

SIR Royalty Income Fund

Consolidated Financial Statements
December 31, 2007 and 2006

February 19, 2008

Auditors' Report

To the Unitholders of SIR Royalty Income Fund

We have audited the consolidated balance sheets of **SIR Royalty Income Fund** as at December 31, 2007 and 2006 and the consolidated statements of earnings and comprehensive income, unitholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) "PricewaterhouseCoopers LLP"

Chartered Accountants, Licensed Public Accountants

Hamilton, Ontario

SIR Royalty Income Fund

Consolidated Balance Sheets

As at December 31, 2007 and 2006

	2007 \$	2006 \$
Assets		
Current assets		
Cash and cash equivalents	105	18
Prepaid expenses and other assets	67,985	77,072
Amounts due from related parties (note 7)	1,171,353	862,593
	<hr/>	<hr/>
	1,239,443	939,683
Loan receivable from SIR Corp. (note 3)	40,000,000	40,000,000
Investment in SIR Royalty Limited Partnership (note 4)	11,166,671	11,166,671
	<hr/>	<hr/>
	52,406,114	52,106,354
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	120,313	124,183
Future income taxes (note 9)	797,000	-
	<hr/>	<hr/>
	917,313	124,183
Unitholders' Equity (note 5)	51,488,801	51,982,171
	<hr/>	<hr/>
	52,406,114	52,106,354
Subsequent event (notes 5 and 7)		

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

Approved by the Board of Trustees

(signed) "Peter Luit"

Trustee

(signed) "Peter Fowler"

Trustee

SIR Royalty Income Fund

Consolidated Statements of Earnings and Comprehensive Income

For the years ended December 31, 2007 and 2006

	2007 \$	2006 \$
Investment income		
Distribution income from Partnership (notes 4 and 7)	4,724,263	4,361,428
Interest income (note 3)	3,000,000	3,000,000
	<hr/> 7,724,263	<hr/> 7,361,428
Expenses		
General and administrative (note 7)	483,749	475,958
Future income taxes (note 9)	797,000	-
	<hr/> 1,280,749	<hr/> 475,958
Net earnings and comprehensive income for the year	<hr/> 6,443,514	<hr/> 6,885,470
Basic and diluted earnings per Fund unit (note 6)	<hr/> \$1.20	<hr/> \$1.29

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

SIR Royalty Income Fund
Consolidated Statements of Unitholders' Equity
For the years ended December 31, 2007 and 2006

	2007 \$	2006 \$
Balance – Beginning of year	51,982,171	51,712,185
Net earnings for the year	6,443,514	6,885,470
Distributions declared and paid (note 5)	<u>(6,936,884)</u>	<u>(6,615,484)</u>
Balance – End of year	<u>51,488,801</u>	<u>51,982,171</u>

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

SIR Royalty Income Fund
 Consolidated Statements of Cash Flows
 For the years ended December 31, 2007 and 2006

	2007 \$	2006 \$
Cash provided by (used in)		
Operating activities		
Net earnings for the year	6,443,514	6,885,470
Item not affecting cash		
Future income taxes (note 9)	797,000	-
Net change in non-cash working capital items (note 8)	(303,543)	(269,968)
	6,936,971	6,615,502
Financing activities		
Distributions paid	(6,936,884)	(6,615,484)
Change in cash and cash equivalents	87	18
Cash and cash equivalents – Beginning of year	18	-
Cash and cash equivalents – End of year	105	18

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

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

1 Nature of operations and seasonality

Nature of operations

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).

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.

2 Summary of significant accounting policies

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.

Cash and cash equivalents

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

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

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 adopted CICA Handbook Section 3855, Financial Instruments – Recognition and Measurement effective January 1, 2007. The Fund has elected to classify its loan receivable from SIR as held to maturity and accordingly, it will be recorded at its amortized cost. The investment in the Partnership does not have a quoted market price in an active market and accordingly, will be accounted for at cost. The adoption of this standard has not changed the Fund's current policies for the investment and loan receivable. The Fund has classified its cash and cash equivalents as held for trading financial assets, its amounts due from related parties as receivables and its accounts payable and accrued liabilities as other payables.

The Fund's financial instruments consist of cash and cash equivalents, loan receivable from SIR, investment in the Partnership, accounts payable and accrued liabilities and amounts due to and from related parties. Management estimates that the fair values of these financial instruments approximate their carrying values due to their short-term maturity except for the loan receivable from SIR and the investment in the Partnership. The fair values of the loan receivable from SIR and the investment in the Partnership could only be determined through the valuation of the individual assets. The aggregate fair value of the SIR Loan and the Investment in the Partnership is approximately \$47,942,000 based on the market value of the Fund units as of the close of business on December 31, 2007.

The Fund is exposed to interest rate risk in respect of the loan receivable from SIR and accordingly, the fair value of the loan receivable from SIR will vary with changes in interest rates.

