

SIR Royalty Income Fund

Consolidated Financial Statements
December 31, 2009 and 2008

March 11, 2010

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, 2009 and 2008 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, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

SIR Royalty Income Fund

Consolidated Balance Sheets

As at December 31, 2009 and 2008

	2009 \$	2008 \$
Assets		
Current assets		
Cash and cash equivalents	96	230
Prepaid expenses and other assets	24,307	70,033
Amounts due from related parties (note 9)	1,192,403	1,422,690
	<u>1,216,806</u>	<u>1,492,953</u>
Loan receivable from SIR Corp. (note 4)	40,000,000	40,000,000
Investment in SIR Royalty Limited Partnership (note 5)	11,166,671	11,166,671
	<u>52,383,477</u>	<u>52,659,624</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	117,749	136,771
Future income taxes (note 12)	676,000	797,000
	<u>793,749</u>	<u>933,771</u>
Unitholders' Equity (note 7)	51,589,728	51,725,853
	<u>52,383,477</u>	<u>52,659,624</u>
Subsequent event (note 9)		

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

Approved by the Board of Trustees

(Signed) "Peter Luit" _____ Director

(Signed) "Peter Fowler" _____ Director

SIR Royalty Income Fund

Consolidated Statements of Earnings and Comprehensive Income
For the years ended December 31, 2009 and 2008

	2009 \$	2008 \$
Investment income		
Distribution income from Partnership (notes 5 and 9)	4,593,480	4,965,627
Interest income (note 4)	3,000,000	3,000,000
	<hr/> 7,593,480	<hr/> 7,965,627
General and administrative expenses (note 9)	458,405	470,291
Recovery of future income taxes (note 12)	(121,000)	-
	<hr/> 7,256,075	<hr/> 7,495,336
Net earnings and comprehensive income for the year		
	<hr/> \$1.35	<hr/> \$1.40

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, 2009 and 2008

	2009 \$	2008 \$
Balance - Beginning of year	51,725,853	51,488,801
Net earnings for the year	7,256,075	7,495,336
Distributions declared and paid (note 7)	(7,392,200)	(7,258,284)
Balance - End of year	<u>51,589,728</u>	<u>51,725,853</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, 2009 and 2008

	2009 \$	2008 \$
Cash provided by (used in)		
Operating activities		
Net earnings for the year	7,256,075	7,495,336
Item not affecting cash		
Recovery of future income taxes (note 12)	(121,000)	-
Net change in non-cash working capital items (note 11)	256,991	(236,927)
	<u>7,392,066</u>	<u>7,258,409</u>
Financing activities		
Distributions paid	<u>(7,392,200)</u>	<u>(7,258,284)</u>
Change in cash and cash equivalents	(134)	125
Cash and cash equivalents - Beginning of year	<u>230</u>	<u>105</u>
Cash and cash equivalents - End of year	<u>96</u>	<u>230</u>

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

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

1 Nature of operations, basis of presentation and seasonality

Nature of operations

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

On October 1, 2004, 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 licence to use the SIR Rights in most of Canada in consideration for a Royalty, payable by SIR to the Partnership, equal to 6% of the revenues of the Royalty Pooled Restaurants (the Licence and Royalty Agreement). The Fund participates, indirectly, in the revenues generated under the Licence and Royalty Agreement through its investment in the Partnership (note 5).

Seasonality

The full-service restaurant sector of the Canadian food-service industry, in which SIR operates, experiences seasonal fluctuations in revenues. Favourable summer weather generally results in increased revenues during SIR's fourth quarter (ending the last Sunday in August) when patios can be open. Additionally, certain holidays and observances also affect dining patterns, both favourably and unfavourably. Accordingly, distribution income recognized by the Fund will vary in conjunction with the seasonality in revenues experienced by SIR.

2 Summary of significant accounting policies

The Fund prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles and includes 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

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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 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.

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. In 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 a loss that is other than temporary. 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 reasonable assurance of timely collection. If there is no reasonable assurance of collection, the loan would be reduced to its estimated realizable amount measured by the present value of expected future cash flows using the original effective interest rate on the loan. The accrual of interest would be suspended if collection becomes doubtful.

