

THE KEG ROYALTIES INCOME FUND

FIRST QUARTER REPORT

For the three months ended March 31, 2006

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, 2006.

RESULTS

The Trustees are delighted to report that The Keg has reached another sales record for the first quarter. The gross sales reported by the 91 Keg restaurants in the Royalty Pool were \$93,957,000, an increase of \$12,767,000 or 15.7% from the comparable quarter of the prior year. Total system sales for The Keg were even more impressive at \$97,040,000 for the quarter, an increase of \$10,143,000 or 11.7% over the comparable quarter of the prior year. These higher system sales reflect the very successful new Keg restaurants which opened during the period from October 3, 2004 through October 2, 2005 and which were added to the Royalty Pool on January 1, 2006 as well as very strong same store sales growth.

The Fund generated earnings of \$2,651,000 or 30.9 cents/Fund unit compared with \$2,288,000 or 28.1 cents/Fund unit during the same quarter of the prior year, an increase of \$363,000. Distributable cash available to pay distributions to public Unitholders increased by \$364,000 to \$2,658,000 or 31.0 cents /Fund unit, from \$2,294,000 or 28.1 cents/Fund unit for the first quarter of the prior year.

DISTRIBUTION INCREASE

In February 2006, the Trustees were pleased to authorize a 2.1% distribution increase to Unitholders. The monthly distributions were increased from \$0.0918 per unit to \$0.0937 per unit beginning with the April 2006 distribution. This equals an annualized distribution slightly in excess of \$1.124 per unit. The Fund's objective is to provide consistent, monthly distributions to Unitholders at the highest sustainable level, and the Fund will continue to review distribution levels on an ongoing basis to fulfill that objective.

OUTLOOK

The Canadian Restaurant and Foodservice Association (CRFA) has projected foodservice sales growth of 4.7% in 2006, with the full-service restaurant category, the category in which The Keg operates, posting some of the strongest gains.

The Keg remains an industry leader in the full-service restaurant category, showing continued growth in both overall sales and same store sales. Management remains committed to maintaining and improving the legendary high standards that have come to define the brand, including The Keg's high quality menu, knowledgeable service and marketing innovation. The Keg's management team is focused not only on developing new Kegs in new markets where opportunities exist, but also on growing sales in existing Kegs year after year, further strengthening the company's position as a market leader throughout North America.

Sincerely,



C.C. Woodward
Chairman, The Keg Royalties Income Fund
on behalf of the Board of Trustees
May 3, 2006

FINANCIAL HIGHLIGHTS

(\$000's except per unit amounts)	Jan. 1 to Mar. 31, 2006	Jan. 1 to Mar. 31, 2005
Restaurants in the Royalty Pool	91	86
Gross sales reported by restaurants in the Royalty Pool	<u>\$ 93,957</u>	<u>\$ 81,190</u>
Royalty income ⁽¹⁾	\$ 3,761	\$ 3,253
Partnership expenses ⁽²⁾	<u>(138)</u>	<u>(116)</u>
Partnership earnings	3,623	3,137
KRL's interest ⁽³⁾	<u>(1,823)</u>	<u>(1,735)</u>
Equity income ⁽⁴⁾	1,800	1,402
Interest income ⁽⁵⁾	<u>1,056</u>	<u>1,056</u>
Total income	2,856	2,458
Interest and financing expenses ⁽⁶⁾	<u>(205)</u>	<u>(170)</u>
Earnings for the period	<u>\$ 2,651</u>	<u>\$ 2,288</u>
Earnings per Fund unit ⁽⁷⁾	<u>\$.31</u>	<u>\$.28</u>
Distributable cash per Fund unit ⁽⁷⁾⁽⁸⁾	<u>\$.31</u>	<u>\$.28</u>
Distributions declared per Fund unit ⁽⁷⁾	<u>\$.18</u>	<u>\$.18</u>

Notes:

