and other assets         | 32,735                    | 47,849                       |
| Amounts due from related parties (note 5) | 944,426                   | -                            |
|   | <hr/>                     | <hr/>                        |
|   | 1,027,837                 | 941,643                      |
| <b>Intangible assets</b> (note 3)         | 53,585,422                | 53,585,422                   |
|   | <hr/>                     | <hr/>                        |
|   | 54,613,259                | 54,527,065                   |
|   | <hr/>                     | <hr/>                        |
| <b>Liabilities</b>                        |                           |                              |
| <b>Current liabilities</b>                |                           |                              |
| Accounts payable and accrued liabilities  | 66,748                    | 79,015                       |
| Amounts due to related parties (note 5)   | 961,079                   | 862,618                      |
|   | <hr/>                     | <hr/>                        |
|   | 1,027,827                 | 941,633                      |
| <b>Partners' Interest</b> (note 4)        | 53,585,432                | 53,585,432                   |
|   | <hr/>                     | <hr/>                        |
|   | 54,613,259                | 54,527,065                   |
|   | <hr/>                     | <hr/>                        |

The accompanying notes are an integral part of these financial statements

# SIR Royalty Limited Partnership

## Statement of Earnings

(Unaudited)

For the period from January 1, 2005 to March 31, 2005

---

|                                    | \$                      |
|------------------------------------|-------------------------|
| <b>Revenue</b>                     |                         |
| Royalty income (notes 1 and 5)     | 1,783,148               |
| Administration fee (note 5)        | 6,000                   |
| Other income                       | <u>1,725</u>            |
|                                    | 1,790,873               |
| <b>Expenses</b>                    |                         |
| General and administrative         | <u>14,327</u>           |
| <b>Net earnings for the period</b> | <u><u>1,776,546</u></u> |

The accompanying notes are an integral part of these financial statements



# SIR Royalty Limited Partnership

## Statement of Partners' Interest

(Unaudited)

For the period from January 1, 2005 to March 31, 2005

---

|                   | <b>Number of<br/>units<br/>(note 4)</b> | <b>Balance –<br/>January 1,<br/>2005<br/>\$</b> | <b>Net earnings<br/>for the period<br/>\$</b> | <b>Distributions<br/>\$</b> | <b>Balance –<br/>March 31,<br/>2005<br/>\$</b> |
|-------------------|---|---|---|-----------------------------|--|
| Ordinary LP units | 1,116,666                               | 7,633,570                                       | 848,875                                       | (848,875)                   | 7,633,570                                      |
| Ordinary GP units | 100                                     | 11  | 15  | (15)                        | 11   |
| Class A GP units  | 595,185                                 | 5,951,850                                       | 177,653                                       | (177,653)                   | 5,951,850                                      |
| Class B GP units  | 100,000,000                             | 1   | 3   | (3)                         | 1  |
| Class C GP units  | 4,000,000                               | 40,000,000                                      | 750,000                                       | (750,000)                   | 40,000,000                                     |
|                   |   | <hr/>   | <hr/>   | <hr/>                       | <hr/>  |
|                   |   | 53,585,432                                      | 1,776,546                                     | (1,776,546)                 | 53,585,432                                     |

The accompanying notes are an integral part of these financial statements

# SIR Royalty Limited Partnership

## Statement of Cash Flows

(Unaudited)

For the period from January 1, 2005 to March 31, 2005

---

|  | \$                   |
|--|----------------------|
| <b>Cash provided by (used in)</b>                      |                      |
| <b>Operating activities</b>                            |                      |
| Net earnings for the period                            | 1,776,546            |
| Net change in non-cash working capital items           | <u>(1,786,960)</u>   |
|  | (10,414)             |
| <b>Financing activities</b>                            |                      |
| Distributions paid                                     | <u>(832,704)</u>     |
| <b>Change in cash and cash equivalents</b>             | (843,118)            |
| <b>Cash and cash equivalents – Beginning of period</b> | <u>893,794</u>       |
| <b>Cash and cash equivalents – End of period</b>       | <u><u>50,676</u></u> |

The accompanying notes are an integral part of these financial statements

# **SIR Royalty Limited Partnership**

Notes to Financial Statements

(Unaudited)

**March 31, 2005**

---

## **1 Nature of operations**

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

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

## **2 Summary of significant accounting policies**

The accompanying interim financial statements of the Partnership have been prepared in accordance with accounting principles generally accepted in Canada. In the opinion of management, all adjustments considered necessary for fair presentation have been included. All such adjustments are of a normal recurring nature. Operating results for the three months ended March 31, 2005 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2005. Independent chartered accountants have not audited the information presented in these interim financial statements.

### **Use of estimates**

The preparation of these 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.

