

THE KEG ROYALTIES INCOME FUND

FIRST QUARTER REPORT

For the three months ended March 31, 2016

TO OUR UNITHOLDERS

On behalf of the Board of Trustees, I am pleased to present the results of The Keg Royalties Income Fund (the “Fund”) for the three months ended March 31, 2016.

RESULTS

The gross sales reported by the 100 Keg restaurants in the Royalty Pool were \$146,787,000 for the quarter, as compared with gross sales of \$146,383,000 reported by the 102 Keg restaurants in the Royalty Pool during the comparable quarter of the prior year. Despite having two less restaurants included in the Royalty pool during 2016, Royalty Pool sales increased by \$404,000 or 0.3%, in part due to a same store sales increase of 1.1%.

Royalty income increased by \$12,000 or 0.2% from \$5,859,000 in the three months ended March 31, 2015 to \$5,871,000 in the three months ended March 31, 2016.

Distributable cash before SIFT tax increased by \$330,000 from \$4,391,000 (38.7 cents/Fund unit) to \$4,721,000 (41.6 cents/Fund unit) for the quarter. Distributable cash available to pay distributions to public unitholders increased by \$367,000 from \$3,263,000 (28.7 cents/Fund unit) to \$3,630,000 (32.0 cents/Fund unit) for the quarter. Distributions paid to Fund unitholders increased by \$233,000 from \$2,747,000 (24.2 cents/Fund unit) during the first quarter of 2015 to \$2,980,000 (26.2 cents/Fund unit) during the first quarter of 2016. The payout ratio for the quarter was 82.1% as compared with 84.2% for the comparable quarter of the prior year.

The Fund remains financially well positioned with surplus cash on hand of \$2,091,000 and a positive working capital balance of \$3,576,000 as at March 31, 2016.

OUTLOOK

In Canada, Restaurants Canada has estimated that sales in the full-service restaurant category, the category in which The Keg operates, increased by 3.3% in 2015 and has projected sales to increase by 3.5% in 2016. In the United States (“US”), the National Restaurant Association has estimated that sales in the full-service category increased by 4.8% in 2015, and has projected sales to increase by 4.9% in 2016. Given the close historical relationship between disposable income and foodservice spending, management of Keg Restaurants Ltd. (“KRL”) expects that as economic conditions and consumer sentiment continue to improve in North America, sales for The Keg will also improve, leading it to once again outperform the full service category with respect to same store sales growth.

COMPETITIVE STRENGTH AND GROWTH

The Keg remains an industry leader in the full-service restaurant category in Canada; a fact confirmed by the independent research firm Technomic Inc. Annually, Technomic Inc. conducts consumer research and asks consumers to rate Canadian restaurant chains on over 60 attributes, as part of their Canadian Restaurant Consumer Choice Awards. In 2014, The Keg was awarded the top service award in the full-service category and in 2015, the top food quality award, in that same category. KRL’s management remains committed to maintaining and improving the legendary high standards that have come to define the brand throughout North America including The Keg’s high quality menu, knowledgeable, friendly service and marketing innovation. KRL has consistently demonstrated its ability to deliver growth in both system sales and same store sales over the long term, which has provided not only stability but also growth in distributable cash and distributions to the Fund’s unitholders.

Sincerely,



C.C. Woodward
Chairman, The Keg Royalties Income Fund
on behalf of the Board of Trustees
May 4, 2016

FINANCIAL HIGHLIGHTS

(\$000's except per unit amounts)	Jan. 1 to Mar. 31, 2016	Jan. 1 to Mar. 31, 2015
Restaurants in the Royalty Pool	100	102
Royalty Pool sales ⁽¹⁾	\$ <u>146,787</u>	\$ <u>146,383</u>
Royalty income ⁽²⁾	\$ 5,871	\$ 5,859
Interest income ⁽³⁾	<u>1,064</u>	<u>1,056</u>
Total income	\$ 6,935	\$ 6,915
Administrative expenses ⁽⁴⁾	(94)	(96)
Interest and financing expenses ⁽⁵⁾	<u>(106)</u>	<u>(149)</u>
Operating income	\$ 6,735	\$ 6,670
Distributions to KRL ⁽⁶⁾	<u>(2,401)</u>	<u>(2,361)</u>
Profit before fair value gain (loss) and income taxes	\$ 4,334	\$ 4,309
Fair value gain (loss) ⁽⁷⁾	(1,917)	(8,511)
Income taxes ⁽⁸⁾	<u>(1,109)</u>	<u>(1,213)</u>
Profit (loss) and comprehensive income (loss)	\$ <u>1,308</u>	\$ <u>(5,415)</u>
Distributable cash before SIFT tax ⁽⁹⁾	\$ <u>4,721</u>	\$ <u>4,391</u>
Distributable cash ⁽¹⁰⁾	\$ <u>3,630</u>	\$ <u>3,263</u>
Distributions to Fund unitholders ⁽¹¹⁾	\$ <u>2,980</u>	\$ <u>2,747</u>
Payout Ratio ⁽¹²⁾	<u>82.1%</u>	<u>84.2%</u>
Per Fund unit information ⁽¹³⁾		
Profit before fair value gain (loss) and income taxes	<u>.382</u>	<u>.380</u>
Profit (loss) and comprehensive income (loss)	<u>.115</u>	<u>(.477)</u>
Distributable cash before SIFT tax ⁽⁹⁾	\$ <u>.416</u>	\$ <u>.387</u>
Distributable cash ⁽¹⁰⁾	\$ <u>.320</u>	\$ <u>.287</u>
Distributions to Fund unitholders ⁽¹¹⁾	\$ <u>.262</u>	\$ <u>.242</u>
SSSG ⁽¹⁴⁾		
Canada	0.0%	6.9%
United States	2.2%	7.9%
Consolidated	1.1%	8.2%
Restaurants in KRL System ⁽¹⁵⁾		
# Beginning of Period	101	107
Opened	--	--
Closed	--	(4)
# End of Period	<u>101</u>	<u>103</u>

Notes:

- ⁽¹⁾ Royalty Pool sales are the gross sales reported by Keg Restaurants included in the Royalty Pool in any period. As of January 1, 2016, the Royalty Pool includes 100 Keg restaurants, 42 of which are owned and operated by KRL and its subsidiaries, (32 in Canada and 10 in the United States), and 58 Keg restaurants which are owned and operated by Keg franchisees (all of which are in Canada).
- ⁽²⁾ The Fund, indirectly through the “Partnership”, earns royalty income equal to 4% of gross sales of Keg restaurants in the Royalty Pool.
- ⁽³⁾ The Fund directly earns interest income on the \$57.0 million Keg Loan, with interest income accruing at 7.5% per annum, payable monthly.
- ⁽⁴⁾ The Fund, indirectly through the Partnership, incurs administrative expenses and interest on the operating line of credit, to the extent utilized.
- ⁽⁵⁾ The Fund, indirectly through The Keg Holdings Trust (the “Trust”), incurs interest expense on the \$14.0 million term loan and amortization of deferred financing charges.
- ⁽⁶⁾ Represents the distributions of the Partnership attributable to KRL during the respective periods on the Class A, entitled Class B, and Class D Partnership units (“Exchangeable units”) and Class C Partnership units held by KRL. The Exchangeable units are exchangeable into Fund units on a one-for-one basis. These distributions are presented as interest expense in the financial statements.
- ⁽⁷⁾ Fair value gain (loss) is the non-cash decrease or increase in the market value of the Exchangeable units held by KRL during the respective period. Exchangeable units are classified as a financial liability under IFRS. The Fund is required to determine the fair value of that liability at the end of each reporting period and adjust for any increase or decrease, taking into consideration the sale of any Exchangeable units and Additional Entitlements during the same period.
- ⁽⁸⁾ Income taxes for the three months ended March 31, 2016, include SIFT tax expense of \$1,091,000 (three months ended March 31, 2015 – \$1,128,000) and non-cash deferred taxes of \$18,000 (three months ended March 31, 2015 – \$85,000).
- ⁽⁹⁾ Distributable cash before SIFT tax is defined as the periodic cash flows from operating activities as reported in the IFRS consolidated financial statements, including the effects of changes in non-cash working capital, plus SIFT tax paid (including current year instalments), less interest and financing fees paid on the term loan, less the Partnership distributions attributable to KRL through its ownership of Exchangeable units. Distributable cash before SIFT tax is a non-IFRS financial measure that does not have a standardized meaning prescribed by IFRS, and therefore may not be comparable to similar measures presented by other issuers.
- ⁽¹⁰⁾ Distributable cash is the amount of cash available for distribution to the Fund’s public unitholders and is calculated as distributable cash before SIFT tax, less current year SIFT tax expense. Distributable cash is a non-IFRS financial measure that does not have a standardized meaning prescribed by IFRS, and therefore may not be comparable to similar measures presented by other issuers. However, the Fund believes that distributable cash, both before and after SIFT tax, provides useful information regarding the amount of cash available for distribution to the Fund’s public unitholders.
- ⁽¹¹⁾ Distributions to Fund unitholders include all regular monthly cash distributions paid to Fund unitholders during a period and any special distributions, either declared or paid, to Fund unitholders in the same period.
- ⁽¹²⁾ Payout ratio is computed as the ratio of aggregate cash distributions paid during the period plus any special distributions declared or paid during the same period (numerator) to the aggregate distributable cash of the period (denominator).
- ⁽¹³⁾ All per unit amounts are calculated based on the weighted average number of Fund units outstanding, which are those units held by public unitholders during the respective period. The weighted average number of Fund units outstanding for the three months ended March 31, 2016 were 11,353,500 (three months ended March 31, 2015 – 11,353,500).
- ⁽¹⁴⁾ Same Store Sales Growth (“SSSG”) is the overall increase or decrease in gross sales from Keg restaurants (that operated during the entire period of both the current and the prior year) as compared to gross sales for the same period of the prior year. SSSG is not an IFRS financial measure and does not have a standardized meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers. However, the Fund believes that SSSG provides useful information regarding the increase or decrease in gross sales for comparable restaurants.
- ⁽¹⁵⁾ The number of restaurants included in the Royalty Pool, may differ from the number of restaurants in the KRL system at any time as the periods for which they are reported differ. The number of restaurants added or removed from the Royalty Pool during any period will differ from the number of restaurant openings and closings reported by KRL, as the periods for which they are reported differ as well.
- ⁽¹⁶⁾ The interim financial results for all periods presented herein have not been audited.