3 Recently issued accounting pronouncements

The Canadian Institute of Chartered Accountants (CICA) Handbook Sections 1582, Business Combinations; 1601, Consolidated Financial Statements; and 1602, Non-Controlling Interests, replace the former CICA Handbook Sections 1581, Business Combinations, and 1600, Consolidated Financial Statements, and establish a new section for accounting for a non-controlling interest in a subsidiary. These sections provide the Canadian equivalent to International Financial Reporting Standard 3, Business Combinations, and International Accounting Standard 27, Consolidated and Separate Financial Statements. CICA Handbook Section 1582 is

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effective for the Fund for business combinations for which the acquisition date is on or after the reporting period beginning on or after January 1, 2011. CICA Handbook Sections 1601 and 1602 are effective for the Fund for interim and annual consolidated financial statements relating to years beginning on or after January 1, 2011. Management has not yet determined the impact of the adoption of these changes on its consolidated financial statements.

4 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, 2009 (2008 - \$3,000,000).

On November 13, 2009, SIR announced that it entered into a \$26,000,000 new senior term debt facility (New Credit Agreement). Part of the proceeds from the New Credit Agreement was used to repay \$12,740,000 outstanding on SIR's construction line. The remaining proceeds, as well as a portion of existing cash on hand, were used to repurchase 5,407,000 common shares of SIR from one shareholder of SIR, to acquire the rights to certain debts owed by U.S. S.I.R. L.L.C. from one shareholder of SIR and to pay professional fees and transaction costs related to these transactions.

The New Credit Agreement has a three-year term with a 10-year amortization. Interest will be calculated as the greater of 7.80% per annum and the three-month Canadian dollar banker's acceptance rate plus 7.55% per annum. Certain financial covenants apply to SIR. The loan is secured by substantially all of the assets of SIR and most of its subsidiaries, which are also guarantors. The Partnership and the Fund did not guarantee the New Credit Agreement. The New Credit Agreement qualifies as "permitted indebtedness" within the meaning of the agreements between the Fund, the Partnership and SIR and, as a result, the Fund and the Partnership have agreed to subordinate and postpone their claims against SIR to the claims of the new lender. The terms of this subordination are as contemplated in the existing agreements between the Fund, the Partnership and SIR. This subordination, which includes a subordination of the Partnership's rights under the Licence and Royalty Agreement between the Partnership and SIR whereby the Partnership licenses to SIR the right to use trademarks and related intellectual property in return for royalty payments based on revenues, is effected pursuant to the terms of a Subordination and Postponement Agreement.

Under the Subordination and Postponement Agreement, absent a default or event of default under the New Credit Agreement, ordinary payments to the Partnership and the Fund could continue. However, if a default or an event of default were to occur, then payments to the Fund and the Partnership could cease and the related rights of the Fund and the Partnership could be subject to a "standstill" obligation for a period of up to 120 days (which may be extended if the lender is pursuing remedies). The Subordination and Postponement Agreement also contains various other typical covenants of the Fund and the Partnership. In addition, SIR provided an undertaking to the Fund and the Partnership to restrict the amount of the additional debt that the Company can incur without the consent of the Fund and the Partnership (which consent shall not be unreasonably withheld).

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

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5 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 as defined in the Partnership Agreement.

The distributions from the Partnership primarily comprise revenues earned by the Partnership under the Licence and Royalty Agreement (note 1) less certain general and administrative expenses. Distributions for the year ended December 31, 2009 amount to \$4,593,480 (2008 - \$4,965,627).

6 Financial instruments

Classification

As at December 31, 2009, the classifications of the financial instruments, as well as their carrying and fair values are as follows:

		<u>Carrying and fair value</u>	
<u>Classification</u>		<u>December 31,</u>	<u>December 31,</u>
		<u>2009</u>	<u>2008</u>
		<u>\$</u>	<u>\$</u>
Cash and cash equivalents	Held for trading	96	230
Distribution and interest received from related parties	Loans and receivables	2,882,864	2,681,584
Loan receivable from SIR Corp.	Held to maturity	see below	see below
Investment in SIR Royalty Limited Partnership	Available for sale	see below	see below
Accounts payable and accrued liabilities	Other financial liabilities	117,749	136,771
Advances payable to related parties	Other financial liabilities	1,690,461	1,258,894

Carrying and fair value

Cash and cash equivalents, amounts due from related parties and accounts payable and accrued liabilities are short-term financial instruments whose fair value approximates the carrying amount given that they will mature in the short term. The SIR loan and the investment in the Partnership are accounted for under the cost method. The carrying values of the SIR loan and the investment in the Partnership at December 31, 2009 are \$40,000,000 and \$11,166,671, respectively (December 31, 2008 - \$40,000,000 and \$11,166,671, respectively). The fair values of the SIR loan 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 \$40,700,000 based on the market value of the Fund units as of the close of business on December 31, 2009.