### **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 revenue during SIR’s fourth quarter (ending the last Sunday in August) when patios can be open. Additionally, certain holidays and observances also affect dining patterns both favourably and unfavourably. Accordingly, royalty income recognized by the Partnership will vary in conjunction with the seasonality in revenue experienced by SIR.

# **SIR Royalty Limited Partnership**

Notes to Financial Statements

(Unaudited)

**March 31, 2005**

---

## **Revenue recognition**

Revenue comprises royalty income equal to 6% of revenue of SIR's restaurants in Canada that are subject to the License and Royalty Agreement and is recognized on an accrual basis.

## **Cash and cash equivalents**

Cash is defined as cash and short-term investments with original maturities of three months or less.

## **Intangible assets**

The SIR Rights are intangible assets with indefinite lives. In accordance with the requirements of The Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3062, Goodwill and Other Intangible Assets, the SIR Rights are not amortized. The Partnership reviews the recoverability of the SIR Rights at least annually or when events or circumstances indicate that the carrying amounts may not be recoverable. The measurement of possible impairment is based on fair value.

## **Income taxes**

The Partnership is not required to pay tax on its earnings as its taxable income is allocated to the partners based on the provisions of the partnership agreement. The partners will be liable for income taxes, if any, and accordingly, no provision for income taxes has been recorded in these financial statements.

## **Recently issued accounting pronouncements**

### **Financial Instruments – Recognition and Measurement, Handbook Section 3855**

Section 3855 prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the balance sheet and at what amount – in certain instances using fair value and in others using cost-based measures. It also specifies how financial instrument gains and losses are to be presented.

Section 3855 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year ending on or after December 31, 2004. The Partnership plans to adopt this standard for its 2007 fiscal year. Transitional provisions for this Section are complex and vary based on the type of financial instrument under consideration.

The Partnership is currently evaluating the effect of this standard.

# SIR Royalty Limited Partnership

Notes to Financial Statements

(Unaudited)

March 31, 2005

---

## Comprehensive Income, Handbook Section 1530

Section 1530 introduces a new requirement to temporarily present certain gains and losses outside net income.

Section 1530 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year ending on or after December 31, 2004. The Partnership plans to adopt this standard for its 2007 fiscal year. Financial statements of prior periods are required to be restated for certain comprehensive income items. In addition, an enterprise is encouraged, but not required, to present reclassification adjustments in comparative financial statements provided for earlier periods.

The Partnership is currently evaluating the effect of this standard.

## Hedges – Handbook Section 3865

Section 3865 establishes standards for when and how hedge accounting may be applied. Hedge accounting is optional. This Section applies for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Retroactive application is not permitted. Earlier adoption is permitted only as of the beginning of a fiscal year that ends on or after December 31, 2004.

The Partnership plans to adopt this standard for its 2007 fiscal year. The Partnership has no arrangements for hedging, and the adoption of this standard is not expected to have any impact on the Partnership at this time.

## 3 Intangible assets

On October 12, 2004, the Partnership acquired the SIR Rights for consideration of \$53,585,422, including acquisition costs of \$420,000, as follows:

|                  | Number of units | \$         |
|------------------|-----------------|------------|
| Cash             |                 | 7,633,570  |
| Class A GP units | 595,185         | 5,951,850  |
| Class B GP units | 100,000,000     | 1          |
| Class C GP units | 4,000,000       | 40,000,000 |
| Ordinary GP unit | 1               | 1          |
|                  |                 | <hr/>      |
|                  |                 | 53,585,422 |
|                  |                 | <hr/>      |

# SIR Royalty Limited Partnership

Notes to Financial Statements

(Unaudited)

March 31, 2005

---

## 4 Partners' interest

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

| <b>Class of unit</b> | <b>Authorized</b> | <b>Issued</b> | <b>Amount<br/>\$</b> |
|----------------------|-------------------|---------------|----------------------|
| Class A LP units     | Unlimited         | -             | -                    |
| Class C LP units     | Unlimited         | -             | -                    |
| Ordinary LP units    | Unlimited         | 1,116,666     | 7,633,570            |
| Class A GP units     | Unlimited         | 595,185       | 5,951,850            |
| Class B GP units     | Unlimited         | 100,000,000   | 1                    |
| Class C GP units     | Unlimited         | 4,000,000     | 40,000,000           |
| Ordinary GP units    | Unlimited         | 100           | 11                   |
|                      |                   |               | <u>53,585,432</u>    |

All units of the Partnership were issued during the period ended December 31, 2004. Issuance costs borne by the Partnership in respect of the offering and the issuance of the Ordinary LP units amounted to \$3,533,090. Generally, the Partnership units have no voting rights, except in certain specified conditions.

### Ordinary LP units and Ordinary GP units

The holders of the Ordinary LP units are entitled to receive a pro rata share of all residual distributions of the Partnership. The holders of the Ordinary LP units have the right to receive distributions in priority to the Class A GP units described below. The Ordinary GP units have the right to receive distributions of \$5 per month in aggregate.