SUMMARY OF QUARTERLY RESULTS

	Q1	Q4	Q3	Q2
(\$000's except per unit amounts)	2016	2015	2015	2015
Restaurants in the Royalty Pool	100	102	102	102
Royalty Pool sales ⁽¹⁾	\$ 146,787	154,528	138,849	\$ 134,288
Royalty income ⁽²⁾	\$ 5,871	\$ 6,387	\$ 5,629	\$ 5,376
Interest income ⁽³⁾	1,064	1,079	1,079	1,067
Total income	\$ 6,935	\$ 7,466	\$ 6,708	\$ 6,443
Administrative expenses ⁽⁴⁾	(94)	(138)	(105)	(96)
Interest and financing expenses ⁽⁵⁾	(106)	(108)	(112)	(150)
Operating income	\$ 6,735	\$ 7,220	\$ 6,491	\$ 6,197
Distributions to KRL ⁽⁶⁾	(2,401)	(2,511)	(2,371)	(2,248)
Profit before fair value gain (loss) and income taxes	\$ 4,334	\$ 4,709	\$ 4,120	\$ 3,949
Fair value gain (loss) ⁽⁷⁾	(1,917)	550	3,642	2,995
Income taxes ⁽⁸⁾	(1,109)	(1,271)	(1,056)	(987)
Profit (loss) and comprehensive income (loss)	\$ 1,308	\$ 3,988	\$ 6,706	\$ 5,957
Distributable cash before SIFT taxes ⁽⁹⁾	\$ 4,721	\$ 4,283	\$ 4,106	\$ 3,901
Distributable cash ⁽¹⁰⁾	\$ 3,630	\$ 3,062	\$ 3,062	\$ 2,909
Distributions to Fund unitholders ⁽¹¹⁾	\$ 2,980	\$ 3,741	\$ 2,878	\$ 2,793
Payout Ratio ⁽¹²⁾	82.1%	122.2%	94.0%	96.0%
Per Fund unit information ⁽¹³⁾				
Profit before fair value gain (loss) and income taxes	\$.382	\$.415	\$.363	\$.348
Profit (loss) and comprehensive income (loss)	\$.115	\$.351	\$.591	\$.525
Distributable cash before SIFT tax ⁽⁹⁾	\$.416	\$.377	\$.362	\$.344
Distributable cash ⁽¹⁰⁾	\$.320	\$.270	\$.270	\$.256
Distributions to Fund unitholders ⁽¹¹⁾	\$.262	\$.330	\$.253	\$.246
SSSG ⁽¹⁴⁾				
Canada	0.0%	9.5%	5.7%	3.8%
United States	2.2%	9.1%	5.7%	5.2%
Consolidated	1.1%	11.1%	7.5%	5.1%
Restaurants in KRL System ⁽¹⁵⁾				
# Beginning of Period	101	102	104	103
Opened	--	1	--	2
Closed	--	(2)	(2)	(1)
# End of Period	<u>101</u>	<u>101</u>	<u>102</u>	<u>104</u>

SUMMARY OF QUARTERLY RESULTS

	Q1	Q4	Q3	Q2
(\$000's except per unit amounts)	2015	2014	2014	2014
Restaurants in the Royalty Pool	102	103	103	103
Royalty Pool sales ⁽¹⁾	\$ 146,383	\$ 130,887	\$ 129,660	\$ 125,394
Royalty income ⁽²⁾	\$ 5,859	5,258	\$ 5,209	\$ 5,038
Interest income ⁽³⁾	1,056	1,080	1,079	1,067
Total income	\$ 6,915	6,338	\$ 6,288	\$ 6,105
Administrative expenses ⁽⁴⁾	(96)	(110)	(103)	(101)
Interest and financing expenses ⁽⁵⁾	(149)	(157)	(161)	(154)
Operating income	\$ 6,670	6,071	\$ 6,024	\$ 5,850
Distributions to KRL ⁽⁶⁾	(2,361)	(2,186)	(2,175)	(2,137)
Profit before fair value gain (loss) and income taxes	\$ 4,309	3,885	\$ 3,849	\$ 3,713
Fair value gain (loss) ⁽⁷⁾	(8,511)	(2,686)	(1,473)	(33)
Income taxes ⁽⁸⁾	(1,213)	(1,005)	(993)	(932)
Profit (loss) and comprehensive income (loss)	\$ (5,415)	\$ 194	\$ 1,383	\$ 2,748
Distributable cash before SIFT tax ⁽⁹⁾	\$ 4,391	\$ 3,735	\$ 3,783	\$ 3,686
Distributable cash ⁽¹⁰⁾	\$ 3,263	\$ 2,757	\$ 2,815	\$ 2,754
Distributions to Fund unitholders ⁽¹¹⁾	\$ 2,748	\$ 2,725	\$ 2,725	\$ 2,725
Payout Ratio ⁽¹²⁾	84.2%	98.8%	96.8%	98.9%
Per Fund unit information ⁽¹³⁾				
Profit before fair value gain (loss) and income taxes	\$.380	\$.342	\$.339	\$.327
Profit (loss) and comprehensive income (loss)	\$ (.477)	\$.017	\$.122	\$.242
Distributable cash before SIFT tax ⁽⁹⁾	\$.387	\$.329	\$.333	\$.325
Distributable cash ⁽¹⁰⁾	\$.287	\$.243	\$.248	\$.243
Distributions to Fund unitholders ⁽¹¹⁾	\$.242	\$.240	\$.240	\$.240
SSSG ⁽¹⁴⁾				
Canada	6.9%	4.5%	7.0%	4.9%
United States	7.9%	8.5%	7.6%	7.5%
Consolidated	8.2%	5.7%	7.4%	5.8%
Restaurants in KRL System ⁽¹⁵⁾				
# Beginning of Period	107	105	104	104
Opened	--	2	1	--
Closed	(4)	--	--	--
# End of Period	<u>103</u>	<u>107</u>	<u>105</u>	<u>104</u>

SELECTED ANNUAL INFORMATION

(\$000's except per unit amounts)	Jan. 1 to Dec. 31, 2015	Jan. 1 to Dec. 31, 2014	Jan. 1 to Dec. 31, 2013
Restaurants in the Royalty Pool	102	103	102
Royalty Pool sales ⁽¹⁾	\$ 574,048	\$ 520,701	\$ 474,864
Royalty income ⁽²⁾	\$ 23,251	\$ 20,896	\$ 19,496
Interest income ⁽³⁾	4,281	4,281	4,279
Total income	\$ 27,532	\$ 25,177	\$ 23,775
Administrative expenses ⁽⁴⁾	(435)	(408)	(422)
Interest and financing expenses ⁽⁵⁾	(519)	(624)	(681)
Operating income	\$ 26,578	\$ 24,145	\$ 22,672
Distributions to KRL ⁽⁶⁾	(9,491)	(8,713)	(8,072)
Profit before fair value gain (loss) and income taxes	\$ 17,087	\$ 15,432	\$ 14,600
Fair value gain (loss) ⁽⁷⁾	(1,324)	(3,926)	(5,740)
Income taxes ⁽⁸⁾	(4,527)	(3,983)	(3,800)
Profit (loss) and comprehensive income (loss)	\$ 11,236	\$ 7,523	\$ 5,060
Distributable cash before SIFT tax ⁽⁹⁾	\$ 16,681	\$ 15,304	\$ 14,641
Distributable cash ⁽¹⁰⁾	\$ 12,296	\$ 11,421	\$ 11,024
Distributions to Fund unitholders ⁽¹¹⁾	\$ 12,160	\$ 10,899	\$ 10,899
Payout Ratio ⁽¹²⁾	98.9%	95.4%	98.9%
Per Fund unit information ⁽¹³⁾			
Profit before fair value gain (loss) and income taxes	\$ 1,505	\$ 1,359	\$ 1,286
Profit (loss) and comprehensive income (loss)	\$.990	\$.663	\$.446
Distributable cash before SIFT tax ⁽⁹⁾	\$ 1,469	\$ 1,348	\$ 1,290
Distributable cash ⁽¹⁰⁾	\$ 1,083	\$ 1,006	\$.971
Distributions to Fund unitholders ⁽¹¹⁾	\$ 1,001	\$.960	\$.960
SSSG ⁽¹⁴⁾			
Canada	6.5%	4.9%	(0.8)%
United States	7.0%	6.4%	1.5%
Consolidated	8.0%	5.8%	(0.3)%
Restaurants in KRL System ⁽¹⁵⁾			
# Beginning of Period	107	105	106
Opened	3	3	3
Closed	(9)	(1)	(4)
# End of Period	<u>101</u>	<u>107</u>	<u>105</u>
	Dec. 31, 2015	Dec. 31, 2014	Dec. 31, 2013
Total assets	\$ 227,114	\$ 222,510	\$ 216,851
Total liabilities	138,316	132,703	123,668

MANAGEMENT'S DISCUSSION AND ANALYSIS

**For the Three Months Ended March 31, 2016
As of May 4, 2016.**

OVERVIEW

KEY ATTRIBUTES OF THE FUND

The Keg Royalties Income Fund (the "Fund") is a limited purpose, open-ended trust which trades on the Toronto Stock Exchange ("TSX") under the symbol KEG.UN. On May 31, 2002, as part of the Initial Public Offering (the "IPO"), the Fund, through its subsidiary The Keg Rights Limited Partnership (the "Partnership"), purchased The Keg trademarks and other related intellectual property (collectively, the "Keg Rights") from Keg Restaurants Ltd. ("KRL"). The Partnership, in turn, granted KRL an exclusive licence to use the Keg Rights for a term of 99 years pursuant to a licence and royalty agreement, which obligates KRL to make monthly royalty payments to the Partnership equal to 4% of gross sales of Keg restaurants included in a specific royalty pool (the "Royalty Pool").

The key feature of the Fund is that royalty income is based on the top-line, gross sales of Keg restaurants in the Royalty Pool and not on the profitability of either KRL or the Keg restaurants in the Royalty Pool. Moreover, the Fund is not subject to the variability of income or expenses associated with an operating business. The Fund's only expenses are nominal administrative expenses and interest on non-amortizing term debt. Thus, the success of the Fund depends primarily on the ability of KRL to maintain and increase the gross sales of the Keg restaurants in the Royalty Pool.

Increases in gross sales are derived from both same store sales growth from existing restaurants ("SSSG") and from the addition of new Keg restaurants. SSSG is the key driver of growth in royalty income and, since the Fund's expenses are relatively fixed in nature, SSSG results in growth in distributable cash which allows for higher distributions to the Fund's unitholders. KRL has generated SSSG through a combination of increased guest counts and increased guest average cheque. SSSG has been achieved by maintaining operational excellence within each Keg restaurant, innovative marketing and promotional programs, and pricing. Over the past eighteen years, the period for which current management has been in control of KRL, SSSG has averaged 3.0% annually, a figure that compares very favourably against the restaurant industry as a whole.

In the event that a Keg restaurant is permanently closed during the year (including the termination of a franchise agreement), KRL will continue to pay the royalty amount for that closed Keg restaurant ("Make-whole Payment") from the date of closure until those sales are replaced with gross sales from new Keg restaurants that are added to the Royalty Pool. The amount of the Make-whole Payment is based on the restaurant's gross sales when it was originally included in the Royalty Pool.

Readers should note that the number of restaurants added to the Royalty Pool each year may differ from the number of restaurant openings and closings reported by KRL on an annual basis, as the periods for which they are reported differ slightly.

THE ROYALTY POOL

Annually, on January 1st, the Royalty Pool is adjusted to include the gross sales from new Keg restaurants that have opened on or before October 2nd of the prior year, less gross sales from any Keg restaurants that have permanently closed during the preceding calendar year. In return for adding these net sales to the Royalty Pool, KRL receives the right to indirectly acquire additional Fund units (the “Additional Entitlement”). The Additional Entitlement is determined based on 92.5% of the estimated net royalty revenue added to the Royalty Pool, divided by the yield of the Fund units, divided by the weighted average unit price of the Fund units. KRL receives 80% of the estimated Additional Entitlement initially, with the balance received on December 31st of each year when the actual full-year performance of the new restaurants is known with certainty.

