

SIR Royalty Limited Partnership

Financial Statements
December 31, 2006 and 2005

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March 26, 2007

Auditors' Report

To the Partners of SIR Royalty Limited Partnership

We have audited the balance sheets of **SIR Royalty Limited Partnership** as at December 31, 2006 and 2005 and the statements of earnings, partners' interest and cash flows for the years then ended. These financial statements are the responsibility of the Partnership'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 financial statements present fairly, in all material respects, the financial position of the Partnership as at December 31, 2006 and 2005 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

Hamilton, Ontario

SIR Royalty Limited Partnership

Balance Sheets

As at December 31, 2006 and 2005

	2006 \$	2005 \$
Assets		
Current assets		
Cash and cash equivalents	695,751	228,183
Prepaid expenses and other assets	37,735	11,628
Amounts due from related parties (note 5)	51,830	330,114
	<hr/>	<hr/>
	785,316	569,925
Intangible assets (note 3)	<hr/>	<hr/>
	57,648,895	53,585,422
	<hr/>	<hr/>
	58,434,211	54,155,347
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	137,114	182,241
Amounts due to related parties (note 5)	648,192	387,674
	<hr/>	<hr/>
	785,306	569,915
Partners' Interest (note 4)	<hr/>	<hr/>
	57,648,905	53,585,432
	<hr/>	<hr/>
	58,434,211	54,155,347
Subsequent event (note 4)		

The accompanying notes are an integral part of these financial statements

Approved by the Managing General Partner

(signed) "Peter Luit"

Partner

(signed) "Peter Fowler"

Partner

SIR Royalty Limited Partnership

Statements of Earnings

For the years ended December 31, 2006 and 2005

	2006 \$	2005 \$
Revenue		
Royalty income (notes 1 and 5)	9,075,596	7,814,778
Administration fee (note 5)	24,000	24,000
Other income	23,441	7,021
	<hr/> 9,123,037	<hr/> 7,845,799
Expenses		
General and administrative	156,489	102,181
	<hr/> 8,966,548	<hr/> 7,743,618
Net earnings for the year	<hr/> 8,966,548	<hr/> 7,743,618

The accompanying notes are an integral part of these financial statements

SIR Royalty Limited Partnership

Statements of Partners' Interest

For the years ended December 31, 2006 and 2005

	Number of units (note 4)	Balance – January 1, 2006 \$	Units issued (note 3)	Net earnings for the year \$	Distributions \$	Balance – December 31, 2006 \$
Ordinary LP units	1,116,666	7,633,570	-	4,361,368	(4,361,368)	7,633,570
Ordinary GP units	100	11	-	60	(60)	11
Class A GP units	1,034,005	5,951,850	4,063,473	1,373,757	(1,373,757)	10,015,323
Class B GP units	99,561,180	1	-	231,363	(231,363)	1
Class C GP units	4,000,000	40,000,000	-	3,000,000	(3,000,000)	40,000,000
		53,585,432	4,063,473	8,966,548	(8,966,548)	57,648,905

	Number of units (note 4)	Balance – January 1, 2005 \$	Net earnings for the year \$	Distributions \$	Balance – December 31, 2005 \$
Ordinary LP units	1,116,666	7,633,570	4,025,052	(4,025,052)	7,633,570
Ordinary GP units	100	11	60	(60)	11
Class A GP units	595,185	5,951,850	718,494	(718,494)	5,951,850
Class B GP units	100,000,000	1	12	(12)	1
Class C GP units	4,000,000	40,000,000	3,000,000	(3,000,000)	40,000,000
		53,585,432	7,743,618	(7,743,618)	53,585,432

The accompanying notes are an integral part of these financial statements

SIR Royalty Limited Partnership

Statements of Cash Flows

For the years ended December 31, 2006 and 2005

	2006 \$	2005 \$
Cash provided by (used in)		
Operating activities		
Net earnings for the year	8,966,548	7,743,618
Net change in non-cash working capital items (note 7)	<u>(486,621)</u>	<u>(353,004)</u>
	8,479,927	7,390,614
Financing activities		
Distributions paid	<u>(8,012,359)</u>	<u>(8,056,225)</u>
Change in cash and cash equivalents	467,568	(665,611)
Cash and cash equivalents – Beginning of year	<u>228,183</u>	<u>893,794</u>
Cash and cash equivalents – End of year	<u>695,751</u>	<u>228,183</u>

The accompanying notes are an integral part of these financial statements

SIR Royalty Limited Partnership

Notes to Financial Statements

December 31, 2006 and 2005

1 Nature of operations and seasonality

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”).

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.

2 Summary of significant accounting policies

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.

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.

SIR Royalty Limited Partnership

Notes to Financial Statements

December 31, 2006 and 2005

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 SIR Rights at least annually or when events or circumstances indicate that the carrying amounts may not be recoverable. Impairment is recognized when the estimated fair value of the intangible assets is lower than the carrying 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. The Partnership will adopt this standard effective January 1, 2007. The Partnership does not anticipate that this standard will have a material impact on its financial statements.