- ⁽¹⁾ The Fund, indirectly through the Partnership, earns royalty income equal to 4% of gross sales of Keg restaurants included 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 and Class C Partnership units. The Class A and entitled Class B Partnership units are exchangeable into Fund units on a one-for-one basis in certain circumstances.
- ⁽⁴⁾ The Fund directly earns equity income from its investment in the Partnership.
- ⁽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 expenses on the long-term debt and amortization of deferred financing charges.
- ⁽⁷⁾ All per unit amounts are calculated based on the weighted average number of Fund units outstanding, which are those units held by public unitholders during the respective period. The weighted average number of Fund units outstanding for the three months ended March 31, 2006 and 2005 were 8,569,611 and 8,153,500 respectively.
- ⁽⁸⁾ 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. Distributable cash per unit is computed as earnings for the period plus non-cash items, divided by the weighted average number of Fund units issued and outstanding.

	Mar. 31, 2006	Dec. 31, 2005
Total assets	\$ 106,204	\$ 97,671
Total liabilities	14,071	14,836

SUMMARY OF QUARTERLY FINANCIAL RESULTS

	Q1 2006	Q4 2005	Q3 2005	Q2 2005
	(\$000's except per unit amounts)			
Restaurants in the Royalty Pool	91	86	86	86
Gross sales reported by Keg restaurants in the Royalty Pool	<u>\$ 93,957</u>	<u>\$ 85,217</u>	<u>\$ 79,877</u>	<u>\$ 79,433</u>
Royalty income ⁽¹⁾	\$ 3,761	\$ 3,449	\$ 3,227	\$ 3,209
Partnership expenses ⁽²⁾	(138)	(89)	(100)	(136)
Partnership earnings	3,623	3,360	3,127	3,073
KRL's interest ⁽³⁾	(1,823)	(1,756)	(1,756)	(1,718)
Equity income ⁽⁴⁾	1,800	1,604	1,371	1,355
Interest income ⁽⁵⁾	1,056	1,079	1,079	1,067
Total income	2,856	2,683	2,450	2,422
Interest and financing expenses ⁽⁶⁾	(205)	(192)	(177)	(172)
Earnings for the period	<u>\$ 2,651</u>	<u>\$ 2,491</u>	<u>\$ 2,273</u>	<u>\$ 2,250</u>
Earnings per Fund unit ⁽⁷⁾	<u>\$.31</u>	<u>\$.30</u>	<u>\$.27</u>	<u>\$.28</u>
Distributable cash per Fund unit ⁽⁷⁾⁽⁸⁾	<u>\$.31</u>	<u>\$.30</u>	<u>\$.27</u>	<u>\$.28</u>
Distributions declared per Fund unit ⁽⁷⁾	<u>\$.18</u>	<u>\$.37</u>	<u>\$.27</u>	<u>\$.27</u>

	Q1 2005	Q4 2004	Q3 2004	Q2 2004
	(\$000's except per unit amounts)			
Restaurants in the Royalty Pool	86	86	86	86
Gross sales reported by Keg restaurants in the Royalty Pool	<u>\$ 81,190</u>	<u>\$ 75,263</u>	<u>\$ 73,505</u>	<u>\$ 72,091</u>
Royalty income ⁽¹⁾	\$ 3,253	\$ 3,096	\$ 3,005	\$ 2,916
Partnership expenses ⁽²⁾	(116)	(93)	(98)	(88)
Partnership earnings	3,137	3,003	2,901	2,828
KRL's interest ⁽³⁾	(1,735)	(1,597)	(1,637)	(1,545)
Equity income ⁽⁴⁾	1,402	1,406	1,270	1,283
Interest income ⁽⁵⁾	1,056	1,076	1,075	1,064
Total income	2,458	2,482	2,345	2,347
Interest and financing expenses ⁽⁶⁾	(170)	(244)	(176)	(174)
Earnings for the period	<u>\$ 2,288</u>	<u>\$ 2,238</u>	<u>\$ 2,169</u>	<u>\$ 2,173</u>
Earnings per Fund unit ⁽⁷⁾	<u>\$.28</u>	<u>\$.27</u>	<u>\$.27</u>	<u>\$.27</u>
Distributable cash per Fund unit ⁽⁷⁾⁽⁸⁾	<u>\$.28</u>	<u>\$.28</u>	<u>\$.27</u>	<u>\$.27</u>
Distributions declared per Fund unit ⁽⁷⁾	<u>\$.18</u>	<u>\$.36</u>	<u>\$.27</u>	<u>\$.27</u>

MANAGEMENT DISCUSSION AND ANALYSIS

**For the Quarter Ended March 31, 2006
As of May 3, 2006**

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, which obligates KRL to make monthly royalty payments to the Partnership.