The total number of Keg restaurants included in the Royalty Pool has increased from the 80 Keg restaurants in existence on March 31, 2002, to 102 as of December 31, 2015. Fifty-nine new Keg restaurants that opened during the period from April 1, 2002, through October 2, 2014, with annual gross sales of \$291.8 million, have been added to the Royalty Pool. Thirty-seven permanently closed Keg restaurants with annual sales of \$111.5 million have been removed from the Royalty Pool. This has resulted in a net increase in Royalty Pool sales of \$180.3 million annually, and KRL receiving a cumulative Additional Entitlement equivalent to 5,752,680 Fund units as of December 31, 2015.

On January 1, 2016, an estimated \$1.9 million in annual net sales were added to the Royalty Pool. Three new restaurants that opened during the period from October 3, 2014 through October 2, 2015, with estimated gross sales of \$21.0 million annually, were added to the Royalty Pool. Five permanently closed Keg restaurants with annual sales of \$19.1 million were removed from the Royalty Pool. The total number of restaurants in the Royalty Pool decreased to 100. The pre-tax yield of the Fund units was determined to be 7.37% calculated using a weighted average unit price of \$18.01.

As a result of the contribution of the additional net sales to the Royalty Pool, and assuming 100% of the estimated Additional Entitlement is received, KRL’s Additional Entitlement will be equivalent to 52,357 Fund units, being 0.35% of the Fund units on a fully diluted basis.

On January 1, 2016, KRL received 80% of this entitlement, representing the equivalent of 41,886 Fund units, being 0.28% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the initial portion of the Additional Entitlement described above, KRL will have the right to exchange its units in the capital of the Partnership for 3,500,510 Fund units, representing 23.57% of the Fund units on a fully diluted basis.

The balance of the additional entitlement will be adjusted on December 31, 2016, to be effective January 1, 2016, once the actual performance of the new restaurants has been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2016, it would have the right to exchange its Partnership units for 3,510,981 Fund units, representing 23.62% of the Fund units on a fully diluted basis.

KRL'S INTEREST IN THE FUND

KRL's interest in the earnings of the Partnership is from its ownership of Class A, entitled Class B, Class C and Class D Partnership units. The Class A, entitled Class B and Class D Partnership units are exchangeable into Fund units on a one-for-one basis in certain circumstances ("Exchangeable Units"). KRL's effective ownership of the Fund and its interest in the earnings of the Partnership has grown from 10.00% at the time of the IPO to 23.35% as of December 31, 2015. The increase in KRL's effective ownership of the Fund is due to the cumulative Additional Entitlement received by KRL equivalent to 5,752,680 Fund units, less 3,200,000 Exchangeable units exchanged by KRL for Fund units and sold through the facilities of the TSX. The sale of the 3,200,000 Fund units increased the number of issued and outstanding Fund units from 8,153,500 at the time of the IPO to 11,353,500 as of February 8, 2011.

On January 1, 2016, KRL became entitled to the initial 80% of the Additional Entitlement for 2016, consisting of 41,886 Exchangeable units, increasing its effective ownership of the Fund to 23.57%.

FAIR VALUE GAIN (LOSS)

Fair value gain (loss) is the non-cash decrease or increase in the market value of the Exchangeable units held by KRL during the respective period. It is a non-cash adjustment and, therefore does not affect distributable cash. The exchangeable units held by KRL are classified as a financial liability under IFRS. The Fund is required to determine the fair value of that liability at the end of each reporting period and adjust for any increase or decrease, during the same period. The closing market price of a Fund unit at the end of each reporting period is used to determine the fair value of the Exchangeable unit liability, since Exchangeable units are exchangeable into Fund units on a one-for-one basis. If the market price of a Fund unit increases during a period, the financial liability of the Fund also increases, and a non-cash loss is recorded during that period. If the market price of a Fund unit decreases during a period, the financial liability of the Fund also decreases, and a non-cash gain is recorded during that period.

FEDERAL GOVERNMENT TAX ON INCOME FUNDS

On January 1, 2011, legislative changes to the tax treatment of certain income trusts, as a result of the Specified Investment Flow-through Trust tax (the "SIFT tax"), came into effect. Due to these changes, income trusts will not be entitled to deduct distributions of certain types of income for tax purposes, and will therefore be subject to taxation similar to corporations. As a result of this taxation imposed by the Federal Government, the Fund's Trustees had to adopt a new distribution policy which reflects the Fund's obligation to make the SIFT tax payments. See "Distributions to Unitholders". The Fund is subject to tax at a rate of 25.0% for 2012, 25.75% for 2013 and 26.0% for 2014 and 2015. The blended rate of 25.75% for 2013 was due to the increase in the general corporate taxation rate from 10.0% to 11.0% enacted by the British Columbia government effective April 1, 2013, which increased the SIFT tax rate from 25.0% to 26.0%, effective that date.

DISTRIBUTIONS TO UNITHOLDERS

The Fund's objective is to provide consistent monthly distributions to unitholders at the highest sustainable level, and the Trustees of the Fund continue to review distribution levels on an ongoing basis to fulfill that objective. Since the inception of the Fund, monthly distributions to unitholders have been increased ten times from the original level of \$0.09 per unit at the time of the IPO, to \$0.1182 per unit, on a pre-tax basis (\$0.08750 on an after-tax basis), starting in the month of November 2015, an increase of 31.3%.

Monthly distributions to Fund unitholders were increased three times during 2015; from 8.0 cents/Fund unit to 8.2 cents/Fund unit, commencing with the March 2015 distribution, from 8.2 cents/Fund unit to 8.45 cents/Fund unit commencing with the July 2015 distribution and from 8.45 cents/Fund unit to 8.75 cents/Fund unit commencing with the November 2015 distribution. In addition, a special distribution, attributable to 2015, of 7.0 cents/Fund unit was declared in December 2015, and paid in January 2016.

As a result of the SIFT tax that came into effect on January 1, 2011, the Fund's Trustees had to adopt a new distribution policy which reflects the Fund's obligation to make these tax payments. Beginning with the distribution for the month of January 2011 (payable to unitholders on February 28, 2011), distributions were set at \$0.08 per unit per month. This amounts to a distribution of \$0.96 per unit annually. At this level, the eligible dividend portion of the Fund's distribution, combined with the return of capital component of the distribution, should provide taxable Canadian individuals with an effective after-tax cash return very closely comparable to the return that existed before the imposition of the SIFT tax.

Annually, two distributions are expected to be declared during the first quarter, three distributions in each of the second and third quarters, and four distributions in the fourth quarter. This is done to ensure that the distribution based on the Royalty Pool sales for the month of December (which is paid the following month in January), is recorded in the period in which it was earned for income tax purposes.

The determination to declare and make payable distributions from the Fund are at the discretion of the Board of Trustees of the Fund and until declared payable, the Fund has no requirement to pay cash distributions to Fund unitholders.

Year-to-date distributions paid were as follows:

Period	Payment Date	\$ / Unit	Distributions	
			Total \$	Year-to-Date \$
December 1-31, 2015	January 29, 2016	8.75¢	\$ 993,431	\$ 993,431
January 1-31, 2016	February 29, 2016	8.75¢	\$ 993,431	\$ 1,986,862
February 1-29, 2016	March 31, 2016	8.75¢	\$ 993,431	\$ 2,980,293
March 1-31, 2016	April 29, 2016	8.75¢*	\$ 993,431*	\$ 3,973,725*

*Paid subsequent to the period.

Distributions paid during the period were funded entirely by cash flow from operations and no debt was incurred at any point during the year to fund distributions.

The special distribution of \$795,000 (7.0 cents/Fund unit) which was declared in December 2015 and paid January 29, 2016, was treated as a distribution in 2015 for Fund reporting purposes.

Since inception, the Fund has generated \$151,035,000 of distributable cash, paid cumulative distributions of \$149,523,000, which resulted in a cumulative surplus of \$1,512,000. The cumulative payout ratio (the ratio of cumulative cash distributions paid plus any special distributions declared since inception to the cumulative distributable cash generated since inception) is 99.0%.

DISTRIBUTABLE CASH

Distributable cash is defined as the periodic cash flows from operating activities as reported in the consolidated financial statements, including the change in non-cash working capital balances, plus SIFT tax paid (including current year instalments), less interest and financing fees paid on the term loan, less the Partnership distributions attributable to KRL, less current year SIFT tax expense. Distributable cash is a non-IFRS financial measure that does not have a standardized meaning prescribed by IFRS, and therefore may not be comparable to similar measures presented by other issuers.

Distributable cash is calculated as follows:

(\$000's)

	Jan. 1 to Mar. 31, <u>2016</u>	Jan. 1 to Mar. 31, <u>2015</u>
Cash flow from operations ⁽¹⁾	\$ 5,773	\$ 5,523
SIFT tax paid on Fund units ⁽²⁾	1,452	1,374
Interest and financing fees paid on term loan ⁽³⁾	(103)	(145)
KRL's interest ⁽⁴⁾	<u>(2,401)</u>	<u>(2,361)</u>
Distributable cash before current year SIFT tax	\$ 4,721	\$ 4,391
SIFT tax expense on Fund units ⁽⁵⁾	<u>(1,091)</u>	<u>(1,128)</u>
Distributable cash ⁽⁶⁾	<u>\$ 3,630</u>	<u>\$ 3,263</u>

Notes:

- ⁽¹⁾ Represents the cash flow from operations as reported in the consolidated statements of cash flows.
- ⁽²⁾ Includes SIFT taxes actually paid during the respective period. During the first quarter of 2016, \$1,452,000 was paid consisting of \$1,030,000 on account for 2016 and \$422,000 for 2015 (first quarter of 2015 – \$1,374,000 consisting of \$938,000 on account for 2015 and \$436,000 for 2014).
- ⁽³⁾ Represents the interest and financing fees paid on the term loan.
- ⁽⁴⁾ Represents the distributions of the Partnership attributable to KRL during the respective periods on the Exchangeable and Class C units held by KRL. The distributions attributable to KRL will differ from the actual distributions paid to KRL during the same periods, due to the timing of the declaration of distributions.
- ⁽⁵⁾ Represents the SIFT tax expense for the respective period calculated at 26.00% of taxable income for 2015 and 2016.
- ⁽⁶⁾ Distributable cash is the amount of cash available for distribution to the Fund's public unitholders. It is defined as the periodic cash flows from operating activities as reported in the IFRS consolidated financial statements, including the change in non-cash working capital, plus SIFT tax paid (including current year instalments), less interest and financing fees paid on the term loan, less the Partnership distributions attributable to KRL, and less current year SIFT tax expense.

OWNERSHIP OF THE FUND

The ownership of the Fund on a fully diluted basis is as follows:

	March 31, 2016 ⁽¹⁾		March 31, 2015	
	#	%	#	%
Fund units held by public unitholders ⁽²⁾	11,353,500	76.43	11,353,500	76.93
Exchangeable Partnership units held by KRL: ⁽³⁾				
Class A units ⁽⁴⁾	905,944	6.10	905,944	6.14
Class B units ⁽⁵⁾	176,700	1.19	176,700	1.20
Class D units ⁽⁵⁾	<u>2,417,866</u>	<u>16.28</u>	<u>2,321,335</u>	<u>15.73</u>
Total Exchangeable Partnership units ⁽⁶⁾	<u>3,500,510</u>	<u>23.57</u>	<u>3,403,979</u>	<u>23.07</u>
Total Fund and Exchangeable Partnership units	<u>14,854,010</u>	<u>100.00</u>	<u>14,757,479</u>	<u>100.00</u>

Notes:

⁽¹⁾ Information is current as of March 31, 2016. On January 1, 2016, KRL became entitled to the initial 80% of the Additional Entitlement for 2016 consisting of 41,886 Exchangeable units. As of the date of this report, there are 11,353,500 Fund units and 3,500,510 Exchangeable Partnership units issued and outstanding.

