

THE KEG ROYALTIES INCOME FUND

FIRST QUARTER REPORT

For the three months ended March 31, 2010

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, 2010.

RESULTS

The gross sales reported by the 102 Keg restaurants in the Royalty Pool were \$116,953,000, a decrease of \$3,905,000 or 3.2% from the comparable quarter of the prior year. These gross sales include the sales of the new Keg restaurants which opened during the period from October 3, 2008 through October 2, 2009, which were added to the Royalty Pool on January 1, 2010, net of a same store sales decrease for the quarter.

The Fund generated earnings before income taxes of \$3,174,000 or 32.7 cents/Fund unit during the quarter compared with \$3,315,000 or 34.2 cents/Fund unit during the comparable quarter of the prior year, a decrease of \$141,000 or 1.5 cents/Fund Unit. Distributable cash available to pay distributions to public Unitholders decreased by \$5,000 to \$3,253,000 or 33.5 cents/Fund unit, from \$3,258,000 or 33.6 cents/Fund unit for the quarter.

OUTLOOK

The loss in consumer confidence as a result of the global recession has had a negative impact on the restaurant industry in North America, and The Keg has not been immune to its effects. Historically, the restaurant industry does not lead the economy out of periods of economic downturn. In the full-service restaurant category specifically, the category where The Keg operates, sales have lagged the rest of the economy by roughly three quarters during such periods. For the full-service restaurant category in 2010, The Canadian Restaurant and Foodservice Association has projected an increase in sales of 3.0% while the National Restaurant Association in the United States has projected a real sales increase of 1.2%.

While the projections of total growth within the full-service category are encouraging, the key driver of growth in royalty income is same store sales growth. As economic conditions and consumer sentiment continue to improve in North America, Management of Keg Restaurants Ltd. ("KRL") believes that sales for The Keg will also improve, leading it to once again outperform the full service category with respect to same store sales growth.

The Keg remains an industry leader in the full-service restaurant category in Canada; a fact confirmed by an independent research report from Angus Reid Strategies in July 2008 that identified The Keg as the first choice of over 60% of diners when choosing a steak dinner. In the United States, management of KRL will continue to emphasize The Keg's unique market niche between lower-priced, themed steakhouse chains and higher-priced, fine steakhouses to continue to grow brand awareness in that market. 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 service and marketing innovation. KRL has consistently demonstrated its ability to deliver growth in both system sales and same store sales growth 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 14, 2010

FINANCIAL HIGHLIGHTS

| (\$000's except per unit amounts) | Jan. 1 to Mar. 31, 2010 | Jan. 1 to Mar. 31, 2009 |
|--|-------------------------------|-------------------------------|
| Restaurants in the Royalty Pool | 102 | 102 |
| Gross sales reported by restaurants in the Royalty Pool | \$ 116,953 | \$ 120,858 |
| Royalty income ⁽¹⁾ | \$ 4,695 | \$ 4,894 |
| Partnership expenses ⁽²⁾ | (98) | (88) |
| Partnership earnings | 4,597 | 4,806 |
| KRL's interest ⁽³⁾ | (2,330) | (2,425) |
| Equity income ⁽⁴⁾ | 2,267 | 2,381 |
| Interest income ⁽⁵⁾ | 1,055 | 1,058 |
| Total income | 3,322 | 3,439 |
| Interest and financing expenses ⁽⁶⁾ | (148) | (124) |
| Earnings before income taxes | \$ 3,174 | \$ 3,315 |
| Net earnings ⁽⁷⁾ | \$ 3,274 | \$ 3,465 |
| Distributable cash ⁽⁸⁾ | \$ 3,253 | \$ 3,258 |
| Distributions paid | \$ 3,100 | \$ 3,100 |
| | | |
| Earnings before income taxes per Fund unit ⁽⁹⁾ | \$.327 | \$.342 |
| Earnings per Fund unit ⁽⁹⁾ | \$.337 | \$.357 |
| Distributable cash per Fund unit ⁽⁸⁾⁽⁹⁾ | \$.335 | \$.336 |
| Distributions paid per Fund unit ⁽⁹⁾ | \$.320 | \$.320 |
| Payout Ratio ⁽¹⁰⁾ | 95.3% | 95.2% |

Notes:

- ⁽¹⁾ The Fund, indirectly through the Partnership, earns royalty income equal to 4% of gross sales of Keg restaurants in the Royalty Pool.
- ⁽²⁾ The Fund, indirectly through the Partnership, incurs administrative expenses and interest on an operating line of credit, to the extent utilized.
- ⁽³⁾ Represents the interest of KRL in the earnings of the Partnership from the 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.
- ⁽⁴⁾ The Fund directly earns equity income from its investment in the Partnership. The amount is calculated as the royalty income, less the Partnership's operating expenses, less earnings attributable to KRL.
- ⁽⁵⁾ The Fund directly earns interest income on the \$57.0 million Keg Loan, with interest income accruing at 7.5% per annum, payable monthly.
- ⁽⁶⁾ The Fund directly incurs interest expense on the long-term debt and amortization of deferred financing charges.
- ⁽⁷⁾ Net earnings for the three months ended March 31, 2010 reflect the non-cash future income tax recovery of \$100,000 (three months ended March 31, 2009 - \$150,000)
- ⁽⁸⁾ Distributable cash is defined as Standardized Distributable Cash which is the periodic cash flows from operating activities as reported in the GAAP financial statements, including the effects of changes in non-cash working capital.
- ⁽⁹⁾ 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 numbers of Fund units outstanding for the three months ended March 31, 2010 were 9,703,500 (three months ended March 31, 2009 - 9,703,500).
- ⁽¹⁰⁾ Payout ratio is computed as the ratio of aggregate cash distributions paid during the period (numerator) to the aggregate Standardized Distributable Cash of the period (denominator).
- ⁽¹¹⁾ Same Store Sales Growth ("SSSG") is the overall increase 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.