During 2005, the Partnership was determined to be a variable interest entity in accordance with the criteria established in the new Canadian Institute of Chartered Accountants’ 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.

The Fund earns equity income from its investment in the Partnership and interest income on a \$57.0 million loan to KRL (the “Keg Loan”). The Fund’s equity income from the Partnership is calculated as the royalty income less the Partnership’s operating expenses less earnings attributable to KRL. The Fund’s interest income on the Keg Loan is calculated at 7.5% per annum, payable monthly.

The Fund, indirectly through the Partnership, earns royalty income equal to 4% of gross sales of Keg restaurants included in a specific royalty pool (the “Royalty Pool”).

The Fund, indirectly through the Partnership, incurs administrative expenses and interest expense on the operating line of credit, to the extent utilized (the “Partnership Expenses”). See “Liquidity and Capital Resources – Operating Line of Credit”.

KRL’s interest in the earnings of the Partnership is from its ownership of Class A, entitled Class B and Class C Partnership units. The Class A and entitled Class B Partnership units are exchangeable into Fund units on a one-for-one basis in certain circumstances. On July 4, 2005, KRL exchanged 250,000 Class B units of the Partnership for an equal amount of Fund units, increasing the number of issued and outstanding Fund units to 8,403,500 and on July 6, 2005, sold these 250,000 Fund units through the facilities of the Toronto Stock Exchange. On March 9, 2006, KRL exchanged 650,000 Class B units of the Partnership for an equal amount of Fund units, increasing the number of issued and outstanding Fund units to 9,053,500 and on March 14, 2006, sold these 650,000 Fund units through the facilities of the Toronto Stock Exchange. As of March 31, 2006, KRL owned 2,301,926 of the entitled exchangeable units of the Partnership or the equivalent of 20.27% of the Fund units on a fully diluted basis.

OVERVIEW (CONTINUED)

The Fund's operating expenses are limited to interest on the term loan and amortization of deferred financing charges. See "Liquidity and Capital Resources – Term Loan".

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 royalty revenue added to the Royalty Pool, divided by the yield 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.

During 2005, it was determined that the roll-in formula used to calculate the Additional Entitlement was inconsistent with other restaurant royalty funds in the Fund's peer group such that the accretion that was intended to result from the addition of new sales to the Royalty Pool was affected by the Fund's unit price at the time of the roll-in. If the unit price was above \$10, the addition of new restaurant sales to the Royalty Pool would be less accretive to unitholders than intended and conversely, if the unit price was below \$10, the addition of new restaurant sales would be more accretive than intended. As a result, on December 12, 2005, the Fund's Trustees and KRL's management amended the arrangements between the Fund and KRL (with effect as if the amendments had been made on May 31, 2002, the date of the Fund's initial public offering) to ensure that the intended accretion to unitholders continues regardless of the Fund's unit price. As part of these new arrangements, KRL agreed to waive its entitlement to receive the equivalent of 43,718 Fund units in connection with the Additional Entitlement as of December 31, 2005 pursuant to the existing formula.

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 86 as of December 31, 2005. Fourteen new Keg restaurants that opened during the period from April 1, 2002 through October 2, 2004, with annual gross sales of \$66.1 million, have been added to the Royalty Pool. Eight permanently closed Keg restaurants with annual sales of \$18.8 million have been removed from the Royalty Pool. This has resulted in a net increase in Royalty Pool sales of \$47.3 million annually and KRL receiving a cumulative Additional Entitlement equivalent to 1,621,730 Fund units as of December 31, 2005.