⁽²⁾ Represents the public's total effective ownership of the Fund as of March 31, 2016 and 2015. The public's average effective ownership of the Fund (based on the weighted average number of Fund units held by public unitholders during the respective period) was 76.43% during the three months ended March 31, 2016 (three months ended March 31, 2015 – 76.93%). The weighted average number of Fund units outstanding for the three-month period ended March 31, 2016 were 11,353,500 (three-month period ended March 31, 2015 – 11,353,500).

⁽³⁾ Exchangeable into Fund units on a one-for-one basis.

⁽⁴⁾ Represents KRL's initial 10% effective ownership of the Fund, prior to the entitlement of Class B or Class D units.

⁽⁵⁾ These exchangeable Partnership units are issued to KRL in return for adding net sales to the Royalty Pool on an annual basis. Class D units are equivalent to Class B units in all material respects but began to be issued once all Class B units became fully entitled to distributions on January 1, 2008. As of March 31, 2016, KRL is the registered holder of 176,700 Class B units and 2,417,866 Class D units (March 31, 2015 – 176,700 Class B units and 2,321,335 Class D units). Also included in these figures is 80% of the Additional Entitlement estimated at the beginning of each year, pursuant to which KRL receives a proportionate increase in monthly distributions from the Partnership. The remaining 20% of KRL's Additional Entitlement to Class B and Class D units is adjusted retroactively to January 1st of each year once the actual sales performance of the new restaurants has been confirmed. KRL is not entitled to proportionate monthly distributions from the Partnership on the remaining 20% of KRL's Additional Entitlement until such time as the Additional Entitlement is adjusted retroactively at the end of each year.

⁽⁶⁾ Represents KRL's total effective ownership of the Fund as of March 31, 2016 and 2015. KRL's average effective ownership of the Fund (based on the weighted average number of Fund and Exchangeable units held by KRL during the respective period) was 23.57% during the three months ended March 31, 2016 (three months ended March 31, 2015 – 23.07%). The weighted average number of Exchangeable units held by KRL during the three-month period ended March 31, 2016 were 3,500,510 (three-month period ended March 31, 2015 – 3,403,979).

SYSTEM SALES

While the Fund's income is indirectly based on a royalty of 4% of sales of Keg restaurants in the Royalty Pool, the total system sales of The Keg chain are of interest to the Fund and its unitholders as the total system sales best reflect the chain's overall performance. The following table sets out The Keg's total system sales for the periods indicated below:

(\$000's)	13 weeks ended Apr. 3, 2016	13 weeks ended Mar. 29, 2015
Corporate Keg restaurants ⁽¹⁾	\$ 72,590	\$ 71,995
Franchised Keg restaurants ⁽²⁾	<u>76,324</u>	<u>75,838</u>
Total system sales	<u>\$ 148,914</u>	<u>\$ 147,833</u>

Notes:

⁽¹⁾ The amount of system sales for the corporate Keg restaurants is the amount of gross sales from corporate Keg restaurants only.

⁽²⁾ The amount of system sales for the franchised Keg restaurants is the amount of gross sales reported to KRL by franchised Keg restaurants without independent audit.

FIRST QUARTER

System sales for the 13 weeks ended April 3, 2016 were \$148,914,000 compared to \$147,833,000 for the 13 weeks ended March 29, 2015, an increase of \$1,081,000 or 0.7%. The increase was due to the net impact of the same store sales increases at comparable restaurants during the quarter (\$177,000 increase in sales), the positive effect of the exchange rate increase on the translation of the US restaurant sales into their Canadian dollar equivalent (\$1,561,000 increase in sales), the sales of the new restaurants that operated during the quarter (\$5,279,000 increase in sales), the sales of restaurants temporarily closed for renovation during the second quarter of the prior year (\$411,000 increase in sales), the loss of sales from restaurants temporarily closed for renovation during the second quarter of the current year (\$612,000 decrease in sales) and the loss of sales from permanently closed restaurants that did not operate during the comparable quarter (\$5,735,000 decrease in sales).

During the 13 weeks ended April 3, 2016, no new restaurants were opened and no restaurants were closed. During the 13 weeks ended March 29, 2015, no new restaurants were opened, and three corporate and one franchise restaurant were closed. As of April 3, 2016, there were a total of 101 Keg restaurants as compared with 103 Keg restaurants at March 29, 2015.

Same store sales (sales of restaurants that operated during the entire 13-week period of both the current and prior years) were flat in Canada and increased by 2.2% in the United States ("US"). Same store sales in the second quarter of the current fiscal year were negatively impacted by the calendar shift of New Year's Eve. The incremental sales typically generated on New Year's Eve were included in the first quarter of the current fiscal year, whereas in the prior fiscal year those incremental sales were reflected in the second quarter. After translating the sales of the US restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 13-week periods increased by 1.1%. The average exchange rate moved from 1.2375 in KRL's second quarter of fiscal 2015 to 1.3691 in KRL's second quarter of fiscal 2016, significantly increasing the Canadian dollar equivalent of the US restaurant sales.

OPERATING RESULTS

FIRST QUARTER

ROYALTY POOL SALES

Royalty Pool sales increased by \$404,000 from \$146,383,000 to \$146,787,000 for the comparable quarter. The increase in Royalty Pool sales was due to the net impact of the same store sales increases at comparable royalty pool restaurants during the comparable 13-week periods (\$177,000 increase in Royalty Pool sales), the positive effect of the exchange rate increase on the translation of the US restaurant sales into their Canadian dollar equivalent (\$1,596,000 increase in Royalty Pool sales), the sales of new restaurants added to the Royalty Pool on January 1, 2016 (\$4,570,000 increase in Royalty Pool sales), the sales of restaurants temporarily closed for renovation during the comparable quarter of the prior year (\$411,000 increase in Royalty Pool sales), the loss of sales from restaurants temporarily closed for renovation during the comparable quarter of the current year (\$613,000 decrease in Royalty Pool sales), and the loss of sales from permanently closed restaurants that did not operate during the comparable quarter (\$5,737,000 decrease in Royalty Pool sales).

ROYALTY INCOME

Total royalty income increased from \$5,859,000 in the first quarter of 2015 to \$5,871,000 in the first quarter of 2016. The increase of \$12,000 during the comparable quarter consists of an increase in royalty fee income of \$16,000, and a decrease in Make-whole fees of \$4,000.

The increase in royalty fee income was due to the net impact of the same store sales increases at comparable royalty pool restaurants during the comparable 13-week periods (\$7,000 increase in royalty fee income), the positive effect of the exchange rate increase on the translation of US restaurant sales into their Canadian dollar equivalent (\$64,000 increase in royalty fee income), the sales of new restaurants added to the Royalty Pool on January 1, 2016 (\$183,000 increase in royalty fee income), the sales of restaurants temporarily closed for renovations during the comparable quarter of the prior year, (\$16,000 increase in royalty fee income), the loss of sales from restaurants temporarily closed for renovation during the comparable quarter of the current year (\$25,000 decrease in royalty fee income), and the loss of sales from permanently closed restaurants that did not operate during the comparable quarter (\$229,000 decrease in royalty fee income).

Make-whole fees decreased, as the first quarter of the prior year included proceeds from a business interruption claim. No restaurants were subject to Make-whole payments during the first quarter of either the current or prior year.

INTEREST INCOME

Interest income earned by the Fund during the first quarter of the current year was \$1,064,000, and was comprised of interest income on the Keg Loan of \$1,063,000 and other interest income of \$1,000. Interest income on the Keg Loan increased by \$9,000 during the quarter as 2016 is a leap year, and therefore the first quarter of the current year included one extra day of interest income. Other interest income earned by the Fund on surplus cash balances decreased by \$1,000 during the comparable quarter, due to reduced interest rates applied to surplus cash balances on hand.

ADMINISTRATIVE EXPENSES

Expenses incurred by the Partnership for the quarter ended March 31, 2016 were \$94,000, comprised entirely of general and administrative expenses. General and administrative expenses decreased by \$2,000, due to the timing of certain expenses.

INTEREST AND FINANCING EXPENSES

Interest and financing expenses incurred by the Fund were \$106,000 for the three months ended March 31, 2016, and included interest on the long-term debt of \$102,000, and amortization of deferred financing charges of \$4,000. Interest and financing expenses decreased by \$43,000 from the comparable quarter of the prior year, consisting of a decrease in the interest on the long-term debt of \$41,000, and a decrease in amortization of deferred finance charges of \$2,000. Interest costs on the long-term debt decreased during the comparable quarter, as the average interest rate on the term loan decreased from 4.15% to 2.95%, due to the combined effect of two reductions in the bank's prime lending rate during the prior year, and a reduction in the Fund's borrowing rate by 1.0% effective June 26, 2015, as part of its amended banking agreement.

OPERATING INCOME

The Fund's operating income increased from \$6,670,000 during the first quarter of 2015, to \$6,735,000 during the first quarter of 2016. The increase of \$65,000 was due to the net impact of the increase in royalty income of \$12,000, the increase in interest income of \$8,000, the decrease in administrative expenses of \$2,000, and the decrease in interest and financing expenses of \$43,000.

DISTRIBUTIONS TO KRL

Distributions attributable to KRL during the three months ended March 31, 2016 were \$2,401,000, which included distributions of \$1,332,000 on the Exchangeable units and \$1,069,000 on the Class C units. Distributions on the Exchangeable units increased by \$40,000 from the comparable quarter of the prior year, due to the combination of an increase in the operating income of the Fund during the first quarter of 2016, and an increase in KRL's average effective ownership of the Fund during that period. KRL's average effective ownership of the Fund increased from 23.07% during the first quarter of 2015 to 23.57% during the first quarter of 2016, as a result of the 2016 Additional Entitlement received by KRL on January 1, 2016, from the roll-in of sales of net new restaurants on that date. The distributions declared on the Class C units remained the same during the comparable periods, which were \$0.0625 per Class C unit per month.

PROFIT BEFORE FAIR VALUE GAIN (LOSS) AND INCOME TAXES

Profit before fair value gain (loss) and income taxes increased by \$25,000 from a profit of \$4,309,000 (38.0 cents/Fund unit) in the first quarter of 2015, to a profit of \$4,334,000 (38.2 cents/Fund unit) in the first quarter of 2016.

FAIR VALUE GAIN (LOSS)

The fair value of the Exchangeable unit liability increased by \$1,917,000 during the three months ended March 31, 2016, as compared with an increase of \$8,511,000 during the three months ended March 31, 2015.

During the three months ended March 31, 2016, the fair value of the 3,458,624 Exchangeable units held by KRL during that entire period increased, as the closing market price of a Fund unit (the basis upon which the Exchangeable units held by KRL are valued) increased from \$17.81 to \$18.36, resulting in a non-cash loss to the Fund of \$1,902,000. In addition, the fair value of the 41,886 Exchangeable units granted to KRL on January 1, 2016, as the initial 80% of the Additional Entitlement for 2016, increased from \$18.01 (the roll-in price) to \$18.36, resulting in a non-cash loss to the Fund of \$15,000.