SUMMARY OF QUARTERLY RESULTS

| | Q1 | Q4 | Q3 | Q2 |
|---|-------------------|-------------------|------------------|-------------------|
| (\$000's except per unit amounts) | 2010 | 2009 | 2009 | 2009 |
| Restaurants in the Royalty Pool | 102 | 102 | 102 | 102 |
| Gross sales reported by Keg restaurants in the Royalty Pool..... | \$ 116,953 | \$ 117,885 | 108,332 | \$ 107,824 |
| Royalty income ⁽¹⁾ | \$ 4,695 | \$ 4,879 | \$ 4,454 | \$ 4,418 |
| Partnership expenses ⁽²⁾ | (98) | (101) | (100) | (108) |
| Partnership earnings | 4,597 | 4,778 | 4,354 | 4,310 |
| KRL's interest ⁽³⁾ | (2,330) | (2,445) | (2,389) | (2,288) |
| Equity income ⁽⁴⁾ | 2,267 | 2,333 | 1,965 | 2,022 |
| Interest income ⁽⁵⁾ | 1,055 | 1,078 | 1,078 | 1,067 |
| Total income..... | 3,322 | 3,411 | 3,043 | 3,089 |
| Interest and financing expenses ⁽⁶⁾ | (148) | (151) | (132) | (102) |
| Earnings before income taxes | \$ 3,174 | \$ 3,260 | \$ 2,911 | \$ 2,987 |
| Net earnings ⁽⁷⁾ | \$ 3,274 | \$ 3,110 | \$ 2,886 | \$ 2,937 |
| Distributable cash ⁽⁸⁾ | \$ 3,253 | \$ 3,182 | \$ 2,991 | \$ 3,069 |
| Distributions paid | \$ 3,100 | \$ 3,100 | \$ 3,100 | \$ 3,100 |
| Earnings before income taxes per Fund unit ⁽⁹⁾ | \$.327 | \$.336 | \$.300 | \$.308 |
| Earnings per Fund unit ⁽⁹⁾ | \$.337 | \$.321 | \$.297 | \$.303 |
| Distributable cash per Fund unit ⁽⁸⁾⁽⁹⁾ | \$.335 | \$.328 | \$.308 | \$.316 |
| Distributions paid per Fund unit ⁽⁹⁾ | \$.320 | \$.320 | \$.320 | \$.320 |
| Payout Ratio ⁽¹⁰⁾ | 95.3% | 97.4% | 103.7% | 101.0% |
| SSSG Canada ⁽¹¹⁾ | (3.2)% | 0.1% | (4.7)% | (6.9)% |
| SSSG United States ⁽¹¹⁾ | (14.4)% | (9.6)% | (19.8)% | (15.7)% |
| SSSG Consolidated ⁽¹¹⁾ | (6.6)% | (2.5)% | (5.9)% | (6.5)% |
| Restaurants Opened | -- | 1 | 2 | -- |
| Restaurants Closed | -- | -- | -- | 1 |
| Restaurants Relocated | 1 | 1 | 1 | -- |
| Net Restaurants Opened (Closed) | -- | 1 | 2 | (1) |
| | | | Mar. 31, 2010 | Dec. 31, 2009 |
| Total assets | | | \$ 116,447 | \$ 116,364 |
| Total liabilities..... | | | 15,857 | 16,880 |

SUMMARY OF QUARTERLY RESULTS

| | Q1 | Q4 | Q3 | Q2 |
|---|--------------------------|--------------------------|--------------------------|--------------------------|
| (\$000's except per unit amounts) | 2009 | 2008 | 2008 | 2008 |
| Restaurants in the Royalty Pool | 102 | 96 | 96 | 96 |
| Gross sales reported by Keg restaurants in the Royalty Pool..... | \$ <u>120,858</u> | \$ <u>105,822</u> | \$ <u>108,035</u> | \$ <u>107,690</u> |
| Royalty income ⁽¹⁾ | \$ 4,894 | \$ 4,289 | \$ 4,383 | \$ 4,334 |
| Partnership expenses ⁽²⁾ | (88) | (103) | (93) | (81) |
| Partnership earnings | 4,806 | 4,186 | 4,290 | 4,253 |
| KRL's interest ⁽³⁾ | (2,425) | (2,045) | (2,118) | (2,033) |
| Equity income ⁽⁴⁾ | 2,381 | 2,141 | 2,172 | 2,220 |
| Interest income ⁽⁵⁾ | 1,058 | 1,083 | 1,084 | 1,075 |
| Total income | 3,439 | 3,224 | 3,256 | 3,295 |
| Interest and financing expenses ⁽⁶⁾ | (124) | (164) | (190) | (192) |
| Earnings before income taxes | \$ <u>3,315</u> | \$ <u>3,060</u> | \$ <u>3,066</u> | \$ <u>3,103</u> |
| Net earnings ⁽⁷⁾ | \$ <u>3,465</u> | \$ <u>3,059</u> | \$ <u>3,066</u> | \$ <u>2,903</u> |
| Distributable cash ⁽⁸⁾ | \$ <u>3,258</u> | \$ <u>2,999</u> | \$ <u>3,120</u> | \$ <u>3,065</u> |
| Distributions paid | \$ <u>3,100</u> | \$ <u>3,100</u> | \$ <u>3,100</u> | \$ <u>3,100</u> |
| Earnings before income taxes per Fund unit ⁽⁹⁾ | \$ <u>.342</u> | \$ <u>.315</u> | \$ <u>.316</u> | \$ <u>.320</u> |
| Earnings per Fund unit ⁽⁹⁾ | \$ <u>.357</u> | \$ <u>.295</u> | \$ <u>.316</u> | \$ <u>.299</u> |
| Distributable cash per Fund unit ⁽⁸⁾⁽⁹⁾ | \$ <u>.336</u> | \$ <u>.309</u> | \$ <u>.322</u> | \$ <u>.316</u> |
| Distributions paid per Fund unit ⁽⁹⁾ | \$ <u>.320</u> | \$ <u>.320</u> | \$ <u>.320</u> | \$ <u>.320</u> |
| Payout Ratio ⁽¹⁰⁾ | <u>95.2%</u> | <u>103.4%</u> | <u>99.4%</u> | <u>101.2%</u> |
| SSSG Canada ⁽¹¹⁾ | (1.5)% | (3.0)% | 1.1% | 4.7% |
| SSSG United States ⁽¹¹⁾ | (4.9)% | (16.3)% | (8.3)% | (7.5)% |
| SSSG Consolidated ⁽¹¹⁾ | 0.7% | (2.2)% | 0.0% | 1.7% |
| Restaurants Opened | 2 | 1 | 3 | 4 |
| Restaurants Closed | 3 | -- | 1 | -- |
| Restaurants Relocated | -- | -- | -- | -- |
| Net Restaurants Opened (Closed) | (1) | 1 | 2 | 4 |