On January 1, 2006, seven new Keg restaurants that opened during the period from October 3, 2004 through October 2, 2005 were added to the Royalty Pool. The gross sales of these seven new restaurants have been estimated at \$30.7 million annually. Two permanently closed Keg restaurants with annual sales of \$6.0 million were removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$24.7 million annually. The total number of restaurants in the Royalty Pool increased to 91. The yield of the Fund units was determined to be 8.19% calculated using a weighted average unit price of \$13.21.

ROYALTY POOL (CONTINUED)

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 842,815 Fund units, being 7.31% of the Fund units on a fully diluted basis. On January 1, 2006, KRL received 80% of this entitlement representing the equivalent of 674,252 Fund units, being 5.94% 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 2,301,926 Fund units (after giving effect to the sale of 650,000 Fund units on March 14, 2006), representing 20.27% of the Fund units on a fully diluted basis. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2006 once the actual performance of the new restaurants have been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2006, it would have the right to exchange its Partnership units for 2,470,489 Fund units (after giving effect to the sale of 650,000 Fund units on March 14, 2006), representing 21.44% of the Fund units on a fully diluted basis.

OWNERSHIP OF THE FUND

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

	March 31, 2006 ⁽¹⁾		March 31, 2005	
	#	%	#	%
Fund units held by public unitholders ⁽²⁾	9,053,500	79.74	8,153,500	77.61
Exchangeable Partnership units held by KRL: ⁽³⁾				
Class A units ⁽⁴⁾	905,944	7.98	905,944	8.62
Class B units ⁽⁵⁾	<u>1,395,982</u>	<u>12.29</u>	<u>1,446,710</u>	<u>13.77</u>
Total Exchangeable Partnership units ⁽⁶⁾	<u>2,301,926</u>	<u>20.27</u>	<u>2,352,654</u>	<u>22.39</u>
Total Fund and Exchangeable Partnership units.....	<u>11,355,426</u>	<u>100.00</u>	<u>10,506,154</u>	<u>100.00</u>

Notes:

⁽¹⁾ Information is current as of March 31, 2006.

⁽²⁾ On July 4, 2005, KRL exchanged 250,000 Class B units of the Partnership for an equal amount of Fund units, increasing the number of issued and outstanding Fund units to 8,403,500 and on July 6, 2005, sold these 250,000 Fund units through the facilities of the Toronto Stock Exchange. On March 9, 2006, KRL exchanged 650,000 Class B units of the Partnership for an equal amount of Fund units, increasing the number of issued and outstanding Fund units to 9,053,500 and on March 14, 2006, sold these 650,000 Fund units through the facilities of the Toronto Stock Exchange. The weighted average number of Fund units issued and outstanding for the three months ended March 31, 2006 and 2005 were 8,569,611 and 8,153,500 respectively.

⁽³⁾ Exchangeable into Fund units on a one-for-one basis in certain circumstances. Class D Partnership units are also exchangeable into Fund units on a one-for-one basis in certain circumstances, but may only be issued after all Class B units have become fully entitled. As at March 31, 2006, no Class D Partnership units have been issued.

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

⁽⁵⁾ KRL is the registered holder of 2,476,700 Class B units as of the date hereof, although only a portion of such are entitled to proportionate distributions from the Partnership, which as at March 31, 2006 comprised 1,395,982 Class B units and as at March 31, 2005 comprised 1,446,710 Class B units. This cumulative entitlement is as a result of adding net sales to the Royalty Pool on an annual basis. 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 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, 2006 and 2005.

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. 2, <u>2006</u>	13 weeks ended Apr. 3, <u>2005</u>
Corporate Keg restaurants	\$ 48,969	\$ 45,017
Franchised Keg restaurants ⁽¹⁾	<u>48,071</u>	<u>41,881</u>
Total system sales	<u>\$ 97,040</u>	<u>\$ 86,898</u>

Notes:

⁽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.