During the comparable period of the prior year, the fair value of the 3,275,225 Exchangeable units held by KRL during that entire period increased, as the closing market price of a Fund unit increased from \$17.47 to \$19.94, resulting in a non-cash loss to the Fund of \$8,090,000. In addition, the fair value of the 128,754 Exchangeable units granted to KRL on January 1, 2015, as the initial 80% of the Additional Entitlement for 2015, increased from \$16.66 (the roll-in price) to \$19.94, resulting in a non-cash loss to the Fund of \$421,000.

INCOME TAXES

Income taxes for the three-month period ended March 31, 2016, were \$1,109,000, and included SIFT tax expense of \$1,091,000 and non-cash deferred taxes of \$18,000. SIFT tax expense decreased by \$37,000, as the comparable quarter of the prior year included an adjustment for additional SIFT taxes payable for 2014. Deferred income taxes decreased by \$67,000 during the comparable quarter, due to changes in the temporary differences between the accounting and tax basis of the Keg Rights owned by the Partnership.

PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

Profit (loss) increased by \$6,723,000 from a loss of \$5,415,000 (-47.7 cents/Fund unit) in the first quarter of 2015, to a profit of \$1,308,000 (11.5 cents/Fund unit) in the first quarter of 2016, mainly due to the decrease in the non-cash fair value gain (loss) of the Exchangeable unit liability.

DISTRIBUTABLE CASH

Distributable cash before SIFT tax increased by \$330,000 from \$4,391,000 (38.7 cents/Fund unit) to \$4,721,000 (41.6 cents/Fund unit) during the comparable quarter. Cash available for distribution to Fund unitholders increased by \$367,000 from \$3,263,000 (28.7 cents/Fund unit) to \$3,630,000 (32.0 cents/Fund unit) during the comparable quarter. The difference between the Fund's profit (loss) and distributable cash is due to non-cash items such as amortization, fair value gain (loss), and deferred income taxes included in the Fund's profit (loss), as well as changes in non-cash working capital balances.

DISTRIBUTIONS TO FUND UNITHOLDERS

Annually, two distributions are expected to be declared during the first quarter, three distributions in each of the second and third quarters and four distributions in the fourth quarter. This is done to ensure that the distribution based on the Royalty Pool sales for the month of December (which is paid the following month in January) is recorded in the period in which it was earned for income tax purposes.

In the first quarter of 2015, distributions to Fund unitholders consisted entirely of cash distributions paid of \$2,747,000 (24.2 cents/Fund unit) whereas in the first quarter of 2016, distributions to Fund unitholders include cash distributions paid of \$2,980,000 (26.2 cents/Fund unit). The special distribution of \$795,000 (7.0 cents/Fund unit) declared in December 2015 and paid in January 2016, was treated as a distribution in 2015 for Fund reporting purposes. The total increase in distributions paid of \$233,000 (2.0 cents/Fund unit) was the result of monthly distributions having been increased three times during 2015.

LIQUIDITY & CAPITAL RESOURCES

It is the Fund's policy to distribute all available cash on a monthly basis in order to provide consistent returns to unitholders and to maximize those returns. Any increase in distributions in the future will be implemented in such a manner so as to maintain uniform monthly distributions.

During the first quarter of 2016, the Fund generated \$3,630,000 in distributable cash, and paid distributions of \$2,980,000 to public unitholders, resulting in a surplus of \$650,000. The special distribution declared in December 2015, which was actually paid in January 2016, was treated as a distribution in 2015 for Fund reporting purposes. The Fund has cash on hand of \$2,091,000 and a positive working capital balance of \$3,576,000 as at March 31, 2016.

TERM LOAN

The Trust has a \$14 million non-revolving term loan facility, which bears interest at bank prime plus 0.25% per annum. The facility was originally arranged during the IPO to partially finance the purchase of the Keg Rights from KRL, and to provide term debt as part of the capital structure. On June 26, 2015, the Fund amended the terms of this loan with its existing banking syndicate and the maturity date was extended to July 1, 2018 and the interest rate reduced from bank prime plus 1.25% to bank prime plus 0.25%. The term loan held by the Trust is subject to certain financial covenants, including minimum equity amounts in both the Trust and the Partnership, and a minimum Partnership cash flow level defined as profit (loss) before interest, fair value gain (loss), taxes, depreciation and amortization ("EBITDA"). As at March 31, 2016, the Trust and Partnership are in compliance with all financial covenants associated with this facility.

OPERATING LINE OF CREDIT

The Partnership, a subsidiary of the Fund, has a \$1 million operating line of credit, which bears interest at bank prime plus 0.25% per annum. This facility is used primarily to bridge timing differences between the receipt of the royalty payments and distributions on the Partnership securities. This operating line is also available for general working capital purposes or, if required, to help finance periodic differences between receipt of the royalty payment (which may vary due to small seasonal variations in the gross sales of those restaurants in the Royalty Pool), and distributions to unitholders. As at March 31, 2016, the entire \$1 million facility is available for use.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Chief Executive Officer and Chief Financial Officer of The Keg GP Ltd., managing general partner of the Partnership and administrator to the Fund, have designed or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS and applicable securities legislation.

The control framework used to design the internal controls over financial reporting is "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in 2013. There have been no significant changes to the internal control over financial reporting for the quarter ended March 31, 2016 that have had or are reasonably likely to have a material effect on the Fund's internal controls over financial reporting.

It should be noted that a control system, including the Fund's disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Fund's consolidated financial statements in conformity with IFRS requires estimates and judgements to be made that affect the reported amounts of assets and liabilities, income and expenses, and related disclosures. These estimates are based on historical experience and knowledge of economics, market factors and the restaurant industry along with various other assumptions that are believed to be reasonable under the circumstances.

The Fund believes that the following selected accounting policies are critical to understanding the estimates, assumptions and uncertainties that affect the amounts reported and disclosed in the Fund's consolidated financial statements and related notes.

CONSOLIDATION

Applying the criteria outlined in IFRS 10, "*Consolidated Financial Statements*", judgement is required in determining whether the Fund controls the Partnership. Making this judgement involves taking into consideration the concept of power over the Partnership, exposure to variable returns, and the ability to use power to direct the relevant activities of the Partnership so as to generate economic returns. Using these criteria, management has determined that the Fund ultimately controls the Partnership through its 90% ownership of the managing general partner, The Keg GP Ltd.

KEG RIGHTS

The Fund carries the Keg Rights at historical cost comprising the amount of consideration paid for the Keg Rights in 2002 as part of the Fund's IPO, as well as the value of additional sales of net new Keg restaurants added to the Royalty Pool since inception. The value of the gross sales of new Keg restaurants added to the Royalty Pool is determined on a formula basis that is designed to estimate the present value of the cash flows due to the Fund as a result of the sales of these new Keg restaurants being added to the Royalty Pool. As such, the calculation is dependent on a number of variables including the estimated long-term sales of the new Keg restaurants and a discount rate. The value assigned to the sales of net new Keg restaurants, and as a result, the value assigned to the Keg Rights, could differ from actual results.

The Fund tests the Keg Rights for impairment annually, which requires that the Fund use a valuation technique to determine if impairment exists. This valuation technique may not represent the actual fair value less costs to sell that the Fund expects the Keg Rights to generate.

EXCHANGEABLE UNIT FAIR VALUE GAIN (LOSS)

The Fund is required under IFRS to classify the Exchangeable units as a financial liability at fair value. This requires that the Fund uses a valuation technique to determine the fair value of the Exchangeable units at the applicable reporting dates. The Fund estimates the fair value of this financial liability using the Fund's market capitalization at the end of the applicable period and allocating KRL's entitlement based upon its percentage ownership of the Fund on a fully-diluted basis as at March 31, 2016.

As at March 31, 2016, the closing price of a Fund unit was \$18.36 resulting in a market capitalization of \$272.7 million. KRL's 23.57% ownership of the Fund (on a fully-diluted basis) was calculated to be \$64.3 million. This valuation technique may not represent the actual value of the financial liability should such Exchangeable units be extinguished, and changes in the distribution rate on the Exchangeable units and the yield of the Fund's units could materially impact the Fund's financial position and results of operations.

DEFERRED INCOME TAX EXPENSE

The Fund uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the deferred income tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of changes in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment of such changes.

The determination of deferred income taxes requires the use of judgement and estimates. If certain judgements or estimates prove to be inaccurate, or if certain tax rates or laws change, the Fund's results of operations and financial position could be materially impacted.

FINANCIAL INSTRUMENTS

The Fund's financial instruments consist of cash and cash equivalents, royalty fee receivable from KRL, interest on note receivable from KRL, note receivable from KRL, accounts payable and accrued liabilities, interest payable on the term loan, distributions payable to Fund unitholders, distributions payable to KRL, Class C Partnership unit liability and the term loan. The requirement for the Fund to settle its note receivable from KRL in exchange for Class C Partnership units is classified as a derivative instrument. The Fund has reviewed the net impact of this potential exchange requirement on its cash flows and has determined that there is no significant value applicable to this feature.

The fair values of the amount due from KRL, accounts payable and accrued liabilities, interest payable on the term loan and the distributions payable to Fund unitholders approximate their carrying amounts, largely due to the short-term maturities of these instruments. The fair value of the note receivable from KRL and the Class C unit liability approximate their carrying values due to the requirement of the Fund to settle the note receivable from KRL in exchange for Class C Partnership units equal to \$10.00 per Class C unit transferred. The fair value of the term loan is not materially different from its carrying value as the variable rate of interest on the facility would not be significantly different from the current market rate of interest due to the considerable security held by the banking syndicate.

OUTLOOK

In Canada, Restaurants Canada has estimated that sales in the full-service restaurant category, the category in which The Keg operates, increased by 3.3% in 2015 and has projected sales to increase by 3.5% in 2016. Restaurants Canada has also forecasted sales in the full-service category to increase by an average of 3.7% per year between 2015 and 2019 (1.2% per year on an inflation adjusted basis). In the US, the National Restaurant Association has estimated that sales in the full-service category increased by 4.8% in 2015, and has projected sales to increase by 4.9% in 2016. The NRA has not yet released a long term forecast. Given the close historical relationship between disposable income and foodservice spending, management of KRL expects that as economic conditions continue to improve in North America, so will sales in the full-service category of the restaurant industry.

While management of KRL does not expect a significant improvement in economic conditions in the near term, management believes that The Keg will continue to outperform the full-service restaurant category with respect to same store sales growth. Management of KRL continues to monitor the global economy and evaluate its potential impact on the North American business environment, particularly the effect on consumer confidence and discretionary spending. Management of KRL has advised the Trustees that it intends to continue to focus on growing same store sales and to continue to expand the number of corporate and franchised restaurants in Canada and the US.

KRL management has also advised the Trustees that it believes that the strong same store sales growth KRL has delivered in the past will continue to be realized over the long term through a combination of increased guest counts and increased guest average cheque. Advertising and promotions programs will continue to focus on food taste, quality and excellent service in a friendly atmosphere.

Management of KRL has further advised the Trustees that it believes that continued Canadian market expansion will be leveraged by KRL's leading market position and national presence.