SELECTED ANNUAL INFORMATION

| | Year Ended Dec. 31, 2009 | Year Ended Dec. 31, 2008 | Year Ended Dec. 31, 2007 |
|--|-----------------------------------|-----------------------------------|-----------------------------------|
| (\$000's except per unit amounts) | | | |
| Restaurants in the Royalty Pool | 102 | 96 | 95 |
| Gross sales reported by Keg restaurants in the Royalty Pool | <u>\$ 454,898</u> | <u>\$ 433,097</u> | <u>\$ 412,759</u> |
| Royalty income ⁽¹⁾ | \$ 18,645 | \$ 17,494 | \$ 16,827 |
| Partnership expenses ⁽²⁾ | (397) | (376) | (369) |
| Partnership earnings..... | 18,248 | 17,118 | 16,458 |
| KRL's interest ⁽³⁾ | (9,546) | (8,253) | (7,696) |
| Equity income ⁽⁴⁾..... | 8,702 | 8,865 | 8,762 |
| Interest income ⁽⁵⁾ | 4,280 | 4,319 | 4,318 |
| Total income | 12,982 | 13,184 | 13,080 |
| Interest and financing expenses ⁽⁶⁾ | (509) | (766) | (943) |
| Earnings before income taxes | <u>\$ 12,473</u> | <u>\$ 12,418</u> | <u>\$ 12,137</u> |
| Net earnings ⁽⁷⁾..... | <u>\$ 12,398</u> | <u>\$ 12,368</u> | <u>\$ 10,387</u> |
| Distributable cash ⁽⁸⁾..... | <u>\$ 12,501</u> | <u>\$ 12,382</u> | <u>\$ 12,199</u> |
| Distributions paid | <u>\$ 12,401</u> | <u>\$ 12,343</u> | <u>\$ 11,463</u> |
| | | | |
| Earnings before income taxes per Fund unit ⁽⁹⁾..... | <u>\$ 1.285</u> | <u>\$ 1.280</u> | <u>\$ 1.263</u> |
| Earnings per Fund unit ⁽⁹⁾..... | <u>\$ 1.278</u> | <u>\$ 1.275</u> | <u>\$ 1.081</u> |
| Distributable cash per Fund unit ⁽⁸⁾⁽⁹⁾..... | <u>\$ 1.288</u> | <u>\$ 1.276</u> | <u>\$ 1.269</u> |
| Distributions paid per Fund unit ⁽⁹⁾..... | <u>\$ 1.278</u> | <u>\$ 1.272</u> | <u>\$ 1.193</u> |
| | | | |
| Payout Ratio ⁽¹⁰⁾..... | <u>99.2%</u> | <u>99.7%</u> | <u>94.0%</u> |
| | | | |
| SSSG Canada ⁽¹¹⁾..... | (3.1)% | 2.0% | 7.3% |
| SSSG United States ⁽¹¹⁾..... | (12.3)% | (9.0)% | 2.1% |
| SSSG Consolidated ⁽¹¹⁾..... | (3.4)% | 0.4% | 5.5% |
| | | | |
| Restaurants Opened | 5 | 9 | 1 |
| Restaurants Closed | 4 | 2 | -- |
| Restaurants Relocated | 2 | -- | 3 |
| Net Restaurants Opened (Closed) | 1 | 7 | 1 |
| | | | |
| | Dec. 31, 2009 | Dec. 31, 2008 | Dec. 31, 2007 |
| Total assets..... | \$ 116,364 | \$ 116,327 | \$ 116,261 |
| Total liabilities..... | 16,880 | 16,840 | 16,770 |

MANAGEMENT DISCUSSION AND ANALYSIS

**For the Three Months Ended March 31, 2010
As of May 14, 2010**

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 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 earnings 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 twelve years, the period for which current management has been in control of KRL, SSSG has averaged 4.2% annually, a figure that compares very favourably against the restaurant industry as a whole. This consistent sales growth is one of the primary reasons that monthly cash distributions to the Fund’s unitholders have been increased 7 times since the Fund’s inception, most recently in March 2008.

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 closed restaurant’s gross sales when it was originally included in the Royalty Pool.

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. 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 29.64% as of December 31, 2009. The change in KRL’s effective ownership of the Fund is the result of adding net sales to the Royalty Pool on an annual basis, in return for which KRL receives the right to indirectly acquire additional Fund units (see “The Royalty Pool”). The total number of restaurants included in the Royalty Pool has increased from 80 Keg restaurants in existence at the time of the IPO to 102 as of December 31, 2009. This has resulted in a net increase in Royalty Pool sales of \$144.8 million and the issuance of 4,731,291 exchangeable units to KRL, as of December 31, 2009. KRL has exchanged a total of 1,550,000 Class B units for an equal number of Fund units (increasing the number of issued and outstanding Fund units from 8,153,500 at the time of the IPO to 9,703,500 as of February 23, 2007) and sold these units through the facilities of the Toronto Stock Exchange. On January 1, 2010, six new Keg restaurants that opened during the period from October 3, 2008 through October 2, 2009 were added to the Royalty Pool. See “The Royalty Pool”.

VARIABLE INTEREST ENTITY

During 2005, the Partnership was determined to be a variable interest entity in accordance with the criteria established in the Canadian Institute of Chartered Accountants' ("CICA") Guideline, Consolidation of Variable Interest Entities ("AcG-15"). As a result of this guideline, the Fund accounts for its investment in the Partnership on an equity basis and KRL consolidates the Partnership. Readers are advised that this is an accounting basis of presentation only and that earnings and distributable cash attributable to Fund unitholders are not impacted nor does this impact the contractual obligations between the Fund, and the Partnership, and KRL. The consolidated financial statements of the Fund therefore include the accounts of the Fund, its wholly-owned subsidiary The Keg Holdings Trust ("KHT") and its 90% owned subsidiary The Keg GP Ltd. ("KGP") (collectively, the "Companies"). KGP is the managing general partner of the Partnership. All residual ownership of the Companies is either directly or indirectly controlled by KRL.

FEDERAL GOVERNMENT TAX ON INCOME FUNDS

On June 12, 2007, the Canadian federal government's legislation to tax publicly traded income trusts passed third reading in the House of Commons and thus the associated income tax became substantively enacted for accounting purposes. The legislation imposes a tax of 29.5% on distributions from Canadian public income trusts. The new tax is not expected to apply to the Fund until January 1, 2011 as a transition period applies to publicly traded trusts that existed prior to November 1, 2006. This rate was subsequently reduced to 26.5% for 2011 and 25% for 2012 and later taxation years. Historically, the Fund had been exempt from recognizing future income tax assets and liabilities associated with temporary differences arising in the Fund and its equity accounted investment, The Keg Rights Limited Partnership. As a result of the substantive enactment of the new tax legislation, the Fund has recognized future income tax assets and liabilities that are expected to reverse subsequent to January 1, 2011. Future income tax expense is a non-cash item that does not affect cash flow.

DISTRIBUTABLE CASH

During 2007, The Canadian Institute of Chartered Accountants and the Canadian Securities Administrators released a guideline on the measurement and reporting of distributable cash for income trusts and other flow through entities in Management's Discussion and Analysis. This guidance attempts to provide comparable measures of distributable cash among income trusts. The Fund adopted this guidance in 2007, and as a result, distributable cash is now defined as the periodic cash flows from operating activities as reported in the GAAP financial statements including the change in non-cash working capital balances, less adjustments for capital expenditures and restrictions on distributions arising from compliance with financial covenants. Distributable cash may not be comparable to other issuers who have adopted this guidance. Previously, distributable cash was computed as earnings for the period plus non-cash items such as amortization and future income taxes; a non-GAAP measure which was also not necessarily comparable to similar measures presented by other issuers. Given the Fund has no capital expenditures and no expected restriction on distributions arising from compliance with financial covenants, the only significant difference that may arise in any particular reporting period between the two definitions is due to the inclusion of changes in non-cash working capital balances.