System sales for the 13 weeks ended April 2, 2006 were \$97.0 million compared to \$86.9 million for the 13 weeks ended April 3, 2005, an increase of \$10.1 million or 11.7%. During the 13 weeks ended April 2, 2006, two new franchised restaurants were opened and one franchised restaurant was closed. The closed restaurant, located in Oakville, Ontario is to be relocated to a far superior site within the year. During the 13 weeks ended April 3, 2005, one new franchised restaurant was opened and one corporate restaurant was closed. The closed restaurant, located in Olympia, Washington closed due to a lease expiry, which had been planned as part of an ongoing property rationalization process. As of April 2, 2006, there were a total of 93 Keg restaurants as compared with 90 restaurants at April 3, 2005.

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) increased by 9.4% in Canada and by 9.2% 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 period increased by 8.1%. The average exchange rate moved from 1.23 in KRL's second quarter of fiscal 2005 to 1.16 in KRL's second quarter of fiscal 2006, significantly reducing the Canadian dollar equivalent of the U.S. restaurant sales.

OPERATING RESULTS

GROSS SALES

Gross sales reported by the restaurants in the Royalty Pool increased from \$81,190,000 to \$93,957,000 for the comparable quarter. The increase of \$12,767,000 or 15.7% reflects both the addition of net new sales to the Royalty Pool at the beginning of the year and the same store sales increases discussed previously.

ROYALTY INCOME

Royalty income earned by the Partnership increased by \$508,000 from \$3,253,000 in the first quarter of 2005 to \$3,761,000 in the first quarter of 2006, as a result of the increase in gross sales for the reasons explained previously.

PARTNERSHIP EXPENSES

Expenses incurred by the Partnership for the three months ended March 31, 2006 were \$138,000 and included general and administrative expenses of \$137,000 and interest on the operating line of credit of \$1,000. The increase of \$22,000 over the comparable quarter in 2005 was due to an increase in general and administrative expenses of \$26,000 due to the timing of certain expenditures associated with the publication of the annual report, and a decrease in interest on the operating line of credit of \$4,000, due to lower utilization of the credit facility during the quarter.

KRL'S INTEREST

KRL's interest in the earnings of the Partnership from the Class A, entitled Class B and Class C Partnership units increased from \$1,735,000 for the three months ended March 31, 2005 to \$1,823,000 for the three months ended March 31, 2006. The increase of \$88,000 was due to the increase in Partnership earnings and the increase in KRL's interest in the Partnership as a result of the Additional Entitlement received on January 1, 2006. This was partially offset by a decrease in KRL's effective ownership of the Fund due to the sale of 650,000 Fund units owned by KRL on March 14, 2006.

EQUITY INCOME

The Fund's equity income from its investment in the Partnership increased from \$1,402,000 during the first quarter of 2005 to \$1,800,000 during the first quarter of 2006. The increase of \$398,000 is due to the net impact of the increase in royalty income of \$508,000, the increase in Partnership expenses of \$22,000, and the increase in KRL's income in the earnings of the Partnership of \$88,000.

INTEREST INCOME

Interest income earned by the Fund for the quarter was \$1,056,000 and included interest income on the Keg Loan of \$1,054,000 and other interest income of \$2,000.

INTEREST AND FINANCING EXPENSES

Interest and financing expenses incurred by the Fund were \$205,000 for the three months ended March 31, 2006 and included interest on the long-term debt of \$199,000 and amortization of deferred financing charges of \$6,000. Interest costs increased by \$35,000 in the quarter as a result of an increase in the average interest rate on the long-term debt from 4.75% in the first quarter of 2005 to 5.75% in the first quarter of 2006.

NET EARNINGS

Net earnings increased by \$363,000 from \$2,288,000 (28.1 cents/Fund unit) in the first quarter of 2005 to \$2,651,000 (30.9 cents/Fund unit) in the first quarter of 2006.

DISTRIBUTABLE CASH

Cash available for distribution to Fund unitholders increased by \$364,000 from \$2,294,000 (28.1 cents/Fund unit) to \$2,658,000 (31.0 cents/Fund unit) during the quarter. Distributions of 18.0 cents per Fund unit were declared in the first quarter of 2005 and 18.4 cents per Fund unit in the first quarter of 2006. The difference between the Fund's earnings and distributable cash is due to non-cash items included in the Fund's operating expenses.