Corporate market expansion in the US will continue to focus on two target markets, specifically: Phoenix, Arizona; and Dallas, Texas. KRL management has advised the Trustees that it intends to continue to pursue franchising opportunities in the US.

KRL continues to refurbish, and in some cases, relocate existing Keg restaurants in order to better serve its guests and to protect and enhance the strong leadership position The Keg brand has enjoyed for over forty years. KRL has opened one corporate restaurant in Canada since October 3, 2015, which will be added to the Royalty Pool on January 1, 2017.

Management of KRL has also advised the Trustees of the Fund that it does not expect to open any additional restaurants prior to October 3, 2016, as a result of delays in both design and municipal approvals. The six additional new restaurants originally scheduled to open during KRL's 2016 fiscal year (before October 2, 2016), consisting of three corporate and three franchised restaurants in Canada, will open during KRL's 2017 fiscal year, and will be added to the Royalty Pool on January 1, 2018. The scheduled opening of these new restaurants remains conditional upon the timely receipt of municipal approvals, construction permits, and ongoing evaluation of the current economic environment.

RISKS AND UNCERTAINTIES

The Fund continues to recognize certain risks and uncertainties associated with the ordinary course of business, including those associated with the business and operations of KRL, upon which the Fund relies solely for its income.

THE RESTAURANT INDUSTRY

The performance of the Fund is directly dependent upon the royalty and interest payments received from KRL. The amount of the royalty is dependent upon restaurant sales, which is subject to a number of factors that affect the restaurant industry generally and the casual dining segment of the industry in particular. The casual dining segment of the restaurant industry is intensely competitive with respect to price, service, location and food quality. There are many well-established competitors, particularly in the US, with substantially greater financial and other resources than KRL. Competitors include national and regional chains, as well as individually owned restaurants.

Recently, competition has increased in the mid-price, full-service, casual dining segment in which Keg restaurants operate. If KRL and The Keg franchisees are unable to successfully compete in the casual dining segment of the restaurant industry, sales may be adversely affected, the amount of the royalty reduced and the ability of KRL to pay the royalty or interest on the Keg Loan may be impaired. The restaurant business is also affected by changes in demographic trends, traffic patterns, and the type, number, and location of competing restaurants.

In addition, factors such as inflation; increased food; labour and benefits costs; government regulations; smoking by-laws; and the availability of experienced management and hourly employees may adversely affect the restaurant industry in general and therefore potentially KRL and its franchisees. Changing consumer preferences, discretionary spending patterns and factors affecting the availability of beef could force KRL to modify its restaurant content and menu, and could result in a reduction of restaurant sales. Accordingly, this could impact the amount of the royalty and financial condition of KRL.

Consumer preferences could be affected by health concerns about the consumption of beef, the primary item served at Keg restaurants, and specific events such as the outbreak of “mad cow disease” could reduce the available supply of beef or significantly raise the price of beef.

KRL’s success also depends on numerous factors affecting discretionary consumer spending including economic conditions, disposable consumer income and consumer confidence. Adverse changes in these factors could reduce guest traffic or impose practical limits on pricing, either of which could reduce restaurant sales and operating income, which could adversely affect the royalty and the ability of KRL to pay the royalty, the Make-whole payment or interest on the Keg Loan.

AVAILABILITY AND QUALITY OF RAW MATERIALS

Management of KRL continues to monitor any cases of mad cow disease found in North America. The continued widespread testing of herds confirms that these were isolated cases; the risk to human health appears to be negligible. Most importantly to The Keg, there has not been any significant negative consumer reaction to beef in North America and there has not been a material impact on its restaurant traffic. KRL has maintained an uninterrupted supply of quality beef that meets its demanding specifications despite previous border closures. Management of KRL expects the demand for beef to remain strong among consumers and its supply to continue uninterrupted.

FLUCTUATIONS IN FOREIGN EXCHANGE RATES

As at March 31, 2016, KRL has 10 restaurants located in the US, all of which are corporately owned through its wholly owned subsidiaries. Keg restaurants located in the US generate sales in US dollars, which must be translated into their Canadian dollar equivalent for Fund reporting purposes. Fluctuations in foreign exchange rates will affect the Canadian dollar equivalent of the sales of the restaurants located in the US, which will affect the amount of the royalty.

FORWARD LOOKING INFORMATION

Certain information included in this report contains forward-looking statements within the meaning of applicable securities laws. These statements include, but are not limited to, statements made in the Overview, Outlook, Competitive Strength and Growth, The Royalty Pool, Distributions to Unitholders, and Critical Accounting Estimates sections and other statements concerning the Fund's business plans and objectives, activities and management's beliefs, plans, estimates and intentions, and similar statements concerning the Fund's anticipated future events, results, performance or expectations that are not historical facts. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "outlook", "objective", "may", "will", "would", "expect", "intend", "estimate", "anticipate", "believe", "should", "plan", "continue", or similar expressions suggesting future outcomes or events. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management. All forward-looking statements in this Management's Discussion and Analysis are qualified by these cautionary statements.

These forward looking statements are not guarantees of future events or performance and, by their nature, are based on the Fund's current estimates and assumptions, which are subject to risks and uncertainties, including those described in this Management's Discussion and Analysis, which could cause actual events or results to differ materially from the forward looking statements made in this Management's Discussion and Analysis. Those risks and uncertainties include, but are not limited to:

- changes in national and local business and economic conditions that may affect competition in the restaurant industry, changes in demographic trends, or changes in consumer preferences and discretionary spending patterns;
- availability and quality of raw materials;
- growth of the royalty fee and the impact on the royalty amount from the closure of Keg restaurants;
- the ability of franchisees' to generate sales and pay franchise fees and other amounts;
- dependence on key personnel;
- maintenance of strong intellectual property and brand equity;
- unexpected costs or liabilities related to changes in regulations governing alcoholic beverages, income or sales tax legislation, environmental matters or food-borne illnesses; and
- fluctuations in the foreign exchange rate between the Canadian and US dollar.

The foregoing list of factors is not exhaustive and should be considered in conjunction with the risks and uncertainties set out in KRL's Management's Discussion and Analysis for the 52 weeks ended September 27, 2015, which are available on SEDAR at www.sedar.com.

Material assumptions or factors that were applied in drawing a conclusion or making an estimate set out in the forward looking information may include, but are not limited to:

- a stable pace of real estate development opportunities;
- absence of material changes in law;
- protection of the Keg Rights;
- continued access to financing by each of KRL and its franchisees;
- no unexpected closings of Keg restaurants that will have a material adverse affect on the royalty amount; and
- expectations related to future general economic conditions.

Although the forward looking information contained in this Management's Discussion and Analysis is based upon what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward looking statements. The forward-looking information contained in this document is current only as of the date of this document and reflects current expectations regarding future events and operating performance. Except as required by law, the Fund undertakes no obligation to publicly update, supplement or revise any forward looking statement, whether as a result of new information, changing circumstances, future events or otherwise. Certain statements included in this Management's Discussion and Analysis may be considered "financial outlook" for purposes of applicable securities laws, and such financial outlook may not be appropriate for purposes other than this Management's Discussion and Analysis.

ADDITIONAL INFORMATION

Additional information about the Fund including the Fund's most recent annual information form is available on SEDAR at www.sedar.com.

UNITHOLDER INFORMATION

CORPORATE HEAD OFFICE

The Keg Royalties Income Fund
10100 Shellbridge Way
Richmond, BC V6X 2W7

BOARD OF TRUSTEES

C. C. Woodward
George Killy
Tim Kerr

BOARD OF DIRECTORS AND OFFICERS OF THE KEG GP LTD., THE GENERAL PARTNER OF THE KEG RIGHTS LIMITED PARTNERSHIP

C. C. Woodward*
Chairman and Director
David Aisenstat
President and Director
Neil Maclean
Secretary, Treasurer and Director
George Killy*
Director
Tim Kerr*
Director

* Audit Committee and Governance Committee Member

REGISTRAR AND TRANSFER AGENT

Computershare Trust Company of Canada

STOCK EXCHANGE LISTING

Toronto Stock Exchange: KEG.UN

INVESTOR ENQUIRIES

Neil Maclean

Telephone: (604) 276-0242
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E-mail: neilm@kegrestaurants.com
Website: www.kegincomefund.com

THE KEG ROYALTIES INCOME FUND

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

For the three months ended March 31, 2016 and 2015

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Expressed in thousands of dollars)

	<u>Note</u>	March 31, 2016 (unaudited)	December 31, 2015
ASSETS			
Current assets:			
Cash		\$ 2,091	\$ 2,770
Prepaid expenses and deposits		66	13
Royalty fee receivable from Keg Restaurants Ltd.	9	2,272	2,768
Interest on note receivable from Keg Restaurants Ltd.	9	<u>362</u>	<u>363</u>
		4,791	5,914
Note receivable from Keg Restaurants Ltd.		57,000	57,000
Intangible assets, Keg Rights	5	<u>164,955</u>	<u>164,200</u>
		<u>\$ 226,746</u>	<u>\$ 227,114</u>
LIABILITIES AND UNITHOLDERS' EQUITY			
Current liabilities:			
Accounts payable and accrued liabilities		\$ 262	\$ 322
Interest payable on term loan		35	35
Distributions payable to Fund unitholders		-	1,788
Distributions payable to Keg Restaurants Ltd.	9	849	1,022
Current income tax payable	8	<u>69</u>	<u>430</u>
		1,215	3,597
Term loan, net of deferred financing charges		13,960	13,956
Deferred income taxes	8	2,183	2,165
Class C Partnership units		57,000	57,000
Exchangeable Partnership units	7	64,269	61,598
Unitholders' equity:			
Fund units		123,275	123,275
Accumulated deficit		<u>(35,156)</u>	<u>(34,477)</u>
		<u>88,119</u>	<u>88,798</u>
		<u>\$ 226,746</u>	<u>\$ 227,114</u>

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board of Trustees

“C.C. Woodward”
C.C. Woodward, Trustee

“George Killy”
George Killy, Trustee

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Expressed in thousands of dollars, except unit and per unit amounts - unaudited)

	<u>Note</u>	January 1 to March 31, 2016	January 1 to March 31, 2015
Revenue:			
Royalty income	4	\$ 5,871	\$ 5,859
Interest income		<u>1,064</u>	<u>1,056</u>
		6,935	6,915
Expenses:			
General and administrative		(94)	(96)
Interest and financing fees		(102)	(143)
Amortization of deferred financing charges		<u>(4)</u>	<u>(6)</u>
		<u>(200)</u>	<u>(245)</u>
Profit before distributions, fair value loss and income taxes		6,735	6,670
Distributions recorded as interest:			
Class C Partnership units		(1,069)	(1,069)
Exchangeable Partnership units	7	<u>(1,332)</u>	<u>(1,292)</u>
		<u>(2,401)</u>	<u>(2,361)</u>
Profit before fair value loss and income taxes		4,334	4,309
Fair value loss on Exchangeable Partnership units	7	<u>(1,917)</u>	<u>(8,511)</u>
Profit (loss) before income taxes		2,417	(4,202)
Income taxes:			
Current	8	(1,091)	(1,128)
Deferred	8	<u>(18)</u>	<u>(85)</u>
		<u>(1,109)</u>	<u>(1,213)</u>
Profit (loss) and comprehensive income (loss) for the period		<u>\$ 1,308</u>	<u>\$ (5,415)</u>
Weighted average Fund units outstanding	3	<u>11,353,500</u>	<u>11,353,500</u>
Weighted average diluted units outstanding	3	<u>14,854,010</u>	<u>14,757,479</u>
Basic and diluted earnings (loss) per Fund unit	3	<u>\$ 0.12</u>	<u>\$ (0.48)</u>