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Income taxes

The Fund is a unit trust for income tax purposes. As such, the Fund is currently only taxable on income not distributed to unitholders. As substantially all taxable income is allocated to unitholders, no provision for current income taxes has been made for earnings of the Fund. During the three month period ended June 30, 2007, the proposed legislation relating to the Federal income taxation of certain publicly traded income trusts commencing with taxation years ending on or after 2011 became substantively enacted. The Fund now accounts for income taxes using the asset and liability method whereby future income tax assets are recognized for deductible temporary differences and future income tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Future income tax assets are recognized only to the extent that management determines that it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment.

Investment and loan receivable

The investment in the Partnership is recorded at cost. The investment is reviewed for impairment and written down to its estimated realizable amount when there is an impairment. Distribution income from the Partnership is recorded when distributions are declared by the Partnership. Distributions in excess of the Fund's share of the Partnership's income are recorded as a reduction in the amount of the investment.

The loan receivable from SIR is reviewed for impairment. If an impairment is identified, the loan would be reduced to its estimated realizable amount measured by the present value of expected future cash flows. The accrual of interest would be suspended if collection becomes doubtful.

At December 31, 2007 there is no impairment of the investment or loan receivable.

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Recently issued accounting pronouncements

Capital Disclosures – Handbook Section 1535

Handbook Section 1535 requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. The Fund adopted this standard effective January 1, 2008. Management is currently assessing the impact of the adoption of this change on the disclosure in its consolidated financial statements.

Financial Instruments – Disclosures – Handbook Section 3862

Handbook Section 3862 increases the disclosures currently required that will enable users to evaluate the significance of financial instruments for an entity's financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about liquidity risk and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how net income and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable. The Fund adopted this standard effective January 1, 2008. Management is currently assessing the impact of the adoption of this change on the disclosure in its consolidated financial statements.

Financial Instruments – Presentation – Handbook Section 3863

Handbook Section 3863 replaces the existing requirements on presentation of financial instruments which have been carried forward unchanged to this new section. The Fund adopted this standard effective January 1, 2008. Management does not expect the adoption of this standard to have a material impact on presentation in its consolidated financial statements.

International Financial Reporting Standards

The CICA plans to converge Canadian GAAP with International Financial Reporting Standards (IFRS) over a transition period expected to end in 2011. Management is reviewing the transition to IFRS on the Fund's consolidated financial statements and has not yet determined the impact.

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

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 \$3,000,000 was earned during the year ended December 31, 2007 (December 31, 2006 - \$3,000,000).

SIR entered into a Credit Agreement for a maximum principal amount of \$16 million. The facility will be used primarily to facilitate construction of new restaurants by SIR. The loan is collateralized by substantially all of the assets of SIR and most of its subsidiaries, which are also guarantors. The Partnership and the Fund have not guaranteed the Credit Facility. On August 9, 2007, the Fund entered into an agreement to subordinate and postpone its claims against SIR in favour of the bank.

The bank 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 bank. 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 an Interlender Agreement.

Under the Interlender Agreement, absent a default or event of default under the Credit Agreement, 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 bank is pursuing remedies). The Interlender Agreement also contains various other typical covenants of the Fund and the Partnership.

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.

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

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 had the right to receive distributions in priority to the initial 595,185 Class A GP units. The subordination on the distributions on the Class A GP units of the Partnership ended on August 26, 2007 when both the minimum revenue condition and the average monthly cash distribution per Fund unit conditions were met. Accordingly, the initial 595,185 Class A GP units are no longer subordinated.

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 for the year ended December 31, 2007 amount to \$4,724,263 (December 31, 2006 - \$4,361,428).

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.

As at December 31, 2007 and December 31, 2006, there are 5,356,667 units issued and outstanding. Each unit is entitled to one vote at any meeting of unitholders.

During the year ended December 31, 2007, the Fund declared distributions of \$1.295 per unit (December 31, 2006 - \$1.235 per unit). Subsequent to December 31, 2007, the Fund declared a distribution of \$0.110 per unit for the month of December 2007.

The distribution policy of the Fund is, at the discretion of the Trustees, to make distributions of its available cash to the fullest extent possible, taking into account trends in revenue, earnings and cash flows.

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

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.

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 earnings per Fund unit	Adjustments for conversion of Class A GP units	Diluted earnings per Fund unit
Net earnings for the year ended December 31, 2007	\$6,443,514	\$1,771,106	\$8,214,620
Net earnings per Fund unit for the year ended December 31, 2007	\$1.20	-	\$1.20
Weighted average number of Fund units outstanding for the year ended December 31, 2007	5,356,667	1,455,009	6,811,676
Net earnings for the year ended December 31, 2006	\$6,885,470	\$1,373,757	\$8,259,227
Net earnings per Fund unit for the year ended December 31, 2006	\$1.29	-	\$1.29
Weighted average number of Fund units outstanding for the year ended December 31, 2006	5,356,667	1,034,005	6,390,672

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

7 Related party transactions and balances

During the year ended December 31, 2007, the Fund received distribution income of \$4,724,263 from the Partnership (2006 - \$4,361,428). 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 for at least 60 days preceding such adjustment date in the previous fiscal year. At each adjustment date, SIR will be entitled to convert its Class B GP units of the Partnership to Class A GP units of the Partnership based on a conversion formula defined in the License and Royalty Agreement.

