

THE KEG ROYALTIES INCOME FUND

FIRST QUARTER REPORT

For the period from January 1, 2003 to March 31, 2003



TO OUR UNITHOLDERS

On behalf of the Trustees of The Keg Royalties Income Fund (the "Fund"), I am pleased to present the results of the Fund for the quarter ended March 31, 2003. Through this first quarter of fiscal 2003, the Fund has continued to deliver expected results in terms of earnings, cash flows and distributions to unitholders.

RESULTS

The system sales reported by the 81 Keg restaurants in the Royalty Pool were \$73,476,000 during the period from January 1, 2003 to March 31, 2003. Total system sales for the Keg during that period were \$77,088,000, an increase of \$5,486,000 or 7.7% over the same period in 2002. Despite a postponement of menu price increases for strategic reasons and the negative impact of the weak U.S. dollar on comparable sales, the Keg's same store sales increased for the period. While the increase of 0.4% is not of the magnitude the Keg has typically enjoyed in recent years, given the industry's current state and the strong comparables posted in this quarter last year, we view this as a good indication of the Keg brand's continued strength.

OUTLOOK

The foodservice industry had a challenging year in 2002 by any measure; the strong rebound, which had been widely expected in 2003, now seems unlikely to materialize to any meaningful degree. However, the industry remains strong and vibrant relative to its position a decade ago and is well positioned for continued growth. The demographic and lifestyle changes that have driven the industry forward over the past twenty years remain favourable.

The management of KRL remains focused on running great steakhouses and bars. This focus served both KRL and the Fund well through the industry's challenging year in 2002, and management is confident that the Keg will continue to outperform the industry through 2003.

Sincerely,

A handwritten signature in black ink, appearing to read "C.C. Woodward", written in a cursive style.

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

May 29, 2003

HIGHLIGHTS

	Jan. 1, 2003 to Mar. 31, 2003
(\$000's except earnings per unit)	
Gross sales reported by the 81 Keg restaurants in the Royalty Pool.....	<u>\$ 73,476</u>
Royalty income.....	\$ 2,939
Interest income.....	<u>1,055</u>
Total income.....	3,994
Expenses.....	(301)
Non-controlling interest ⁽¹⁾	<u>(1,405)</u>
Earnings for the period.....	<u>\$ 2,288</u>
Basic and diluted earnings per Fund unit.....	<u>\$ 28</u>

⁽¹⁾Represents the effective interest of KRL in the earnings of the Fund.

MANAGEMENT DISCUSSION AND ANALYSIS

OVERVIEW

On May 31, 2002, The Keg Royalties Income Fund (the "Fund"), through its subsidiary The Keg Rights Limited Partnership (the "Partnership"), purchased the Keg trademarks and related 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. This agreement obligates KRL to make a monthly royalty payment equal to 4% of the gross sales of Keg restaurants in Canada and the United States.

Annually, on January 1st, the pool of Keg restaurants on which KRL pays a royalty (the "Royalty Pool") to the Partnership will be adjusted to include the gross sales from new Keg restaurants opened on or before October 2nd of the prior year, less gross sales from any Keg restaurants that have permanently closed during the year. In return for adding these net sales to the Royalty Pool, KRL will receive the right to indirectly acquire additional Fund units (the "Additional Entitlement"). The Additional Entitlement is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund units. KRL receives 80% of the Additional Entitlement initially, with the balance received when the actual full year performance of the new restaurants are known with certainty.

On January 1, 2003, three new Keg restaurants that opened during the period from April 1, 2002 through October 2, 2002 were added to the Royalty Pool. The gross sales of these three new restaurants have been estimated at \$14.0 million annually. Two permanently closed Keg restaurants with annual sales of \$3.8 million have been removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$10.2 million annually. The total number of restaurants in the Royalty Pool has increased to 81. The yield of the Fund units was determined to be 11.25% calculated using a weighted average unit price of \$9.60. As a result of the contribution of the additional net sales to the Royalty Pool, and assuming 100% of the

OVERVIEW CONTINUED

estimated Additional Entitlement is received, KRL's Additional Entitlement will be equivalent to 336,689 Fund units, being 3.58% of the Fund units on a fully diluted basis. On January 1, 2003, KRL received 80% of this entitlement representing the equivalent of 269,351 Fund units, being 2.89% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the Additional Entitlement described above, KRL has the right to exchange its units in the capital of the Partnership for 1,175,295 Fund units, representing 12.60% of the Fund units on a fully diluted basis. If KRL receives 100% of the estimated Additional Entitlement for 2003, it would have the right to exchange its Partnership units for 1,242,633 Fund units, representing 13.22% of the Fund units on a fully diluted basis. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2003 once the actual performance of the new restaurants have been confirmed. All Fund units obtained by KRL in exchange for these Partnership units are subject to a contractual re-sale restriction, which expires on May 31, 2005.