The Trustees are of the opinion that the inclusion of changes in non-cash working capital balances in the determination of distributable cash will provide less meaningful information for Unitholders as the Fund's working capital requirements are not permanent in nature and are primarily due to the timing of payments between related parties. Readers are advised that this is a reporting change only, and that earnings and actual cash available for distribution to the Fund's unitholders are not impacted, nor are the contractual obligations between the Fund, the Partnership, and KRL.

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.

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 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, 2009. Thirty-nine new Keg restaurants that opened during the period from April 1, 2002, through October 2, 2008, with annual gross sales of \$187.7 million have been added to the Royalty Pool. Seventeen permanently closed Keg restaurants with annual sales of \$42.9 million have been removed from the Royalty Pool. This has resulted in a net increase in Royalty Pool sales of \$144.8 million annually, and KRL receiving a cumulative Additional Entitlement equivalent to 4,731,291 Fund units as of December 31, 2009.

On January 1, 2010, six new Keg restaurants that opened during the period from October 3, 2008 through October 2, 2009 were added to the Royalty Pool. The gross sales of these six new restaurants have been estimated at \$25.5 million annually. Six permanently closed Keg restaurants with annual sales of \$17.1 million were removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$8.4 million annually. The total number of restaurants in the Royalty Pool will remain the same at 102. The yield of the Fund units was determined to be 13.97% calculated using a weighted average unit price of \$9.15.

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 242,070 Fund units, being 1.73% of the Fund units on a fully diluted basis. On January 1, 2010, KRL received 80% of this entitlement representing the equivalent of 193,656 Fund units, being 1.38% 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 4,280,891 Fund units representing 30.61% of the Fund units on a fully diluted basis. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2010 once the actual performance of the new restaurants has been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2010, it would have the right to exchange its Partnership units for 4,329,305 Fund units representing 30.85% of the Fund units on a fully diluted basis.

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 seven times from the original level of \$0.09 per unit at the time of the IPO, to the current level of \$0.1065 per unit, an increase of 18.3%.

Year-to-date distributions were as follows:

| Period | Payment Date | Per/Unit |
|---------------------|---------------------|-----------------|
| January 1-31, 2010 | February 26, 2010 | 10.65¢ |
| February 1-28, 2010 | March 31, 2010 | 10.65¢ |
| March 1-31, 2010* | April 30, 2010 | 10.65¢ |

*Paid subsequent to the period

DISTRIBUTIONS TO UNITHOLDERS (CONTINUED)

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

Since inception, the Fund has generated \$82,128,000 of distributable cash and has paid cumulative distributions of \$81,134,000, which resulted in a cumulative surplus of \$994,000. The cumulative payout ratio (the ratio of cumulative cash distributions paid since inception to the cumulative standardized distributable cash generated since inception) is 98.8%.

OWNERSHIP OF THE FUND

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

| | March 31, 2010 ⁽¹⁾ | | March 31, 2009 | |
|--|-------------------------------|---------------|-------------------|---------------|
| | # | % | # | % |
| Fund units held by public unitholders ⁽²⁾ | 9,703,500 | 69.39 | 9,703,500 | 71.21 |
| Exchangeable Partnership units held by KRL: ⁽³⁾ | | | | |
| Class A units ⁽⁴⁾ | 905,944 | 6.48 | 905,944 | 6.65 |
| Class B units ⁽⁵⁾ | 1,826,700 | 13.06 | 1,826,700 | 13.41 |
| Class D units ⁽⁵⁾ | <u>1,548,247</u> | <u>11.07</u> | <u>1,190,755</u> | <u>8.73</u> |
| Total Exchangeable Partnership units ⁽⁶⁾ | <u>4,280,891</u> | <u>30.61</u> | <u>3,923,399</u> | <u>28.79</u> |
| Total Fund and Exchangeable Partnership units..... | <u>13,984,391</u> | <u>100.00</u> | <u>13,626,899</u> | <u>100.00</u> |

Notes:

⁽¹⁾ Information is current as of March 31, 2010. On April 9, 2010, KRL exchanged 900,000 Class B Partnership units for an equal number of Fund units, and sold them through the facilities of the Toronto Stock Exchange. See "Subsequent Event".

⁽²⁾ Represents the public's total effective ownership of the Fund as of March 31, 2010 and 2009. 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 69.39% during the three months ended March 31, 2010 (three months ended March 31, 2009 – 71.21%). The weighted average number of Fund units outstanding for the three months ended March 31, 2010 was 9,703,500 (three months ended March 31, 2009 – 9,703,500).

⁽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 may only be issued to KRL after all Class B units have become fully entitled to proportionate distributions from the Partnership (which occurred on January 1, 2008). As of March 31, 2010, KRL is the registered holder of 1,826,700 Class B units and 1,548,247 Class D units (March 31, 2009 – 1,826,700 Class B units and 1,190,755 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 or 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, 2010 and 2009. 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 30.61% during the three months ended March 31, 2010 (three months ended March 31, 2009 – 28.79%).

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. 4, 2010 | 13 weeks ended Mar. 29, 2009 |
|---|-----------------------------------|------------------------------------|
| Corporate Keg restaurants ⁽¹⁾ | \$ 60,253 | \$ 62,257 |
| Franchised Keg restaurants ⁽²⁾ | <u>60,073</u> | <u>60,430</u> |
| Total system sales | <u>\$ 120,326</u> | <u>\$ 122,687</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.

System sales for the 13 weeks ended April 4, 2010 were \$120.3 million compared to \$122.7 million for the 13 weeks ended March 29, 2009, a decrease of \$2.4 million or 1.9%. During the 13 weeks ended April 4, 2010, one corporate restaurant was relocated, and no restaurants were closed. During the 13 weeks ended March 29, 2009, one new corporate and one new franchised restaurant were opened, and three corporate restaurants were closed. As of April 4, 2010, there were a total of 104 Keg restaurants as compared with 102 Keg restaurants at March 29, 2009.

The Keg's same store sales (sales of restaurants that operated during the entire 13-week period of both the current year and the prior year) decreased by 3.2% in Canada and by 14.4% in the United States. After translating the sales of the U.S. restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 13-week periods decreased by 6.6%. The average exchange rate moved from 1.24 in KRL's second quarter of fiscal 2009 to 1.04 in KRL's second quarter of fiscal 2010, significantly reducing the Canadian dollar equivalent of the U.S. restaurant sales. Management of KRL attributes the same store sales performance experienced during the quarter solely to weak economic conditions in both Canada and the United States

OPERATING RESULTS

GROSS SALES

Gross sales reported by the restaurants in the Royalty Pool decreased from \$120,858,000 to \$116,953,000 for the comparable quarter. The decrease of \$3,905,000, or 3.2%, reflects the addition of net new sales to the Royalty Pool at the beginning of the year, net of the same store sales decreases discussed previously.

