

THE KEG ROYALTIES INCOME FUND

THIRD QUARTER REPORT

For the three and nine months ended September 30, 2004

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 September 30, 2004. The Fund's earnings and cash flows have continued to generate distributions to unitholders in the expected amount of 9 cents per unit per month, or \$1.08 per unit on an annual basis.

RESULTS

The Keg has once again reached a new sales record for the third quarter. The gross sales reported by the 86 Keg restaurants in the Royalty Pool were \$73,505,000, an increase of \$6,892,000 or 10.3% from the third quarter of 2003. Total system sales for the Keg were even more impressive at \$80,670,000 for the quarter, an increase of \$8,397,000 or 11.6% over the comparable quarter of the prior year. These higher system sales reflect the very successful new Keg restaurants which have opened since October 2, 2003 and which will be added to the Royalty Pool on January 1, 2005.

The Fund generated earnings of \$2,169,000 or 26.6 cents/unit, compared with \$2,072,000 or 25.4 cents/unit for the same quarter of the prior year, an increase of \$97,000 or 4.7%. The earnings increase is primarily attributable to the increase in royalty revenue but is also due in part to a decrease in the operating expenses of the Fund. Distributable cash available to pay distributions to unitholders increased by \$75,000 or 3.6% to \$2,174,000 or 26.7 cents/unit from \$2,099,000 or 25.8 cents/unit for the third quarter of the prior year.

OUTLOOK

Following challenging back-to-back years in 2002 and 2003, the foodservice industry appears to be resuming the growth it has typically enjoyed over the past twenty-five years. The perfect storm of one-time events that plagued the industry in 2003 in particular would appear to have been just that – a series of one-time events.

We feel that The Keg's strategies through the past two difficult years will continue to yield positive sales results through the balance of 2004. Overall growth continues at The Keg. Keg management remains committed to maintaining and improving the legendary high standards that have come to define the brand. Most importantly, The Keg continues to deliver consistently great overall experiences and as a result continues to enjoy the loyalty of its guests.

Sincerely,



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

November 9, 2004

FINANCIAL HIGHLIGHTS

	July 1 to Sept 30, 2004	July 1 to Sept 30, 2003	Jan. 1 to Sept 30, 2004	Jan. 1 to Sept 30, 2003
(\$000's except restaurants and per unit amounts)				
Restaurants in the Royalty Pool	86	81	86	81
Gross sales reported by Keg restaurants in the Royalty Pool	<u>\$ 73,505</u>	<u>\$ 66,613</u>	<u>\$ 221,487</u>	<u>\$ 205,250</u>
Royalty income	\$ 3,004	\$ 2,677	\$ 8,956	\$ 8,231
Interest income	<u>1,075</u>	<u>1,078</u>	<u>3,203</u>	<u>3,201</u>
Total income	4,079	3,755	12,159	11,432
Expenses	(273)	(314)	(815)	(928)
Non-controlling interest ⁽¹⁾	<u>(1,637)</u>	<u>(1,369)</u>	<u>(4,744)</u>	<u>(4,133)</u>
Earnings for the period	<u>\$ 2,169</u>	<u>\$ 2,072</u>	<u>\$ 6,600</u>	<u>\$ 6,371</u>
Basic and diluted earnings per Fund unit	<u>\$.27</u>	<u>\$.25</u>	<u>\$.81</u>	<u>\$.78</u>
Distributable cash per Fund unit ⁽²⁾	<u>\$.27</u>	<u>\$.26</u>	<u>\$.82</u>	<u>\$.79</u>
Distributions declared per Fund unit	<u>\$.27</u>	<u>\$.27</u>	<u>\$.81</u>	<u>\$.81</u>

Notes:

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

⁽²⁾ 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 Fund unit is computed as earnings for the period plus non-cash items such as non-controlling interest and amortization less cash required for distributions to non-controlling interest, divided by the number of Fund units issued and outstanding.