SIR Royalty Income Fund

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Objectives and policy relating to financial risk management

Financial risk management is carried out by the management and Trustees of the Fund. The Fund's main financial risk exposure, as well as its risk management policy, is detailed as follows:

Interest rate risk

The SIR loan has a fixed interest rate of 7.5% per annum and has been designated as a held-to-maturity financial asset. Accordingly, changes in interest rates would not impact the consolidated statements of earnings and comprehensive income or the carrying value of the SIR loan. However, the fair value of the SIR loan will vary with changes in interest rates. The Fund is restricted to investing excess cash in short-term investments and it is not the Fund's practice to hedge against changes in interest rates.

Credit risk

The Fund is exposed to credit risk in its cash and cash equivalents, amounts due from related parties and the SIR loan. The maximum exposure to credit risk is the full carrying value of the financial instrument. The Fund minimizes the credit risk of cash and cash equivalents by depositing funds with reputable financial institutions and minimizes the credit risk of its due from related parties by managing and analyzing the cash flow of these related parties through the preparation of budgets and forecasts of these related parties. As at December 31, 2009, no amounts due from related parties are past due. Credit risk also arises from the potential default of SIR on the SIR loan. Management monitors the SIR loan for impairment. To date, a provision for uncollectible amounts has not been necessary.

SIR has certain restrictions related to its bank financing which could affect payments to the Fund, if a default or an event of default were to occur (note 4).

Liquidity risk

Liquidity risk is the risk that the Fund will not be able to meet its financial obligations as they fall due and meet expected distributions to its unitholders. The Fund currently settles these obligations out of cash and cash equivalents. The ability to do this relies on the Fund collecting its distributions from the Partnership and interest on the SIR loan. The Fund intends to maintain equal monthly distributions to its unitholders. However, the Trustees of the Fund may authorize increased or decreased distributions from time to time or halt distributions entirely, as they see fit, in their sole discretion. Both the Fund and the Partnership prepare budgets and forecasts to evaluate their ability to meet future cash obligations.

7 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

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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, 2009 and 2008, 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, 2009, the Fund declared distributions of \$1.38 per unit (2008 - \$1.355 per unit). Subsequent to December 31, 2009, the Fund declared a distribution of \$0.115 per unit for each of the months of December 2009 and January 2010.

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 revenues, earnings and cash flows.

8 Earnings per Fund unit

Basic earnings per Fund unit are 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 on a one for one basis. Diluted earnings per Fund unit are 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	Adjustment for conversion of Class A GP units	Diluted earnings
Net earnings for the year ended December 31, 2009	\$7,256,075	\$3,630,220	\$10,886,295
Net earnings per Fund unit for the year ended December 31, 2009	\$1.35	-	\$1.35
Weighted average number of Fund units outstanding for the year ended December 31, 2009	5,356,667	2,725,415	8,082,082
Net earnings for the year ended December 31, 2008	\$7,495,336	\$2,306,713	\$9,802,049
Net earnings per Fund unit for the year ended December 31, 2008	\$1.40	-	\$1.40
Weighted average number of Fund units outstanding for the year ended December 31, 2008	5,356,667	1,648,544	7,005,211

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9 Related party transactions and balances