ROYALTY INCOME

Total royalty income earned by the Partnership decreased by \$199,000 from \$4,894,000 in the first quarter of 2009, to \$4,695,000 in the first quarter of 2010. Royalty income decreased by \$156,000 during the quarter as a result of the decrease in gross sales for the reasons explained previously, and Make-whole Payments decreased by \$43,000 due to the number of restaurants closed during the quarter (18 less closed weeks).

PARTNERSHIP EXPENSES

Expenses incurred by the Partnership for the three months ended March 31, 2009 were \$98,000 and included general and administrative expenses of \$99,000 and interest income on the surplus cash balances of \$1,000. The increase of \$10,000 over the comparable quarter in 2009 was due to an increase in general and administrative expenses of \$10,000, mostly due to an increase in audit costs incurred as a result of the pending implementation of International Financing Reporting Standards.

KRL'S INTEREST

KRL's interest in the earnings of the Partnership from the Class A, entitled Class B, Class C and Class D Partnership units decreased from \$2,425,000 for the three-month period ended March 31, 2009 to \$2,330,000 for the three-month period ended March 31, 2010. The decrease of \$95,000 was primarily due to the decrease in Partnership earnings as a result of the decreased royalty income. This was partially offset by an increase in KRL's average effective ownership interest in the Partnership from 28.79% during the three-month period ended March 31, 2009, to 30.61% during the three-month period ended March 31, 2010. The change in the average effective ownership of the Partnership during the period was a result of the Additional Entitlement received by KRL on January 1, 2010.

EQUITY INCOME

The Fund's equity income from its investment in the Partnership decreased from \$2,381,000 during the first quarter of 2009, to \$2,267,000 during the first quarter of 2010. The decrease of \$114,000 is due to the net impact of the decrease in royalty income of \$199,000, the increase in Partnership expenses of \$10,000, and the decrease in KRL's interest in the earnings of the Partnership of \$95,000.

INTEREST INCOME

Interest income earned by the Fund for the quarter was \$1,055,000 and included interest income on the Keg Loan of \$1,054,000 and other interest income of \$1,000. Other interest income decreased by \$3,000 due to lower effective interest rates applied to the surplus cash balances on hand during the quarter.

INTEREST AND FINANCING EXPENSES

Interest and financing expenses incurred by the Fund were \$148,000 for the three months ended March 31, 2010, and included interest on the long-term debt of \$138,000, and amortization of deferred financing charges of \$10,000. Interest costs increased by \$19,000 in the quarter as a result of an increase in the average interest rate on the long-term debt from 3.46% in the first quarter of 2009, to 4.00% in the first quarter of 2010. Amortization of deferred financing charges increased by \$5,000 during the quarter.

EARNINGS BEFORE INCOME TAXES

Earnings before income taxes decreased by \$141,000 from \$3,315,000 (34.2 cents/Fund unit) in the first quarter of 2009, to \$3,174,000 (32.7 cents/Fund unit) in the first quarter of 2010.

FUTURE INCOME TAXES

Future income taxes increased by \$50,000 from a future income tax recovery of \$150,000 for the three months ended March 31, 2009, to a future income tax recovery of \$100,000 for the three months ended March 31, 2010. Future income tax is a non-cash expense or recovery which does not affect distributable cash.

NET EARNINGS AND COMPREHENSIVE INCOME

Net earnings decreased by \$191,000 from \$3,465,000 (35.7 cents/Fund unit) in the first quarter of 2009, to \$3,274,000 (33.7 cents/Fund unit) in the first quarter of 2010, mostly due to the decrease in equity income discussed previously.

DISTRIBUTABLE CASH

Cash available for distribution to Fund unitholders decreased by \$5,000 from \$3,258,000 (33.6 cents/Fund unit) to \$3,253,000 (33.5 cents/Fund unit) during the comparable quarter. The difference between the Fund's earnings and distributable cash is due to non-cash items such as amortization and future income taxes included in the Fund's net earnings, as well as changes in non-cash working capital balances.

DISTRIBUTIONS

Distributions of \$3,100,000 (32.0 cents/Fund unit) were paid in both the first quarter of 2009, and the first quarter of 2010.

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. The Fund has cash on hand of \$1,532,000 and a positive working capital balance of \$1,861,000 as at March 31, 2010.

TERM LOAN

The Keg Holdings Trust ("KHT"), a subsidiary of the Fund, has a \$14 million non-revolving term loan facility, which bears interest at bank prime plus 1.75% 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 August 12, 2009, this facility was refinanced, and the maturity date extended to October 31, 2011. The term loan held by KHT is subject to certain financial covenants, including minimum equity amounts in both KHT and the Partnership, and a minimum Partnership cash flow level defined as earnings before interest, taxes, depreciation and amortization ("EBITDA"). As at March 31, 2010, the KHT and Partnership equity amounts are approximately \$6.3 million and \$20.3 million in excess of the required minimum equity covenants, respectively. The Partnership EBITDA for the year ended December 31, 2009 (last four financial quarters) is approximately \$2.8 million greater than the required minimum amount.

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 1.50% 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.

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 GAAP. 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. There have been no significant changes to the internal control over financial reporting for the quarter ended March 31, 2010, that have had or are reasonably likely to have a material effect on the Fund’s internal controls over financial reporting.

CRITICAL ACCOUNTING ESTIMATES

The Fund's only critical accounting estimate is the valuation of its investment in the Partnership. As the Partnership's only significant assets are intangible assets consisting of the Keg Rights, the valuation of the Fund's investment is based primarily upon the valuation of intangible assets in the Partnership. The Keg Rights are not amortized as they have an indefinite life. The Keg GP Ltd., as the general partner of the Partnership and administrator of the Fund, reviews the carrying values of the intangible assets in the Partnership and the Fund's investment at least annually, taking into consideration any events or circumstances which may have impaired the carrying values of these items. If permanent declines in the carrying amounts are determined, these items are written down to their estimated net recoverable amount. The Keg GP Ltd. believes that there have been no declines in either the carrying value of the intangible assets in the Partnership or in the carrying value of the Fund's investment in the Partnership as of March 31, 2010.

FUTURE CHANGES IN ACCOUNTING POLICY

INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Canadian Accounting Standards Board announced in February 2008 that publicly accountable enterprises will be required to adopt IFRS in place of GAAP for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. The Fund’s transition from GAAP to IFRS will take place in the first quarter of 2011 at which time the Fund will report both the current and comparative financial information using IFRS.