The Fund's operating expenses are limited to administration expenses, interest on long-term debt and amortization of deferred financing fees.

SYSTEM SALES

While the Fund's income is based on a royalty of 4% of sales of those 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	
	March 30, <u>2003</u>	March 31, <u>2002</u>
Corporate Keg restaurants.....	\$ 43,387	\$ 41,944
Franchised Keg restaurants ⁽¹⁾	<u>33,701</u>	<u>29,658</u>
Total system sales.....	<u>\$ 77,088</u>	<u>\$ 71,602</u>

⁽¹⁾ 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 and includes the gross sales of a joint venture restaurant located in Coquitlam, British Columbia.

Total system sales for the 13 weeks ended March 30, 2003 were \$77.1 million compared to \$71.6 million for the 13 weeks ended March 30, 2002, an increase of \$5.5 million or 7.7%. During the 13 weeks ended March 30, 2003, no new restaurants were opened and no restaurants were closed. During the same period in the prior year, no new restaurants were opened while two corporate restaurants were closed. As at March 30, 2003, there were a total of 84 Keg restaurants as compared with the 80 restaurants at March 31, 2002.

Same store sales (sales of restaurants that operated during the entire period of both the current and the prior year) were up 0.4% for the period. While this increase is more modest than Keg has historically posted, it does in fact represent real growth as management of KRL decided to postpone menu price increases for strategic reasons. In addition, comparable sales from the U.S. Keg restaurants were unfavourably impacted upon consolidation due to the weakening of the US. dollar relative to the Canadian dollar.

OPERATING RESULTS

For the period January 1, 2003 to March 31, 2003 royalty income was \$2,939,000 based on system sales of \$73,476,000 from the 81 Keg restaurants in the Royalty Pool.

Operating expenses for the quarter ended March 31, 2003 were \$301,000 and included general and administrative expenses of \$95,000, interest on the long-term debt of the Fund in the amount of \$177,000 and amortization on the deferred financing charges of \$29,000.

Net earnings of the Fund were \$2,288,000 resulting in earnings per Fund unit of 28.1 cents. Cash available for distribution to unitholders during the period amounted to 28.4 cents and distributions of 27.0 cents have been declared relative to this period. It is anticipated that the monthly distribution to unitholders of 9.0 cents per unit will remain at least at this level for the balance of this fiscal year, which equates to an annualized distribution of \$1.08 per unit.

OUTLOOK

Canada's foodservice industry faced many challenges in 2002, with real sales in the commercial foodservice sector falling for the first time since the introduction of the GST in 1991. The U.S. industry also experienced weak results. A rebound in foodservice sales had been widely expected in 2003; global and economic uncertainties now clearly threaten that outlook.

Throughout 2002, the Keg brand remained strong as result of a focus on operational excellence and the spirit and dedication of the Keg employees. In contrast to the overall industry results, the Keg enjoyed both record sales and record operating earnings. Management intends to remain fully focused on running great steakhouses and bars. This does not make the company totally immune to general industry conditions, but management expects the Keg will continue to outperform the industry and to deliver strong sales and operating earnings in 2003.

KRL remains committed to growth, both through expansion and same store sales increases. In addition to new Kegs in both Canada and the U.S., we continue to refurbish, and in some cases relocate, existing Keg restaurants in order to better serve our guests and to protect and enhance the strong leadership position our brand has enjoyed for over thirty years.

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.

It is of note that on May 20, 2003 the Canadian Food Inspection Agency announced that a single case of BSE, also known as “Mad Cow Disease”, was confirmed in an Alberta cow. Management of KRL has advised the Trustees that it is closely monitoring developments in this situation, but is fully confident that no risk to human health exists and that Keg’s beef supply will remain totally safe and uninterrupted. Management of KRL has further advised the Trustees that Keg restaurants could possibly experience sales declines in the event that the perception of beef as a safe food product is negatively affected, but believes that any potential declines would be moderate in magnitude and short term in nature.

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.