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

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN UNITHOLDERS' EQUITY

(Expressed in thousands of dollars - unaudited)

	<u>Note</u>	<u>Fund units</u>	<u>Accumulated deficit</u>	<u>Unitholders' equity</u>
Balance, January 1, 2015		\$ 123,275	\$ (33,468)	\$ 89,807
Loss and comprehensive loss for the period		-	(5,415)	(5,415)
Distributions declared to Fund unitholders	6	-	(1,839)	(1,839)
Balance, March 31, 2015		<u>\$ 123,275</u>	<u>\$ (40,722)</u>	<u>\$ 82,553</u>
Balance, January 1, 2016		\$ 123,275	\$ (34,477)	\$ 88,798
Profit and comprehensive income for the period		-	1,308	1,308
Distributions declared to Fund unitholders	6	-	(1,987)	(1,987)
Balance, March 31, 2016		<u>\$ 123,275</u>	<u>\$ (35,156)</u>	<u>\$ 88,119</u>

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

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars - unaudited)

	<u>Note</u>	<u>January 1 to March 31, 2016</u>	<u>January 1 to March 31, 2015</u>
Cash provided by (used for):			
OPERATIONS:			
Profit (loss) for the period		\$ 1,308	\$ (5,415)
Items not involving cash:			
Amortization of deferred financing charges		4	6
Deferred income tax expense	8	18	85
Fair value loss on Exchangeable Partnership units	7	1,917	8,511
Distributions recorded as interest:			
Class C Partnership units		1,069	1,069
Exchangeable Partnership units	7	1,332	1,292
Changes in non-cash operating working capital:			
Royalty fee receivable from Keg Restaurants Ltd.		496	58
Prepaid expenses and deposits		(53)	(49)
Accounts payable and accrued liabilities		(60)	69
Interest and financing fees		102	143
Interest income		(1,064)	(1,056)
Current income taxes	8	1,091	1,128
Interest received		1,065	1,056
Income taxes paid	8	<u>(1,452)</u>	<u>(1,374)</u>
		5,773	5,523
FINANCING:			
Distributions paid to Class C unitholder		(1,069)	(1,069)
Distributions paid to Exchangeable unitholder		(1,505)	(1,289)
Distributions paid to Fund unitholders		(3,775)	(2,747)
Interest and financing fees paid		<u>(103)</u>	<u>(145)</u>
		<u>(6,452)</u>	<u>(5,250)</u>
Increase (decrease) in cash		(679)	273
Cash, beginning of period		<u>2,770</u>	<u>1,651</u>
Cash, end of period		<u>\$ 2,091</u>	<u>\$ 1,924</u>
Non-cash transactions:			
Increase in intangible assets on Royalty Pool net sales roll-in		<u>\$ 754</u>	<u>\$ 2,146</u>

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2016 and 2015

1. ORGANIZATION AND NATURE OF BUSINESS:

The Keg Royalties Income Fund (the “Fund”) is an unincorporated open-ended limited purpose trust established under the laws of Ontario, with the authority to issue an unlimited number of trust units and is governed by the Declaration of Trust signed May 31, 2002 and as amended on December 20, 2010. The Fund is registered and domiciled in Canada and its principal business office is located at 10100 Shellbridge Way, Richmond, British Columbia.

The Fund was established to invest in The Keg Rights Limited Partnership (the “Partnership”), which owns the trademarks, trade names, operating procedures and systems and other intellectual property (collectively, the “Keg Rights”) used in connection with the operation of Keg steakhouse restaurants and bars.

The business of the Partnership is the ownership of the Keg Rights and through a Licence and Royalty Agreement (the “Licence and Royalty Agreement”) with Keg Restaurants Ltd. (“KRL”) to exploit the use of the Keg Rights and the collection of the royalty payable under the Licence and Royalty Agreement. KRL’s principal activity is the operation and franchising of Keg steakhouse and bar restaurants in Canada and the United States.

2. BASIS OF PREPARATION:

(a) Statement of compliance:

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34, *Interim Financial Reporting*, as issued by the International Accounting Standards Board (“IASB”). These statements represent a condensed set of financial statements, and accordingly, do not include all of the information required for annual financial statements. These statements follow the same accounting policies and methods of their application as the most recent annual financial statements. These condensed consolidated interim financial statements should be read in conjunction with the Fund’s consolidated financial statements for the year ended December 31, 2015.

These condensed consolidated interim financial statements were authorized for issue by the Fund’s Board of Trustees on May 2, 2016.

(b) Functional and presentation currency:

These condensed consolidated interim financial statements have been prepared in Canadian dollars, which is also the Fund’s functional currency.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars, except unit and per unit amounts - unaudited)

For the three months ended March 31, 2016 and 2015

3. EARNINGS PER UNIT:

Basic earnings per unit calculations are based on the weighted average number of Fund units outstanding during the period. Diluted earnings per unit calculations are based on the weighted average number of Fund units and Exchangeable Partnership units outstanding during the period.

Diluted earnings per unit includes the Exchangeable Partnership units and is calculated by adjusting the weighted average number of Fund units outstanding to assume conversion of all potentially dilutive Fund units. For the purposes of the weighted average number of units outstanding, units are determined to be outstanding from the date they are issued and adjusted to be effective January 1 of each year on December 31 when the actual full-year performance of the new restaurants is known with certainty.

The following reconciles the basic profit to the diluted profit:

	January 1 to March 31, <u>2016</u>	January 1 to March 31, <u>2015</u>
Basic profit for the period	\$ 1,308	\$ (5,415)
Distributions on Exchangeable Partnership units	1,332	1,292
Increase in current income tax expense	(346)	(336)
Change in fair value of Exchangeable Partnership units	<u>1,917</u>	<u>8,511</u>
Diluted profit for the period	<u>\$ 4,211</u>	<u>\$ 4,052</u>
Weighted average number of Fund units	11,353,500	11,353,500
Weighted average number of Exchangeable Partnership units	<u>3,500,510</u>	<u>3,403,979</u>
Weighted average number of units	<u>14,854,010</u>	<u>14,757,479</u>
Basic and diluted earnings (loss) per Fund unit	<u>\$ 0.12</u>	<u>\$ (0.48)</u>

For the periods ended March 31, 2016 and March 31, 2015, the Exchangeable Partnership units are anti-dilutive. Accordingly, the diluted earnings per Fund unit equals the basic earnings per Fund unit.

4. ROYALTY POOL:

The royalty payment from KRL to the Partnership is four percent of system sales for such period reported by Keg restaurants in a specific royalty pool (the "Royalty Pool") plus a make-whole payment, if required by a restaurant closure, based on four percent of lost system sales. System sales for any period and for any Keg restaurant located in Canada and the United States, as defined in the Licence and Royalty Agreement, means the gross sales by such Keg restaurants for such period.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars, except number of restaurants - unaudited)

For the three months ended March 31, 2016 and 2015

4. ROYALTY POOL (CONTINUED):

On January 1, 2016, an estimated \$1.9 million in annual net sales were added to the Royalty Pool. Three new restaurants that opened during the period from October 3, 2014 through October 2, 2015, with estimated gross sales of \$21.0 million annually, were added to the Royalty Pool. Five permanently closed Keg restaurants with annual sales of \$19.1 million were removed from the Royalty Pool. The total number of restaurants in the Royalty Pool decreased to 100. The pre-tax yield of the Fund units was determined to be 7.37% calculated using a weighted average unit price of \$18.01.

As a result of the contribution of the additional net sales to the Royalty Pool, and assuming 100% of the estimated Additional Entitlement is received, KRL's Additional Entitlement will be equivalent to 52,357 Fund units, being 0.35% of the Fund units on a fully diluted basis.

On January 1, 2016, KRL received 80% of this entitlement, representing the equivalent of 41,886 Fund units, being 0.28% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the initial portion of the Additional Entitlement described above, KRL will have the right to exchange its units in the capital of the Partnership for 3,500,510 Fund units representing 23.57% of the Fund units on a fully diluted basis.

The balance of the additional entitlement will be adjusted on December 31, 2016 to be effective January 1, 2016 once the actual performance of the new restaurants has been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2016, it would have the right to exchange its Partnership units for 3,510,981 Fund units representing 23.62% of the Fund units on a fully diluted basis.

There were no make-whole payments received from January 1 to March 31, 2016 as no restaurants were closed during this period (January 1 to March 31, 2015 – one temporary closure related to a business interruption insurance claim).

Royalty income was calculated as follows:

	January 1 to March 31, <u>2016</u>	January 1 to March 31, <u>2015</u>
Restaurants in Royalty Pool	100	102
Royalty Pool system sales	<u>\$ 146,787</u>	<u>\$ 146,383</u>
Royalty income at 4% of system sales reported above	5,871	5,855
Make-whole payment, based on 4% of lost system sales	<u>-</u>	<u>4</u>
Total royalty income	<u>\$ 5,871</u>	<u>\$ 5,859</u>

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars, except unit and per unit amounts - unaudited)

For the three months ended March 31, 2016 and 2015

5. INTANGIBLE ASSETS:

On May 31, 2002, the Partnership acquired the Keg Rights from KRL for \$113,546,820 of which \$30,487,380 was paid in cash, \$9,059,440 was paid by the issuance of 905,944 Class A Partnership units ("Class A Units"), \$17,000,000 was paid by the issuance of 3,376,700 Class B Partnership units ("Class B units") and \$57,000,000 was paid by the issuance of 5,700,000 Class C units ("Class C units"). Concurrent with the sale of the Keg Rights, the Partnership granted KRL a licence to use the Keg Rights for a period of 99 years. As consideration, KRL pays the Partnership a royalty of four percent of system sales reported by the Keg restaurants included the Royalty Pool (note 4).

The Fund has adopted a policy of accounting for the Additional Entitlement of Class B and Class D units based on the fair value of these units at the date of determination which results in an increase in intangible assets and in the Exchangeable Partnership unit liability. The value of the Keg Rights increased by \$754,000 as a result of the January 1, 2016 Additional Entitlement (2015 Additional Entitlement – \$3,056,000).