The Fund’s IFRS transition project consists of three phases:

PRILIMINARY DIAGNOSTIC REVIEW

In 2009, the Fund, with the assistance of its external consultant, completed the preliminary diagnostic review, which involved a high level review of the major differences between current GAAP and IFRS. The major differences identified were:

Basis of consolidation of the Fund’s interest in the Partnership – under GAAP, the Partnership was determined to be a Variable Interest Entity and is currently consolidated with KRL. Under IFRS, consolidation is based on “control” which is the power to govern the financial and operating policies of an entity to obtain benefits from its activities. A detailed analysis will be performed when the revised IFRS standard is issued.

Classification of Unitholders’ equity – currently the Units are classified as equity under GAAP. However under IFRS, an instrument is classified as a financial liability if it contains a contractual obligation to transfer cash or other financial assets. The Fund is reviewing whether the Units would be classified as a financial liability.

Impairment of assets – the Fund accounts for its investment in the Partnership using the equity method. Under GAAP, an impairment test is conducted at least annually. Under IFRS, an impairment test of the investment is required at the transition date with any impairment recorded in retained earnings and annually thereafter. If an indicator of impairment exists, an analysis under IFRS will need to be completed. Under IFRS, impairment losses may be reversed and any impairments reversed or recorded require significant additional disclosure.

PRILIMINARY DIAGNOSTIC REVIEW (CONTINUED)

Method of calculation for future income taxes – there are future income tax assets and liabilities that are accounted for under IFRS but not recognized under GAAP and vice versa. The Fund is currently investigating how these differences will impact its future tax calculations.

Accounting for the Fund structure – under existing GAAP, the Fund has determined the appropriate accounting treatment for the following activities which are unique to its structure: the investment in the Partnership, annual roll-ins of restaurants into the Royalty Pool and the exchange of Partnership units for units of the Fund. As there is no direct accounting guidance dealing with these particular topics, the Fund is currently evaluating whether IFRS deals with any of these topics and whether it would result in any different accounting or disclosure requirements.

DETAILED ASSESSMENT

A detailed assessment is currently underway and involves identifying the impact on financial reporting, information technology and systems, financial reporting expertise, accounting policies, internal controls over financial reporting and disclosure controls and procedures, and developing systems and accounting policies to address identified issues. This phase will also require a detailed analysis of the differences between IFRS and GAAP. Significant increases in disclosure are anticipated and the Fund is identifying and assessing these additional disclosure requirements. The Fund anticipates completing the detailed assessment by the middle of 2010.

POLICY DESIGN AND IMPLEMENTATION

This phase will result in the selection of policies together with changes to information systems to facilitate collection of the necessary financial information to compile IFRS financial statements for 2011 interim and annual financial statements. At this time, the Fund can not quantify the impact of IFRS on its consolidated financial statements. The International Accounting Standards Board (“IASB”) also has several projects slated for completion in 2010 and 2011 that may significantly impact the transition to IFRS and the financial statements of the Fund. The Fund will continue to monitor the IASB’s progress on these projects. As the IFRS transition project progresses, the Fund will continue to report on the status of the plan including further information on accounting policy changes and their impacts on the financial statements. The transition to IFRS is not expected to have an impact on the Fund’s operating results or cash flows.

FINANCIAL INSTRUMENTS

The Fund’s financial instruments consist of cash, amounts due from KRL and the Partnership, note receivable from KRL, interest payable on the term loan, distributions payable to Fund unitholders, 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 there is no significant value applicable to this feature. The fair values of the amounts due from KRL and the Partnership, 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 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.

SUBSEQUENT EVENT

On April 9, 2010, the Fund completed a secondary offering of units after filing a short form prospectus with the British Columbia Securities Commission to qualify the distribution by KRL of 900,000 units of the Fund at a price of \$12.15 per unit, for gross proceeds of \$10,935,000. The Fund did not receive any proceeds pursuant to this offering. As a result of the transaction, the number of Fund units outstanding increased from 9,703,500 as at March 31, 2009 to 10,603,500 on April 9, 2010 and the public’s average affective ownership of the Fund increased from 69.39% as at March 31, 2010 to 75.82% on April 9, 2010.

OUTLOOK

The Canadian Restaurant Foodservice Association (CRFA) has projected an increase in sales in the full-service restaurant category, the category in which The Keg operates, of 3.0% in 2010. The National Restaurant Association in the United States has projected a real sales increase of 1.2% in the full service category in 2010. While management of KRL expects limited improvement in economic conditions in North America 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 United States. 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 United States will continue to focus on three target markets, specifically: Phoenix, Arizona; Denver, Colorado; and Dallas, Texas. KRL management has advised the Trustees that it intends to aggressively pursue franchising opportunities in the United States.

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 thirty-eight years. Management of KRL has advised the Trustees that it has revised the number of restaurants it expects to open prior to October 2, 2010, primarily due to general economic conditions. Management of KRL has advised that it currently expects to open two restaurants, consisting of one new corporate restaurant in Canada, as well as one franchised restaurant in the United States. In addition management of KRL expect to relocate two corporate and one franchised restaurant in Canada during the same period. Management of KRL continues to monitor economic conditions and intends to regularly review the timing of its scheduled restaurant openings and adjust these as necessary.

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 United States, 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.

THE RESTAURANT INDUSTRY (CONTINUED)

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 has advised the Trustees that it continues to monitor the situation regarding the cases of BSE found in North America during the past several years. The widespread testing of herds confirms these are isolated cases; the risk to human health appears to be negligible. Most importantly to The Keg, there has been no significant negative consumer reaction to beef in North America and there has not been a material impact on its restaurant traffic. KRL management has further advised the Trustees that KRL has maintained an uninterrupted supply of quality beef that meets its demanding specifications despite the border closures and the unfortunate impact on cattle producers. Management of KRL has advised the Trustees that it expects the demand for beef to remain strong among consumers and its supply to continue uninterrupted.

FLUCTUATIONS IN FOREIGN EXCHANGE RATES

KRL presently has 16 restaurants located in the United States, 15 of which are corporately owned through its wholly owned subsidiaries, and one of which is franchised. Keg restaurants located in the United States generate sales in United States 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 United States, which will affect the amount of the royalty.

FORWARD LOOKING INFORMATION

The information provided in this report includes forward-looking statements with respect to business plans, activities and events anticipated by the Fund and the Fund’s future results. Although the Fund believes the assumptions underlying such statements to be reasonable, any of the assumptions may prove to be inaccurate and, as a result, the forward-looking information may prove to be incorrect. The forward-looking information contained in this document is current only as of the date of this document. There should not be an expectation that such information will in all circumstances be updated, supplemented or revised whether as a result of new information, changing circumstances, future events or otherwise.