CONSOLIDATED BALANCE SHEET

(Expressed in thousands of dollars)

	March 31, <u>2003</u> (unaudited)	December 31, <u>2002</u>
ASSETS		
Current assets:		
Cash	\$ 74	\$ -
Accounts receivable	1	1
Due from Keg Restaurants Ltd. (note 5).....	1,530	1,558
Prepaid expenses and deposits.....	<u>21</u>	<u>25</u>
	1,626	1,584
 Note receivable from Keg Restaurants Ltd.	 57,000	 57,000
Intangible assets	113,547	113,547
Deferred financing charges	<u>249</u>	<u>278</u>
	<u>\$ 172,422</u>	<u>\$ 172,409</u>
 LIABILITIES AND UNITHOLDERS' EQUITY		
Current liabilities:		
Bank indebtedness.....	\$ -	\$ 40
Accounts payable and accrued liabilities	260	315
Interest payable on term loan	7	7
Distributions payable to Fund unitholders.....	-	734
Distributions payable to non-controlling interest	<u>-</u>	<u>460</u>
	267	1,556
 Term loan	 14,000	 14,000
Non-controlling interest (note 7).....	83,532	83,050
Unitholders' equity.....	<u>74,623</u>	<u>73,803</u>
	<u>\$ 172,422</u>	<u>\$ 172,409</u>

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board of Trustees

“C.C. Woodward” Trustee

“George Tidball” Trustee

CONSOLIDATED STATEMENT OF EARNINGS

(Expressed in thousands of dollars - unaudited)

	January 1, 2003 to March 31, <u>2003</u>
Gross sales reported by Keg restaurants in the Royalty Pool (note 2).....	\$ <u>73,476</u>
Revenue:	
Royalty income	\$ 2,939
Interest income.....	<u>1,055</u>
	3,994
Expenses:	
General and administrative.....	95
Interest and financing fees	177
Amortization of deferred financing charges	<u>29</u>
	<u>301</u>
Earnings before non-controlling interest	3,693
Non-controlling interest (note 7).....	<u>1,405</u>
Net earnings for the period.....	2,288
Basic and diluted earnings per Fund Unit (8,153,500 units).....	<u>0.28</u>

CONSOLIDATED STATEMENTS OF UNITHOLDER'S EQUITY

(Expressed in thousands of dollars - unaudited)

	January 1, 2003 to March 31, <u>2003</u>
Balance, beginning of period	\$ 73,803
Issue of Fund Units, net of issue costs	-
Net earnings	2,288
Distributions declared to Fund unitholders (note 4)	<u>(1,468)</u>
Balance, end of period	<u>\$ 74,623</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Expressed in thousands of dollars - unaudited)

	January 1, 2003 to March 31, <u>2003</u>
Cash provided by (used for):	
OPERATIONS:	
Net earnings for the period	\$ 2,288
Items not involving cash:	
Amortization of deferred charges	29
Non-controlling interest	1,405
Change in non-cash operating working capital (note 8(a)).....	<u>(23)</u>
	3,699
FINANCING:	
Distributions paid to Fund unitholders (note 4).....	(2,201)
Distributions paid to non-controlling interest	<u>(1,384)</u>
	<u>(3,585)</u>
Increase in cash	114
Bank indebtedness, beginning of period	<u>(40)</u>
Cash, end of period.....	<u>\$ 74</u>

See note 8(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 period from January 1, 2003 to March 31, 2003

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 on a basis consistent with those used and described in the annual consolidated financial statements for the period from April 12, 2002 (establishment) to December 31, 2002. The disclosures contained in these interim consolidated financial statements do not include all the requirements of Canadian generally accepted accounting principles for annual financial statements.

These interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the period April 12, 2002 to December 31, 2002.

2. GROSS SALES:

The gross sales reported by the 81 Keg restaurants on which Keg Restaurants Ltd. ("KRL") pays a royalty (the "Royalty Pool") are from January 1, 2003 to March 31, 2003.

The royalty payment from KRL to The Keg Rights Limited Partnership (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. Make-whole payments were not required for the period from January 1, 2003 to March 31, 2003 as there were no restaurant closures.

	January 1, 2003 to March 31, <u>2003</u>
System sales reported by Keg restaurants in the Royalty Pool	\$ <u>73,476</u>
Royalty income at 4% of system sales reported above	2,939
Make-whole payment, based on 4% of lost system sales	<u>-</u>
Total royalty income	<u>\$ 2,939</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars – unaudited)

For the period from January 1, 2003 to March 31, 2003

3. DISTRIBUTABLE CASH:

	January 1, 2003 to March 31, <u>2003</u>
Earnings for the period	\$ 2,288
Amortization of deferred financing charges	29
Non-controlling interest	<u>1,405</u>
	3,722
Distributable cash required for non-controlling interest	<u>(1,406)</u>
Distributable cash available for Fund unitholders.....	<u>\$ 2,316</u>
Basic and diluted distributable cash per Fund Unit (8,153,500 units).....	<u>\$ 0.28</u>

Distributable cash is not an earnings measure recognized by generally accepted accounting principles (“GAAP”) and therefore may not be comparable to similar measures presented by other issuers. Basic and diluted distributable cash per Fund Unit is computed on a basis consistent with that described by GAAP for computing earnings per Fund Unit.