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.

TERM LOAN

The Keg Holdings Trust, a subsidiary of the Fund, has a \$14 million non-revolving term loan facility, which bears interest at bank prime plus 0.50% 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 October 28, 2004, this facility was refinanced, and the maturity date extended to October 28, 2007. Certain conditions must be maintained for the term loan to be in good standing, all of which have been met.

OPERATING LINE OF CREDIT

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

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, 2006.

FINANCIAL INSTRUMENTS

The Fund's financial instruments consist of cash, accounts receivable, note receivable, accounts payable and accrued liabilities, and the term loan. Due to the interrelationship between the note receivable from KRL and the Class C Partnership units held by KRL, it is not practicable to estimate the fair value of the note receivable with sufficient reliability. The Keg GP Ltd., as the general partner and administrator of the Fund, estimates that the fair value of these financial instruments approximate their carrying values. It is The Keg GP Ltd.'s opinion that the Fund is not exposed to significant interest rate or credit risk arising from these financial instruments.

OUTLOOK

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 in the future 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-five years.

Management of KRL has also advised the Trustees that it expects to add two new corporate and four new franchised restaurants, to relocate one corporate and one franchised restaurant and to close one corporate restaurant during 2006. Management of KRL has further advised the Trustees that it intends to open 30 new restaurants over the next ten 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.

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. 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 two 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 not been any significant negative consumer reaction to beef in North America and there has not been a material impact on its restaurant traffic. KRL 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 17 restaurants located in the United States, 16 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, 2006 and 2005

CONSOLIDATED BALANCE SHEETS

(Expressed in thousands of dollars)

	March 31, 2006 (unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash	\$ 139	\$ 185
Due from Keg Restaurants Ltd. (note 4)	363	363
Due from The Keg Rights Limited Partnership (note 5)	519	962
	1,021	1,510
Note receivable from Keg Restaurants Ltd.	57,000	57,000
Investment in The Keg Rights Limited Partnership (note 2)	48,142	39,114
Deferred financing charges	41	47
	\$ 106,204	\$ 97,671
LIABILITIES AND UNITHOLDERS' EQUITY		
Current liabilities:		
Interest payable on term loan	\$ 71	\$ 65
Distributions payable to Fund unitholders	-	771
	71	836
Term loan	14,000	14,000
Unitholders' equity:		
Fund units (note 6(a))	90,946	82,696
Retained earnings	1,187	139
	92,133	82,835
	\$ 106,204	\$ 97,671

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board of Trustees

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

“George Tidball”
George Tidball, Trustee

CONSOLIDATED STATEMENTS OF EARNINGS

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

	January 1 to March 31, <u>2006</u>	January 1 to March 31, <u>2005</u>
Gross sales reported by Keg restaurants in the Royalty Pool (note 2)	\$ <u>93,957</u>	\$ <u>81,190</u>
Revenue:		
Equity income (note 2)	\$ 1,800	\$ 1,402
Interest income	<u>1,056</u>	<u>1,056</u>
	2,856	2,458
Expenses:		
Interest and financing fees	199	164
Amortization of deferred financing charges	<u>6</u>	<u>6</u>
	<u>205</u>	<u>170</u>
Net earnings for the period	\$ <u>2,651</u>	\$ <u>2,288</u>
Weighted average units outstanding (note 6(a))	<u>8,569,611</u>	<u>8,153,500</u>
Earnings per unit	\$ <u>0.31</u>	\$ <u>0.28</u>

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

(Expressed in thousands of dollars)