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

George Tidball

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

George Tidball*

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

Karyn Byrne

Investor Relations Manager

Telephone: (416) 646-4960

Facsimile: (416) 695-2401

E-mail: karynb@kegrestaurants.com

Website: www.kegincomefund.com

THE KEG ROYALTIES INCOME FUND

CONSOLIDATED
FINANCIAL STATEMENTS
For the three months ended March 31, 2010 and 2009

CONSOLIDATED BALANCE SHEETS

(Expressed in thousands of dollars)

| | March 31, 2010 (unaudited) | December 31, 2009 |
|---|----------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 1,532 | \$ 1,379 |
| Due from Keg Restaurants Ltd. (note 6) | 363 | 363 |
| Due from The Keg Rights Limited Partnership (note 7) | <u>14</u> | <u>1,036</u> |
| | 1,909 | 2,778 |
| Note receivable from Keg Restaurants Ltd. | 57,000 | 57,000 |
| Investment in The Keg Rights Limited Partnership (note 3) | <u>57,538</u> | <u>56,586</u> |
| | <u>\$ 116,447</u> | <u>\$ 116,364</u> |
| LIABILITIES AND UNITHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Interest payable on term loan | \$ 48 | \$ 48 |
| Distributions payable to Fund unitholders | <u>-</u> | <u>1,033</u> |
| | 48 | 1,081 |
| Term loan, net of deferred financing charges | 13,934 | 13,924 |
| Future income taxes | 1,775 | 1,875 |
| Unitholders' equity: | | |
| Capital contributions | 100,014 | 100,014 |
| Retained earnings (deficit) | <u>676</u> | <u>(530)</u> |
| | <u>100,690</u> | <u>99,484</u> |
| | <u>\$ 116,447</u> | <u>\$ 116,364</u> |

See accompanying notes to consolidated financial statements.

Subsequent event (note 10)

Approved on behalf of the Board of Trustees

"C.C. Woodward"
C.C. Woodward, Trustee

"George Tidball"
George Tidball, Trustee

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

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

| | January 1 to March 31, <u>2010</u> | January 1 to March 31, <u>2009</u> |
|--|--|--|
| Revenue: | | |
| Equity income (note 3) | \$ 2,267 | \$ 2,381 |
| Interest income | <u>1,055</u> | <u>1,058</u> |
| | 3,322 | 3,439 |
| Expenses: | | |
| Interest and financing fees | (138) | (119) |
| Amortization of deferred financing charges | <u>(10)</u> | <u>(5)</u> |
| | <u>(148)</u> | <u>(124)</u> |
| Earnings before income taxes | 3,174 | 3,315 |
| Future income tax recovery | <u>100</u> | <u>150</u> |
| Net earnings and comprehensive income for the period | <u>\$ 3,274</u> | <u>\$ 3,465</u> |
| Weighted average units outstanding | <u>9,703,500</u> | <u>9,703,500</u> |
| Basic and diluted earnings per unit | <u>\$ 0.34</u> | <u>\$ 0.36</u> |

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

(Expressed in thousands of dollars - unaudited)

| | January 1 to March 31, <u>2010</u> | January 1 to March 31, <u>2009</u> |
|--|--|--|
| Deficit, beginning of period | \$ (530) | \$ (527) |
| Net earnings | 3,274 | 3,465 |
| Distributions declared to Fund unitholders | <u>(2,068)</u> | <u>(2,068)</u> |
| Retained earnings, end of period | <u>\$ 676</u> | <u>\$ 870</u> |

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars - unaudited)

| | January 1 to March 31, <u>2010</u> | January 1 to March 31, <u>2009</u> |
|--|--|--|
| Cash provided by (used for): | | |
| OPERATIONS: | | |
| Net earnings for the period | \$ 3,274 | \$ 3,465 |
| Items not involving cash: | | |
| Amortization of deferred financing charges | 10 | 5 |
| Equity income (note 3) | (2,267) | (2,381) |
| Future income tax recovery | (100) | (150) |
| Distributions from The Keg Rights Limited Partnership (note 3) | 1,314 | 1,420 |
| Change in non-cash operating working capital (note 9(a)) | <u>1,022</u> | <u>899</u> |
| | 3,253 | 3,258 |
| FINANCING: | | |
| Distributions paid to Fund unitholders | <u>(3,100)</u> | <u>(3,100)</u> |
| Increase in cash | 153 | 158 |
| Cash, beginning of period | <u>1,379</u> | <u>1,337</u> |
| Cash, end of period | <u>\$ 1,532</u> | <u>\$ 1,495</u> |

See note 9(b) for supplementary cash flow information.

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2010 and 2009

1. BASIS OF PRESENTATION:

The Keg Royalties Income Fund (the "Fund") prepares its interim consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") on a basis consistent with those used and described in the annual consolidated financial statements for the year ended December 31, 2009, except as described below in note 2. The disclosures contained in these interim consolidated financial statements do not include all the requirements of Canadian GAAP for annual financial statements.

These interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements of the Fund for the year ended December 31, 2009.

2. NEW ACCOUNTING STANDARDS AND ACCOUNTING POLICIES:

International Financial Reporting Standards:

The Canadian Institute of Chartered Accountants plans to converge Canadian GAAP for public companies with International Financial Reporting Standards ("IFRS") commencing with fiscal years beginning on or after January 1, 2011. This will result in the Fund having to report under IFRS commencing with its fiscal year ended December 31, 2011. The Trustees of the Fund are currently evaluating the impact of IFRS on the Fund's financial statements and disclosures. While the effects of IFRS have not fully been determined, the Trustees have identified the key areas expected to be impacted to be the accounting treatment for the Fund's interest in the Partnership, the classification of unitholders' equity, whether a derivative exists in the note receivable from KRL and the method of calculation of future income taxes.

3. EQUITY INVESTMENT:

The Keg Rights Limited Partnership (the "Partnership") 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 Fund, through its ownership of The Keg Holdings Trust ("KHT"), holds all of the issued and outstanding Limited Partnership units ("LP units"), 1,550,000 Class B units and 99% of the General Partnership units ("GP units") of the Partnership through its 90% interest in The Keg GP Ltd.

| | March 31, 2010 | December 31, 2009 |
|--|-------------------|----------------------|
| Investment in the Partnership, at cost | \$ 56,669 | \$ 56,669 |
| Accumulated equity earnings less distributions received, beginning of period | (84) | (117) |
| Equity income in the Partnership | 2,267 | 8,702 |
| Distributions from the Partnership | <u>(1,314)</u> | <u>(8,668)</u> |
| Equity investment in the Partnership | <u>\$ 57,538</u> | <u>\$ 56,586</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2010 and 2009