6. DISTRIBUTIONS ON FUND UNITS:

	January 1 to March 31, <u>2016</u>	January 1 to March 31, <u>2015</u>
Distributions declared to Fund unitholders	\$ <u>1,987</u>	\$ <u>1,839</u>
Weighted average Fund units outstanding	<u>11,353,500</u>	<u>11,353,500</u>
Distributions declared per unit	\$ <u>0.175</u>	\$ <u>0.162</u>

Annually, two distributions are expected to be declared during the first quarter, three distributions in each of the second and third quarters and four distributions in the fourth quarter. This is done to ensure that the distribution based on December KRL Royalty Pool system sales, which is paid the following month in January, is recorded in the period it was earned for income tax purposes. The determination to declare and make payable distributions from the Fund are at the discretion of the Board of Trustees of the Fund and until declared payable, the Fund has no requirement to pay cash distributions to Fund unitholders.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars, except unit amounts - unaudited)

For the three months ended March 31, 2016 and 2015

7. EXCHANGEABLE PARTNERSHIP UNITS:

KRL has the following Exchangeable Partnership units that are exchangeable into Fund units:

	<u>March 31,</u> <u>2016</u>	<u>Fair Value</u>
Class A Partnership units	905,944	\$ 16,633
Class B Partnership units	176,700	3,244
Class D Partnership units	<u>2,417,866</u>	<u>44,392</u>
	<u>3,500,510</u>	<u>\$ 64,269</u>
	<u>December 31,</u> <u>2015</u>	<u>Fair Value</u>
Class A Partnership units	905,944	\$ 16,135
Class B Partnership units	176,700	3,147
Class D Partnership units	<u>2,375,980</u>	<u>42,316</u>
	<u>3,458,624</u>	<u>\$ 61,598</u>

The Exchangeable Partnership units are presented in the Fund's financial statements as a financial liability and measured at fair value. Changes in fair value are recognized in profit or loss in the period in which they occur. The fair value of the Exchangeable Partnership units is determined by using Level 2 inputs being the closing market price of the Fund units on the Toronto Stock Exchange ("TSX") at the respective reporting date as Exchangeable Partnership units have similar distribution and voting rights as the Fund units. The closing unit price as at March 31, 2016 was \$18.36 (December 31, 2015 – \$17.81).

The components of the change in balances in the Exchangeable Partnership unit liability for the three month periods are as follows:

	<u>Total number of</u> <u>Exchangeable</u> <u>Partnership units</u>	<u>Fair Value</u>
Exchangeable Partnership units, January 1, 2016	3,458,624	\$ 61,598
January 1 initial estimate of Class D unit entitlement (80%)	41,886	754
Fair value loss	<u>-</u>	<u>1,917</u>
Fair value of Exchangeable Partnership units, March 31, 2016	<u>3,500,510</u>	<u>\$ 64,269</u>
	<u>Total number of</u> <u>Exchangeable</u> <u>Partnership units</u>	<u>Fair Value</u>
Exchangeable Partnership units, January 1, 2015	3,275,225	\$ 57,218
January 1 initial estimate of Class D unit entitlement (80%)	128,754	2,146
Fair value loss	<u>-</u>	<u>8,511</u>
Fair value of Exchangeable Partnership units, March 31, 2015	<u>3,403,979</u>	<u>\$ 67,875</u>

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2016 and 2015

7. EXCHANGEABLE PARTNERSHIP UNITS (CONTINUED):

Pursuant to the declaration of trust, the holders (other than the Fund or its subsidiaries) of the Class A units, Class B units and Class D units are entitled to vote in all votes of Fund unitholders as if they were holders of the number of Fund units they would receive if Class A, entitled Class B and Class D units were exchanged into Fund units as of the record date of such votes, and will be treated in all respects as Fund unitholders for the purpose of any such votes.

- (i) The Class A units are entitled to a preferential proportionate distribution equal to the distribution on the Class C units, multiplied by the number of Class A units divided by the number of LP Partnership units (“LP units”) issued and outstanding. KHT holds all of the 8,153,500 LP units issued and outstanding at March 31, 2016. In addition, the Class A units receive a residual distribution proportionately with the Class B units, Class D units, LP units and GP units relative to the aggregate number of each class issued and outstanding (or in the case of the Class B units and Class D units, the number issued and outstanding multiplied by the Class B and Class D current distribution entitlement, respectively). Class A units are exchangeable for Fund units on the basis of one Class A unit for one Fund unit and represent KRL’s initial 10% effective ownership of the Fund prior to the entitlement of Class B and Class D units.
- (ii) The Class B units were issued to KRL in return for adding net sales from new Keg restaurants to the Royalty Pool and are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership. The distribution entitlements of the Class B units were adjusted annually on January 1 until the January 1, 2008 roll-in when the Class B Termination Date was reached and the last of the Class B units became entitled. Class B units held by KRL are exchangeable for Fund units on the basis of one Class B unit for one Fund unit. Class B units held by KRL receive a distribution entitlement.
- (iii) The Class D units were issued to KRL in return for adding net sales from new Keg restaurants to the Royalty Pool and are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership. The distribution entitlements of the Class D units are adjusted annually on January 1. Class D units held by KRL are exchangeable for Fund units on the basis of one Class D unit for one Fund unit and receive the same distribution entitlement as the Class B units.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2016 and 2015

8. INCOME TAXES:

The Fund is subject to tax at a rate of 26.00% for the 2015 and later taxation years.

The components of income tax expense are as follows:

	January 1 to March 31, <u>2016</u>	January 1 to March 31, <u>2015</u>
Current income tax expense	\$ (1,091)	\$ (1,128)
Deferred tax expense	<u>(18)</u>	<u>(85)</u>
	<u>\$ (1,109)</u>	<u>\$ (1,213)</u>

During the three months ended March 31, 2016, the Fund made cash tax instalment payments of \$1,030,000 (three months ended March 31, 2015 – \$938,000). Management estimates the Fund's current income tax expense for each reporting period based on actual results and adjusts current income tax expense accordingly. Instalment payments required by the Canada Revenue Agency are an estimate based on prior year's results. As a result, the Fund has an estimated \$69,000 income tax payable as at March 31, 2016 (December 31, 2015 – \$430,000)

Total cash income taxes paid during the respective periods are as follows:

	January 1 to March 31, <u>2016</u>	January 1 to March 31, <u>2015</u>
Tax instalment payments related to the current fiscal year	\$ (1,030)	\$ (938)
Tax payment related to balance owing from the prior fiscal year	<u>(422)</u>	<u>(436)</u>
	<u>\$ (1,452)</u>	<u>\$ (1,374)</u>

The balance of the Fund's deferred tax liability increased to \$2,183,000 as at March 31, 2016 (December 31, 2015 – \$2,165,000). The deferred tax liability arises mainly as a result of the Fund recording, in the current period, its cumulative share of the temporary differences between the accounting and tax bases of the Keg Rights, owned by the Partnership, generated since inception of the Fund.

The tax effect of the temporary difference that gives rise to the deferred tax liability is as follows:

	<u>March 31, 2016</u>	<u>December 31, 2015</u>
Deferred tax liabilities:		
Temporary difference related to the Keg Rights.....	\$ 2,183	\$ 2,165
Deferred tax liability	<u>\$ 2,183</u>	<u>\$ 2,165</u>

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2016 and 2015

9. RELATED PARTY TRANSACTIONS AND BALANCES:

KRL is considered to be a related party of the Fund by virtue of common directors of KRL and KGP, the General Partner of the Partnership and Administrator of the Fund. The Fund has entered into an administrative agreement with its subsidiary, the Partnership, whereby the Partnership will provide, or arrange for the provision of, services required in the administration of the Fund. In turn, the Partnership has arranged for certain of these services to be provided by KRL in its capacity as a partner of the Partnership. KRL provided these services at no cost to the Partnership or the Fund.

The following is a summary of the balances due to and due from KRL:

	March 31, <u>2016</u>	December 31, <u>2015</u>
Royalty fee, including GST/HST	\$ 2,272	\$ 2,768
Interest on note receivable from KRL	<u>362</u>	<u>363</u>
Due from KRL	<u>\$ 2,634</u>	<u>\$ 3,131</u>

The above amounts were received from KRL when due, subsequent to the end of the above periods to facilitate the following month's distribution to Fund unitholders.

	March 31, <u>2016</u>	December 31, <u>2015</u>
Distribution payable to KRL	<u>\$ 849</u>	<u>\$ 1,022</u>

The above amounts were paid to KRL when due, subsequent to the end of the periods above.

10. FINANCIAL INSTRUMENTS:

Financial assets and liabilities are recognized when the Fund becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Fund has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount is reported in the consolidated statements of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2016 and 2015

10. FINANCIAL INSTRUMENTS (CONTINUED):

At initial recognition, the Fund classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

- Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is generally classified in this category if acquired principally for the purposes of selling or repurchasing in the short term. Derivatives are also included in this category unless they are designated as hedges. The Exchangeable Partnership unit liability is classified as a financial liability due to the Partnership's contractual obligation to distribute cash on the Exchangeable Partnership units and is measured at fair value through profit or loss due to certain conversion features discussed in note 7.

Financial instruments in this category are recognized initially and subsequently at fair value and transaction costs are charged to comprehensive income in the period incurred. Gains and losses arising from changes in fair value are charged in comprehensive income in the period in which they arise. These instruments are classified as current except for the portion expected to be realized or paid beyond twelve months of the balance sheet date, which is classified as non-current.

The requirement of the Fund to settle its note receivable from KRL in exchange for Class C Partnership units is classified as a derivative financial instrument. The Fund has reviewed the net impact of this potential exchange requirement on its cash flows and has determined there is no significant value applicable to this feature.

- Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in the active market. Cash, interest receivable on the note receivable from KRL, royalties receivable from KRL, and the note receivable from KRL are included in this category. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized costs using the effective interest method and when material, an adjustment to discount the loans and receivables to fair value.
- Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable and accrued liabilities, interest payable on term loan, distributions payable to Fund unitholders, distributions payable to KRL, Class C Partnership unit liability and the term loan. These items are initially recognized at the amount required to be paid, less a discount to reduce the payables to fair value or transactions costs incurred. Subsequently, these items are measured at amortized cost using the effective interest rate method. Financial liabilities are classified as current liabilities if payment is due within twelve months of the statement of financial position date. Otherwise, they are presented as non-current liabilities.

The carrying value of current financial assets and liabilities approximate their fair value due to their short-term nature. The note receivable from KRL and the Class C Partnership unit liability approximate their fair values due to the requirement of the Fund to settle the note receivable from KRL in exchange for Class C Partnership units. The term loan approximates fair value based on prevailing market interest rates in effect at the statement of financial position dates.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2016 and 2015

10. FINANCIAL INSTRUMENTS (CONTINUED):

The Fund must classify fair value measurements according to a hierarchy that reflects the significance of the inputs used in performing such measurements. The Fund's fair value hierarchy comprises the following levels:

- Level 1 – quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – pricing inputs are other than quoted in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date.
- Level 3 – valuations in this level are those with inputs for the asset or liability that are not based on observable data.

The fair value of the Exchangeable Partnership unit liability is determined using Level 2 inputs, and measured on a recurring basis.

The following table presents the carrying amounts of each category of financial assets and liabilities:

	March 31, <u>2016</u>	December 31, <u>2015</u>
Financial assets at amortized costs:		
Loans and receivables:		
Cash	\$ 2,091	\$ 2,770
Royalty fee receivable from Keg Restaurants Ltd.	2,272	2,768
Interest on note receivable from Keg Restaurants Ltd.	362	363
Note receivable from Keg Restaurants Ltd.	<u>57,000</u>	<u>57,000</u>
	<u>\$ 61,725</u>	<u>\$ 62,901</u>
Financial liabilities:		
Amortized cost:		
Accounts payable and accrued liabilities	\$ 262	\$ 322
Interest payable on term loan	35	35
Distributions payable to Fund unitholders	-	1,788
Distributions payable to Keg Restaurants Ltd.	849	1,022
Term loan, net of deferred financing charges	13,960	13,956
Class C Partnership units	57,000	57,000
Fair value through profit and loss:		
Exchangeable Partnership units.....	<u>64,269</u>	<u>61,598</u>
	<u>\$ 136,375</u>	<u>\$ 135,721</u>