	January 1 to March 31, <u>2006</u>	January 1 to March 31, <u>2005</u>
Retained earnings (deficit), beginning of period.....	\$ 139	\$ (124)
Net earnings	2,651	2,288
Distributions declared to Fund unitholders	<u>(1,603)</u>	<u>(1,468)</u>
Retained earnings, end of period.....	\$ <u>1,187</u>	\$ <u>696</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>2006</u>	January 1 to March 31, <u>2005</u>
Cash provided by (used for):		
OPERATIONS:		
Net earnings for the period	\$ 2,651	\$ 2,288
Items not involving cash:		
Amortization of deferred financing charges	6	6
Equity income (note 2)	(1,800)	(1,402)
Distributions from The Keg Rights Limited Partnership	1,022	822
Change in non-cash operating working capital (note 7(a))	<u>449</u>	<u>351</u>
	2,328	2,065
FINANCING:		
Distributions paid to Fund unitholders	<u>(2,374)</u>	<u>(2,201)</u>
Decrease in cash.....	(46)	(136)
Cash, beginning of period	<u>185</u>	<u>389</u>
Cash, end of period	<u>\$ 139</u>	<u>\$ 253</u>

See note 7(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, 2006 and 2005

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 year ended December 31, 2005. 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 year ended December 31, 2005.

2. EQUITY INVESTMENT:

	March 31, <u>2006</u>	December 31, <u>2005</u>
Investment in the Partnership, at cost	\$ 47,601	\$ 39,352
Accumulated equity earnings less distributions received, beginning of period	(238)	(159)
Equity income in the Partnership	1,800	5,732
Distributions from the Partnership	<u>(1,021)</u>	<u>(5,811)</u>
Equity investment in the Partnership	<u>\$ 48,142</u>	<u>\$ 39,114</u>

The Fund, through its ownership of The Keg Holdings Trust ("KHT"), holds all of the issued and outstanding Limited Partnership units ("LP units"), 900,000 Class B units and 99% of the General Partnership units ("GP units") of the Partnership through its 90% interest in KGP.

Summarized financial information of the Partnership is as follows:

	March 31, <u>2006</u>	December 31, <u>2005</u>
Current assets	\$ 1,888	\$ 1,726
Long-term assets, being Keg Rights	<u>127,716</u>	<u>122,201</u>
Total assets	<u>\$ 129,604</u>	<u>\$ 123,927</u>
Current liabilities	\$ 761	\$ 2,008
Partners' equity	<u>128,843</u>	<u>121,919</u>
Total liabilities and equity	<u>\$ 129,604</u>	<u>\$ 123,927</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2006 and 2005

2. EQUITY INVESTMENT (CONTINUED):

	January 1 to March 31, <u>2006</u>	January 1 to March 31, <u>2005</u>
System sales reported by Keg restaurants in the Royalty Pool	\$ 93,957	\$ 81,190
Royalty income at 4% of system sales reported above	\$ 3,758	\$ 3,248
Make-whole payment, based on 4% of lost system sales	<u>3</u>	<u>5</u>
Total royalty income	3,761	3,253
Expenses	<u>(138)</u>	<u>(116)</u>
Net earnings of the Partnership for the period	3,623	3,137
KRL's interest in the net earnings of the Partnership.....	<u>(1,823)</u>	<u>(1,735)</u>
Equity income for the period	<u>\$ 1,800</u>	<u>\$ 1,402</u>

The gross sales reported by the 91 Keg restaurants on which KRL pays a royalty to the Partnership (the "Royalty Pool") are from January 1 to March 31, 2006 (January 1 to March 31, 2005 – 86 Keg restaurants).

On January 1, 2006, seven new Keg restaurants that opened during the period from October 3, 2004 to October 2, 2005 were added to the Royalty Pool. The gross sales of these seven new restaurants have been estimated at \$30.7 million annually. Two permanently closed Keg restaurants with annual sales of \$6.0 million have been removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$24.7 million annually.

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, 2006 (January 1 to March 31, 2005 – one restaurant closure).

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, 2006 and 2005

3. UNITHOLDER DISTRIBUTIONS:

	January 1 to March 31, <u>2006</u>	January 1 to March 31, <u>2005</u>
Distributions declared to Fund unitholders	\$ <u>1,603</u>	\$ <u>1,468</u>
Weighted average Fund units outstanding (note 6(a)).....	<u>8,569,611</u>	<u>8,153,500</u>
Distributions declared per unit	\$ <u>0.18</u>	\$ <u>0.18</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.

4. DUE FROM KEG RESTAURANTS LTD.:

	March 31, <u>2006</u>	December 31, <u>2005</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.

5. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

For the three months ended March 31, 2006 and 2005

6. UNITHOLDERS' EQUITY:

(a) Fund units:

On May 31, 2002, the Fund issued 8,153,500 Fund units at \$10.00 per unit pursuant to a public underwriting. Expenses of the offering amounted to \$2,150,000 and were charged to unitholders' equity.

On July 4, 2005, the Fund issued 250,000 Fund units to KRL in exchange for 250,000 Class B units. The fair value of these units was approximately \$13.25 which resulted in an additional \$3,312,500 recorded as unitholders' equity. Thereafter, on July 6, 2005, KRL sold these 250,000 Fund units through the facilities of the Toronto Stock Exchange.

On March 9, 2006, the Fund issued 650,000 Fund units to KRL in exchange for 650,000 Class B units. The fair value of these units was approximately \$12.69 which resulted in an additional \$8,248,500 recorded as unitholders' equity. Thereafter, on March 14, 2006, KRL sold these 650,000 Fund units through the facilities of the Toronto Stock Exchange.

The declaration of trust of the Fund provides that an unlimited number of Fund units may be issued. Each Fund unit is transferable and represents an equal undivided beneficial interest in any distributions of the Fund and in the net assets of the Fund. All units have equal rights and privileges. Each Fund unit entitles the holder thereof to participate equally in the allocations and distributions and to one vote at all meetings of Fund unitholders for each whole Fund unit held. The Fund units issued are not subject to future calls or assessments.

Fund units are redeemable at any time at the option of the holder at a price based on market value as defined in the trust agreement, subject to a maximum of \$50,000 in cash redemptions by the Fund in any one month. The limitation may be waived at the discretion of the Trustees of the Fund. Redemption in excess of these amounts, assuming no waiving of the limitation, shall be paid by way of a pro-rata distribution of Partnership securities held by the Fund.

(b) Exchangeable Partnership units:

	March 31, <u>2006</u>	December 31, <u>2005</u>
Class A Partnership units (i)	905,944	905,944
Class B Partnership units (ii)	<u>1,395,982</u>	<u>1,371,730</u>
	<u><u>2,301,926</u></u>	<u><u>2,277,674</u></u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2006 and 2005

6. UNITHOLDERS' EQUITY (CONTINUED):

(b) Exchangeable Partnership units (continued):

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

- (i) The Class A units are entitled to a preferential proportionate distribution equal to the distribution on the Class C Partnership units, multiplied by the number of Class A units divided by the number of LP units issued and outstanding. KHT holds all of the 8,153,500 LP units issued and outstanding at March 31, 2006. In addition, the Class A units receive a residual distribution proportionately with the Class B 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, 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.
- (ii) 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. Class B units held by KRL are exchangeable for Fund units based upon a defined calculation that itself is based on system sales from new restaurants. As at March 31, 2006, 1,395,982 (December 31, 2005 – 1,371,730) Class B units held by KRL receive a distribution entitlement.

In addition to these exchangeable Class B units, KRL also holds 1,080,718 (December 31, 2005 – 1,754,970) Class B units which are not yet entitled to receive distributions and are not exchangeable for Fund units.

7. SUPPLEMENTARY CASH FLOW INFORMATION:

	January 1 to March 31, 2006	January 1 to March 31, 2005
(a) Change in non-cash operating working capital:		
Due from Keg Restaurants Ltd. (note 4)	\$ -	\$ (1)
Due to The Keg Rights Limited Partnership	443	352
Interest payable on term loan	<u>6</u>	<u>-</u>
	<u>\$ 449</u>	<u>\$ 351</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2006 and 2005

7. SUPPLEMENTARY CASH FLOW INFORMATION (CONTINUED):

	January 1 to March 31, <u>2006</u>	January 1 to March 31, <u>2005</u>
(b) Supplementary information:		
Interest received	\$ 1,056	\$ 1,055
Interest paid	193	164
Non-cash transactions:		
Issuance of Fund units to acquire additional interest in The Keg Rights Limited Partnership	8,249	-