3. EQUITY INVESTMENT (CONTINUED):

Summarized financial information of the Partnership is as follows:

| | March 31, <u>2010</u> | December 31, <u>2009</u> |
|--|--|--|
| Current assets | \$ 1,946 | \$ 2,360 |
| Long-term assets, being Keg Rights | <u>152,969</u> | <u>151,198</u> |
| Total assets | <u>\$ 154,915</u> | <u>\$ 153,558</u> |
| Current liabilities | \$ 279 | \$ 2,410 |
| Partners' equity | <u>154,636</u> | <u>151,148</u> |
| Total liabilities and equity | <u>\$ 154,915</u> | <u>\$ 153,558</u> |
| | January 1 to March 31, <u>2010</u> | January 1 to March 31, <u>2009</u> |
| System sales reported by Keg restaurants in the Royalty Pool | <u>\$ 116,953</u> | <u>\$ 120,858</u> |
| Royalty income at 4% of system sales reported above | \$ 4,678 | \$ 4,834 |
| Make-whole payment, based on 4% of lost system sales | <u>17</u> | <u>60</u> |
| Total royalty income | 4,695 | 4,894 |
| Expenses | <u>(98)</u> | <u>(88)</u> |
| Net earnings of the Partnership for the period | 4,597 | 4,806 |
| KRL's interest in the net earnings of the Partnership | <u>(2,330)</u> | <u>(2,425)</u> |
| Equity income for the period | <u>\$ 2,267</u> | <u>\$ 2,381</u> |

4. ROYALTY POOL:

Annually, on January 1, the Keg restaurants on which Keg Restaurants Ltd. ("KRL") pays a royalty to the Partnership (the "Royalty Pool") is adjusted to include the gross sales from new Keg restaurants that have opened on or before October 2 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 31 of each year when the actual full year performance of the new restaurants is known with certainty.

The gross sales reported by the 102 Keg restaurants in the Royalty Pool are from January 1 to March 31, 2010 (January 1 to March 31, 2009 – 102 Keg restaurants).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

For the three months ended March 31, 2010 and 2009

4. ROYALTY POOL (CONTINUED):

The royalty payment from KRL to the Partnership is four percent of system sales for such period reported by Keg restaurants in 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. The make-whole payment is based on one restaurant closure for the period from January 1 to March 31, 2010 (January 1 to March 31, 2009 – three restaurant closures).

On January 1, 2010, six new Keg restaurants that opened during the period from October 3, 2008 to October 2, 2009 were added to the Royalty Pool. The gross sales of these six new restaurants have been estimated at \$25.5 million annually. Six permanently closed Keg restaurants with annual sales of \$17.1 million have been removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$8.4 million annually. The total number of restaurants in the Royalty Pool remains at 102. The yield of the Fund Units was determined to be 13.97% calculated using a weighted average unit price of \$9.15.

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 242,070 Fund units, being 1.73% of the Fund units on a fully diluted basis. On January 1, 2010, KRL received 80% of this entitlement representing the equivalent of 193,656 Fund units, being 1.38% 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 Additional Entitlement described above, KRL has the right to exchange its units in the capital of the Partnership for 4,280,891 Fund units, representing 30.61% of the Fund units on a fully diluted basis. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2010 once the actual performance of the new restaurants has been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2010, it would have the right to exchange its Partnership Units for 4,329,305 Fund units, representing 30.85% of the Fund units on a fully diluted basis.

5. UNITHOLDER DISTRIBUTIONS:

| | January 1 to March 31, <u>2010</u> | January 1 to March 31, <u>2009</u> |
|--|--|--|
| Distributions declared to Fund unitholders | \$ <u>2,068</u> | \$ <u>2,068</u> |
| Weighted average Fund units outstanding | <u>9,703,500</u> | <u>9,703,500</u> |
| Weighted average distributions declared per unit | \$ <u>0.21</u> | \$ <u>0.21</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 CONSOLIDATED FINANCIAL STATEMENTS

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

For the three months ended March 31, 2010 and 2009

6. DUE FROM KEG RESTAURANTS LTD.:

| | March 31, <u>2010</u> | December 31, <u>2009</u> |
|--|--------------------------|-----------------------------|
| Interest on note receivable from Keg Restaurants Ltd. | \$ <u>363</u> | \$ <u>363</u> |

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

7. DUE FROM THE KEG RIGHTS LIMITED PARTNERSHIP:

The amounts due from the Partnership are working capital items owing to the Fund or its subsidiaries and are in the normal course of operations.

8. EXCHANGEABLE UNITS:

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

| | March 31, <u>2010</u> | December 31, <u>2009</u> |
|-------------------------------------|--------------------------|-----------------------------|
| Class A Partnership units (a) | 905,944 | 905,944 |
| Class B Partnership units (b) | 1,826,700 | 1,826,700 |
| Class D Partnership units (c) | <u>1,548,247</u> | <u>1,354,591</u> |
| | <u>4,280,891</u> | <u>4,087,235</u> |

Pursuant to the declaration of trust, the holders (other than the Fund or its subsidiaries) of the Class A Partnership units ("Class A units"), Class B Partnership units ("Class B units") and Class D Partnership units ("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.

- (a) The Class A units are entitled to a preferential proportionate distribution equal to the distribution on the Class C Partnership units ("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, 2010. 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 Fund unit for one Class A unit and represent KRL's initial 10% effective ownership of the Fund prior to the entitlement of Class B and Class D units.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2010 and 2009

8. EXCHANGEABLE UNITS (CONTINUED):

- (b) 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 Fund unit for one Class B unit. As at March 31, 2010, 1,826,700 (December 31, 2009 – 1,826,700) Class B units held by KRL receive a distribution entitlement.
- (c) 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 Fund unit for one Class D unit. As at March 31, 2010, 1,548,247 (December 31, 2009 – 1,354,591) Class D units held by KRL receive a distribution entitlement. Class D units are issued subsequent to the Class B Termination Date and are identical to Class B units except that the Trustees of KHT can require KRL to surrender any or all of the issued Class D units for a price that is equal to the one originally used in the formula to calculate the number of units issued.

9. SUPPLEMENTARY CASH FLOW INFORMATION:

| | January 1 to March 31, <u>2010</u> | January 1 to March 31, <u>2009</u> |
|---|--|--|
| (a) Change in non-cash operating working capital: | | |
| Due from Keg Restaurants Ltd. | \$ - | \$ (1) |
| Due from The Keg Rights Limited Partnership | 1,022 | 913 |
| Interest payable on term loan | <u>-</u> | <u>(13)</u> |
| | <u>\$ 1,022</u> | <u>\$ 899</u> |
| (b) Supplementary information: | | |
| Interest received | \$ 1,055 | \$ 1,057 |
| Interest paid | 138 | 133 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2010 and 2009

10. SUBSEQUENT EVENT:

On April 9, 2010, the Fund completed a secondary offering of units after filing a short form prospectus with the British Columbia Securities Commission to qualify the distribution by KRL of 900,000 units of the Fund at a price of \$12.15 per unit, for gross proceeds of \$10,935,000. The Fund did not receive any proceeds pursuant to this offering. As a result of this transaction, the number of Fund units outstanding increased from 9,703,500 as at December 31, 2009 to 10,603,500 on April 9, 2010, upon completion of this transaction. The Fund's ownership of the Partnership has also increased from 70.36% as at December 31, 2009 to 75.82% subsequent to KRL's exchange of Class B Partnership units for Fund units.