On January 1 of each year, Class B GP units are converted into Class A GP units for new SIR Restaurants added to the Royalty pool based on 80% of the initial estimated revenue and 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 revenue and the formula defined in the Partnership Agreement. Conversely, converted Class A GP units may be returned by SIR if the actual revenues of the new SIR Restaurants are less than 80% of the initial estimated revenue. In December of each year, an Additional Distribution will be payable to the Class B GP unitholders provided that actual revenues of the new SIR Restaurants exceed 80% of the initial estimated revenue 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 revenue.

On January 1, 2007, three (2006 – two) new SIR Restaurants were added to the Royalty Pooled Restaurants in accordance with the License and Royalty Agreement. As consideration for the additional Royalty associated with the addition of three (2006 – two) new restaurants on January 1, 2007, as well as the second incremental adjustment for the two new SIR Restaurants added to the Royalty Pooled Restaurants on January 1, 2006, SIR converted its Class B GP units into Class A GP units based on the formula defined in the Partnership Agreement. The number of Class B GP units that SIR converted to Class A GP units was reduced by an adjustment for the closure of one (2006 – nil) SIR Restaurants during the prior year. The net effect of these adjustments to the Royalty Pooled Restaurants was that SIR converted 421,004 (2006 – 438,820) Class B GP units of the Partnership into 421,004 (2006 – 438,820) Class A GP units of the Partnership on January 1, 2007 at an estimated fair value of \$3,531,911 (2006 - \$4,063,473).

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

On January 1, 2008, three new SIR Restaurants were added to the Royalty Pooled Restaurants in accordance with the License and Royalty Agreement. As consideration for the additional Royalty associated with the addition of three new restaurants on January 1, 2008, as well as the second incremental adjustment for the three new SIR Restaurants added to the Royalty Pooled Restaurants on January 1, 2007, SIR converted its Class B GP units into Class A GP units based on the formula defined in the Partnership Agreement. The number of Class B GP units that SIR converted to Class A GP units was reduced by an adjustment for the closure of two SIR Restaurants during 2007. The net effect of these adjustments to the Royalty Pooled Restaurants was that SIR converted 193,535 Class B GP units of the Partnership into 193,535 Class A GP units of the Partnership on January 1, 2008 at an estimated fair value of \$1,455,577.

In addition, the revenues of the three (2006 – two) new SIR Restaurants added to the Royalty pool on January 1, 2007 exceeded 80% of the Initial Adjustment's estimated revenue and, as a result, an Additional Distribution of \$76,935 (2006 - \$231,351) was declared in December 2007 and paid in cash to SIR the following January.

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

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 year ended December 31, 2007, the Partnership provided these services to the Fund and the Trust for consideration of \$24,000 (December 31, 2006 - \$24,000), which was the amount of consideration agreed to by the related parties.

Amounts due from (to) related parties consist of:

	2007 \$	2006 \$
SIR Royalty Limited Partnership		
Distribution receivable	2,174,240	1,386,861
Advances payable	(1,214,178)	(738,669)
	<hr/>	<hr/>
Amounts receivable from SIR Royalty Limited Partnership	960,062	648,192
SIR Corp.		
Interest receivable	250,000	250,000
Advances payable	(38,709)	(35,599)
	<hr/>	<hr/>
Amounts receivable from SIR Corp.	211,291	214,401
	<hr/>	<hr/>
Amounts due from related parties – net	1,171,353	862,593

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

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

8 Net change in non-cash working capital items

Net change in non-cash working capital items comprises:

	2007 \$	2006 \$
Prepaid expenses and other assets	9,087	(44,495)
Amounts due from related parties	(308,760)	(244,631)
Accounts payable and accrued liabilities	(3,870)	19,158
	<u>(303,543)</u>	<u>(269,968)</u>

9 Future income taxes

During the three-month period ended June 30, 2007, the proposed legislation relating to the taxation of certain publicly traded income trusts commencing with taxation years ending on or after 2011 became substantively enacted. Accordingly, the Fund recorded the future tax liability of \$797,000 related to the estimated difference between the accounting basis and tax basis of the Fund's investment in the Partnership which is expected to reverse after January 1, 2011.

10 Economic dependence and credit risk

The Fund's income is derived from interest income on the SIR loan and distributions from the Partnership and accordingly, the Fund is economically dependent upon SIR.

Credit risk arises from the potential default of SIR on the SIR loan. Management monitors the SIR loan for credit risk – to date a provision for uncollectible amounts has not been necessary.