4. UNITHOLDER DISTRIBUTIONS:

The \$733,815 difference between the \$1,467,630 in distributions declared and the \$2,201,445 in distributions paid to Fund unitholders during the period from January 1, 2003 to March 31, 2003 is due to the declaration of the January 2003 distribution on December 31, 2002. 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.

5. DUE FROM KEG RESTAURANTS LTD.:

Royalty fee, including GST of \$76,335	\$ 1,167
Interest on note receivable from Keg Restaurants Ltd.....	<u>363</u>
	<u>\$ 1,530</u>

The above amounts were received when due from KRL subsequent to March 31, 2003 to facilitate the April 30, 2003 distribution to Fund unitholders.

6. ACQUISITION OF KEG RIGHTS:

On May 31, 2002, the Partnership, a subsidiary of the Fund, acquired the trademarks, trade names, operating procedures and systems and other intellectual property (collectively, 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 5,7000,000 Class C Partnership Units (Class C Units).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the period from January 1, 2003 to March 31, 2003

6. ACQUISITION OF KEG RIGHTS (CONTINUED):

Concurrently with the acquisition of the Keg Rights, the Partnership granted KRL a licence to use the Keg Rights for a term of 99 years for which KRL pays the Partnership a royalty of four percent of the system sales reported by KRL for restaurants included in the Royalty Pool (note 2).

7. NON-CONTROLLING INTEREST:

Balance, beginning of period.....	\$	83,050
Non-controlling interest in earnings of the Partnership.....		1,405
Distributions declared to non-controlling interest.....		<u>(923)</u>
Balance, end of period.....	\$	<u>83,532</u>

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 Limited Partnership Units ("LP Units") issued and outstanding. The Keg Holdings Trust ("KHT"), a subsidiary of the Fund, holds all of the 8,153,500 LP Units issued and outstanding at March 31, 2003. The LP Units are eliminated upon consolidation of the Fund. In addition, the Class A Units receive a residual distribution proportionately with the Class B Units, LP Units and General Partnership Units relative to the aggregate number of each class issued and outstanding (or in the case of the Class B Units, the number issued and outstanding multiplied by the Class B current distribution entitlement). Class A Units are exchangeable for Fund Units on the basis of one Fund Unit for one Class A Unit.

The Class B Units are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership from new Keg restaurants. The distribution entitlements of the Class B Units are adjusted annually on January 1 beginning in January 2003. Class B Units are exchangeable for Fund Units based upon a defined calculation that itself is based on system sales from new restaurants. As at March 31, 2003, 269,351 Class B Units receive a distribution entitlement and may be exchanged for Fund Units.

The Class C Units are entitled to a preferential monthly distribution equal to \$0.0625 per Class C Unit issued and outstanding. KRL, the holder of the Class C Units has the right to transfer Class C Units to KHT, in consideration for the assumption by KHT of an amount of the note receivable from KRL equal to \$10.00 per Class C Unit transferred.

All Fund Units obtained by KRL in exchange for the above Partnership Units are subject to a contractual re-sale restriction, which expires on May 31, 2005.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the period from January 1, 2003 to March 31, 2003

8. SUPPLEMENTARY CASH FLOW INFORMATION:

	January 1, 2003 to March 31, <u>2003</u>
(a) Change in non-cash operating working capital:	
Due from Keg Restaurants Ltd. (note 5)	\$ 28
Prepaid expense and deposits.....	4
Accounts payable and accrued liabilities	<u>(55)</u>
	<u>\$ (23)</u>
(b) Supplementary information:	
Interest received	\$ 1,055
Interest paid.....	177

UNITHOLDER INFORMATION

CORPORATE HEAD OFFICE

The Keg Royalties Income Fund
#150 – 10760 Shellbridge Way
Richmond, BC V6X 3H1

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

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* Audit Committee and Governance Committee Member

REGISTRAR AND TRANSFER AGENT

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STOCK EXCHANGE LISTING

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