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

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

# **SIR Royalty Limited Partnership**

Notes to Financial Statements

(Unaudited)

**March 31, 2005**

---

## **Class A and Class B GP units**

The holders of the Class A GP units are entitled to receive a pro rata share of all residual distributions of the Partnership and subject to the subordination provisions, the Class A GP units are exchangeable into units of the Fund. Distributions to SIR, as holder of the Class A GP units of the Partnership, representing the initial retained interest in the Fund, through the exchange feature, as at the closing date of the offering, are subordinated to distributions by the Partnership to the Trust on the Ordinary LP units and the Class A LP units (if any). The subordination of distributions on the Class A GP units ends on the date that both of the following conditions have been satisfied:

- a) Revenue of the SIR restaurants subject to the License and Royalty Agreement has not been less than \$127.4 million for each of two consecutive years commencing with SIR's fiscal year ending August 28, 2005; and
- b) Average monthly cash distributions of \$0.10 per Fund unit have been paid by the Fund and average quarterly cash distributions of at least \$0.30 have been paid by the Partnership to the Class A GP unitholders, in each case for the immediately preceding 12 month period.

Class B GP units are convertible into Class A GP units based on a conversion formula defined in the License and Royalty Agreement for each new restaurant opened in the previous fiscal year. On dissolution of the Partnership, the Class B units are entitled to receive \$10.00 in aggregate.

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

## **Class C GP units**

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

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

## **Class A and Class C LP units**

The Class A and Class C LP units have similar attributes to the Class A and Class C GP units, except that the Class A LP units are not subordinated to the distributions by the Partnership on the Ordinary LP units.

# SIR Royalty Limited Partnership

Notes to Financial Statements

(Unaudited)

March 31, 2005

---

## 5 Related party balances and transactions

Amounts due from related parties consist of:

|  | <b>March 31,<br/>2005</b> | <b>December 31,<br/>2004</b> |
|--|---------------------------|------------------------------|
|  | \$                        | \$                           |
| Distributions payable  | (271,669)                 | -                            |
| Advances   | 1,216,095                 | -                            |
|  | <hr/>                     | <hr/>                        |
| Amounts receivable from SIR Royalty Income Fund and its subsidiaries – net | 944,426                   | -                            |
|  | <hr/>                     | <hr/>                        |

Amounts due to related parties consist of:

|   | <b>March 31,<br/>2005</b> | <b>December 31,<br/>2004</b> |
|---|---------------------------|------------------------------|
|   | \$                        | \$                           |
| Royalties receivable  | (922,140)                 | -                            |
| Advances payable (receivable)                                 | 222,260                   | (58,250)                     |
| Distributions payable   | 1,660,959                 | 178,328                      |
|   | <hr/>                     | <hr/>                        |
| Payable to SIR Corp. – net                                    | 961,079                   | (58,250)                     |
|   | <hr/>                     | <hr/>                        |
| Advances receivable   | -                         | (67,918)                     |
| Distributions payable   | -                         | 810,458                      |
|   | <hr/>                     | <hr/>                        |
| Payable to SIR Royalty Income Fund and its subsidiaries – net | -                         | 742,540                      |
|   | <hr/>                     | <hr/>                        |
| Amounts due to related parties – net                          | 961,079                   | 684,290                      |
|   | <hr/>                     | <hr/>                        |

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



# **SIR Royalty Limited Partnership**

Notes to Financial Statements

(Unaudited)

**March 31, 2005**

---

During the period from January 1, 2005 to March 31, 2005, the Partnership earned royalty income of \$1,783,148 from SIR. The royalty income is determined based on 6% of the revenues from certain SIR restaurants as defined in the License and Royalty Agreement between the Partnership and SIR. 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 restaurants in the royalty pool is equal to or greater than 68 or following October 12, 2019, whichever occurs first. On January 1 of each year (the adjustment date) following December 31, 2005, the restaurants subject to the License and Royalty Agreement are adjusted for new restaurants opened in the previous fiscal year. At each adjustment date, SIR will be entitled to convert its Class B GP units of the Partnership to Class A GP units of the Partnership based on a conversion formula defined in the License and Royalty Agreement.

The Partnership has entered into an arrangement with the Fund and the Trust whereby the Partnership will provide or arrange for the provision of services required in the administration of the Fund and the Trust. The Partnership has arranged for these services to be provided by SIR GP Inc. in its capacity as the Managing General Partner, or SIR as General Partner, of the Partnership. SIR, on behalf of SIR GP Inc., also provides services to the Partnership for its administration. For the period January 1, 2005 to March 31, 2005, the Partnership provided these services to the Fund and the Trust for consideration of \$6,000, which was the amount of consideration agreed to by the related parties.

## **6 Comparative figures**

Certain comparative figures have been restated to conform to the current period's presentation.