During the year ended December 31, 2009, the Fund received distribution income of \$4,593,480 from the Partnership (2008 - \$4,965,627). 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 on the revenues generated by SIR for the restaurants subject to the Licence and Royalty Agreement. Under the terms of the Licence and Royalty Agreement, SIR may be required to pay a Make-Whole Payment in respect of the reduction in revenues for restaurants closed during a reporting period. SIR is not required to pay any Make-Whole Payment in respect of a closed restaurant following the date on which the number of Royalty Pooled Restaurants is equal to or greater than 68 or following October 12, 2019, whichever occurs first. On January 1 of each year (the Adjustment Date), the restaurants subject to the Licence and Royalty Agreement are adjusted for new restaurants opened for at least 60 days preceding such Adjustment Date in the previous fiscal year. At each Adjustment Date, SIR will be entitled to convert its Class B GP units into Class A GP units based on a conversion formula defined in the Partnership 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 Pooled Restaurants based on 80% of the initial estimated revenues and the formula defined in the Partnership Agreement. Additional Class B GP units may be converted into Class A GP units in respect of these new SIR Restaurants if actual revenues of the new SIR Restaurants exceeded 80% of the initial estimated revenues and the formula defined in the Partnership Agreement. Conversely, converted Class A GP units are required to be returned by SIR if the actual revenues of the new SIR Restaurants are less than 80% of the initial estimated revenues. In December of each year, an Additional Distribution will be payable to the Class B GP unitholders provided that actual revenues of the new SIR Restaurants exceed 80% of the initial estimated revenues or there will be a reduction in the distributions to the Class A GP unitholders if revenues are less than 80% of the initial estimated revenues. In December 2009, an Additional Distribution of \$336,594 (2008 - \$177,888) was declared and paid in cash in January 2010.

On January 1, 2010, nil (2009 - six) new SIR Restaurants were added to and nil (2009 - nil) closed SIR Restaurants were removed from the Royalty Pooled Restaurants in accordance with the Partnership Agreement. As consideration for the additional Royalty associated with the addition of nil (2009 - six) new restaurants on January 1, 2010, as well as the second incremental adjustment for the six (2008 - three) new SIR Restaurants added to the Royalty Pooled Restaurants on January 1, 2009, SIR converted a portion of its Class B GP units into Class A GP units based on the formula defined in the Partnership Agreement. The number of Class B GP units that SIR converted into Class A GP units was reduced by an adjustment for the closure of nil (2009 - nil) SIR Restaurants during the prior year. The net effect of these adjustments to the Royalty Pooled Restaurants was that SIR converted 243,909 (2009 - 1,076,871) Class B GP units of the Partnership into 243,909 (2009 - 1,076,871) Class A GP units of the Partnership on January 1, 2010 at an estimated fair value of \$1,236,621 (2009 - \$5,972,477).

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 the General Partner of the Partnership. SIR, on behalf of SIR GP Inc., also provides

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services to the Partnership for its administration. For the year ended December 31, 2009, the Partnership provided these services to the Fund and the Trust for consideration of \$24,000 (2008 - \$24,000), which was the amount of consideration agreed to by the related parties.

Amounts due from (to) related parties consist of:

	2009 \$	2008 \$
SIR Royalty Limited Partnership		
Distribution receivable	2,632,864	2,431,584
Advances payable	(1,614,537)	(1,190,744)
	<hr/>	<hr/>
Amounts receivable from SIR Royalty Limited Partnership	1,018,327	1,240,840
	<hr/>	<hr/>
SIR Corp.		
Interest receivable	250,000	250,000
Advances payable	(75,924)	(68,150)
	<hr/>	<hr/>
Amounts receivable from SIR Corp.	174,076	181,850
	<hr/>	<hr/>
Amounts due from related parties - net	1,192,403	1,422,690
	<hr/>	<hr/>

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

10 Capital management

The Fund's capital consists of units of the Fund, as described in note 7. The objectives in managing the capital are to safeguard the Fund's ability to continue as a going concern, to provide an adequate return to unitholders appropriate for the level of risk and to distribute excess cash to the unitholders. The Fund has no third party debt or bank lines of credit. The Fund had no capital expenditures during the year ended December 31, 2009 and by its nature is not expected to have significant capital expenditures in the future.

On November 13, 2009, SIR entered into a new credit agreement, which required the Fund and the Partnership to subordinate and postpone their claims against SIR to the claims of the bank, in the event of a default (note 4).

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11 Net change in non-cash working capital items

Net change in non-cash working capital items comprises:

	2009 \$	2008 \$
Prepaid expenses and other assets	45,726	(2,048)
Amounts due from related parties	230,287	(251,337)
Accounts payable and accrued liabilities	(19,022)	16,458
	<hr/>	<hr/>
	256,991	(236,927)
	<hr/>	<hr/>

12 Future income taxes

In 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. For the year ended December 31, 2009, the Fund recorded a reduction in future income taxes of \$121,000, which is attributed to a decrease in the substantively enacted tax rates.

13 Economic dependence

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 on SIR.