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. The Partnership will adopt this standard effective January 1, 2007. 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. This standard will not have an impact on the Partnership’s financial statements.

SIR Royalty Limited Partnership

Notes to Financial Statements

December 31, 2006 and 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.

The Partnership will adopt this standard effective January 1, 2007. The Partnership has no arrangements for hedging, and the adoption of this standard will not have any impact on the Partnership's financial statements.

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
		<u>53,585,422</u>

On January 1, 2006, two new SIR Restaurants were added to the Royalty pool in accordance with the License and Royalty Agreement. As consideration for the additional Royalty associated with the addition of the two new restaurants, SIR converted 438,820 Class B GP units to 438,820 Class A GP units based on the formula defined in the Partnership Agreement. The 438,820 Class A GP units have been recorded at their estimated fair value of \$4,063,473. A summary of the SIR Rights as a result of the acquisition of the trademarks associated with the additional two restaurants added to the Royalty pool is as follows:

	2006	2005
	\$	\$
SIR Rights – beginning of year	53,585,422	53,585,422
Adjustment to Royalty pool	4,063,473	-
SIR Rights – end of year	<u>57,648,895</u>	<u>53,585,422</u>

The tax basis of the intangible assets as at December 31, 2006 is \$4,808,424 (2005 - \$5,170,348).

SIR Royalty Limited Partnership

Notes to Financial Statements

December 31, 2006 and 2005

4 Partners' interest

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

Class of unit	Authorized	2006		2005	
		Issued	Amount \$	Issued	Amount \$
Class A LP units	Unlimited	-	-	-	-
Class C LP units	Unlimited	-	-	-	-
Ordinary LP units	Unlimited	1,116,666	7,633,570	1,116,666	7,633,570
Class A GP units (note 3)	Unlimited	1,034,005	10,015,323	595,185	5,951,850
Class B GP units	Unlimited	99,561,180	1	100,000,000	1
Class C GP units	Unlimited	4,000,000	40,000,000	4,000,000	40,000,000
Ordinary GP units	Unlimited	100	11	100	11
			<u>57,648,905</u>		<u>53,585,432</u>

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

December 31, 2006 and 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 initial 595,185 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.

The subordination on the distributions on the initial Class A GP units of the Partnership is expected to continue until at least August 26, 2007.

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.

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.

SIR Royalty Limited Partnership

Notes to Financial Statements

December 31, 2006 and 2005

On January 1, 2006, two new SIR Restaurants were added to the Royalty pool in accordance with the License and Royalty Agreement. As consideration for the additional Royalty associated with the addition of two new restaurants, SIR converted 438,820 Class B GP units to 438,820 Class A GP units based on the formula defined in the Partnership Agreement. The 438,820 Class A GP units have been recorded at their estimated fair value of \$4,063,473. The revenues of the new SIR Restaurants exceeded 80% of the Initial Adjustment's estimated revenue and, as a result, an Additional Distribution of \$231,351 was declared in December 2006 and paid in cash to SIR in January 2007.

On January 1, 2007, 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, 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 is able to convert 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 is able to convert to Class A GP units was reduced by an adjustment for the closure of one SIR Restaurant during the year. The net effect of these adjustments to the Royalty Pooled Restaurants was that SIR converted 421,004 Class B GP units of the Partnership into 421,004 Class A GP units of the Partnership on January 1, 2007 at an estimated fair value of \$3,531,911.

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

December 31, 2006 and 2005

5 Related party balances and transactions

	2006 \$	2005 \$
Royalties receivable	1,144,615	1,003,221
Advances payable	(132,850)	(171,417)
Distributions payable	(959,935)	(501,690)
	<hr/>	<hr/>
Net receivable from SIR Corp.	51,830	330,114
	<hr/>	<hr/>
Advances receivable	738,669	503,243
Distributions payable	(1,386,861)	(890,917)
	<hr/>	<hr/>
Payable to SIR Royalty Income Fund and its subsidiaries	(648,192)	(387,674)
	<hr/>	<hr/>
Amounts due to related parties – net	(596,362)	(57,560)

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

During the year ended December 31, 2006, the Partnership earned Royalty income of \$9,075,596 from SIR (December 31, 2005 - \$7,814,778). The Royalty income is determined based on 6% of the revenues from certain SIR restaurants subject to 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 the conversion formula defined in the License and Royalty Agreement (note 4).

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, 2006, the Partnership provided these services to the Fund and the Trust for consideration of \$24,000 (December 31, 2005 - \$24,000), which was the amount of consideration agreed to by the related parties.

SIR Royalty Limited Partnership

Notes to Financial Statements

December 31, 2006 and 2005

6 Economic dependence

The Partnership earns substantially all of its revenue from SIR and therefore is economically dependent upon SIR.

7 Net change in non-cash working capital items

Net change in non-cash working capital items comprises:

	2006	2005
	\$	\$
Prepaid expenses and other assets	(26,107)	36,221
Amounts due from related parties	(179,961)	(120,401)
Accounts payable and accrued liabilities	(45,127)	103,226
Amounts due to related parties	(235,426)	(372,050)
	<u>(486,621)</u>	<u>(353,004)</u>