	Sept 30, 2004	Dec 31, 2003
Total Assets	\$ 175,889	\$ 172,378
Total Liabilities	101,480	98,698

SUMMARY OF QUARTERLY FINANCIAL RESULTS

	Q3 2004	Q2 2004	Q1 2004	Q4 2003
(\$000's except restaurants and per unit amounts)				
Restaurants in the Royalty Pool	86	86	86	81
Gross sales reported by Keg restaurants in the Royalty Pool	<u>\$ 73,505</u>	<u>\$ 72,091</u>	<u>\$ 75,891</u>	<u>\$ 75,067</u>
Royalty income	\$ 3,004	\$ 2,916	\$ 3,036	\$ 3,017
Interest income	1,075	1,064	1,064	1,079
Total income	4,079	3,980	4,100	4,096
Expenses	(273)	(262)	(281)	(345)
Non-controlling interest ⁽¹⁾	(1,637)	(1,545)	(1,562)	(1,438)
Earnings for the period	<u>\$ 2,169</u>	<u>\$ 2,173</u>	<u>\$ 2,257</u>	<u>\$ 2,313</u>
Basic and diluted earnings per Fund unit	<u>\$.27</u>	<u>\$.27</u>	<u>\$.28</u>	<u>\$.28</u>
Distributable cash per Fund unit ⁽²⁾	<u>\$.27</u>	<u>\$.27</u>	<u>\$.28</u>	<u>\$.29</u>
Distributions declared per Fund unit	<u>\$.27</u>	<u>\$.27</u>	<u>\$.18</u>	<u>\$.36</u>

	Q3 2003	Q2 2003	Q1 2003	Q4 2002
(\$000's except restaurants and per unit amounts)				
Restaurants in the Royalty Pool	81	81	81	80
Gross sales reported by Keg restaurants in the Royalty Pool	<u>\$ 66,613</u>	<u>\$ 65,161</u>	<u>\$ 73,476</u>	<u>\$ 67,285</u>
Royalty income	\$ 2,677	\$ 2,615	\$ 2,939	\$ 2,729
Interest income	1,078	1,068	1,055	1,078
Total income	3,755	3,683	3,994	3,807
Expenses	(314)	(314)	(301)	(327)
Non-controlling interest ⁽¹⁾	(1,369)	(1,359)	(1,405)	(1,309)
Earnings for the period	<u>\$ 2,072</u>	<u>\$ 2,010</u>	<u>\$ 2,288</u>	<u>\$ 2,171</u>
Basic and diluted earnings per Fund unit	<u>\$.25</u>	<u>\$.25</u>	<u>\$.28</u>	<u>\$.27</u>
Distributable cash per Fund unit ⁽²⁾	<u>\$.26</u>	<u>\$.25</u>	<u>\$.28</u>	<u>\$.27</u>
Distributions declared per Fund unit	<u>\$.27</u>	<u>\$.27</u>	<u>\$.18</u>	<u>\$.36</u>

MANAGEMENT DISCUSSION AND ANALYSIS

**For the Quarter Ended September 30, 2004
As of November 9, 2004**

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. 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 is also the lender to KRL of a \$57.0 million loan (the "Keg Loan") with interest income accruing at 7.5% per annum, payable monthly.

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

KRL effectively owns 17.58% of the units of the Fund on a fully diluted basis through its ownership of Partnership units and has the obligation to pay monthly royalties to the Fund.

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 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 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 each year when the actual full year performance of the new restaurants is 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 actual gross sales of these three new restaurants were \$13.2 million for the 52 weeks ended September 28, 2003. Two permanently closed Keg restaurants with annual sales of \$3.8 million were removed from the Royalty Pool. This resulted in KRL receiving an Additional Entitlement equivalent to 310,815 Fund units effective as of January 1, 2003. The total number of restaurants in the Royalty Pool 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.

THE ROYALTY POOL (CONTINUED)

On January 1, 2004, seven new Keg restaurants that opened during the period from October 3, 2002 through October 2, 2003 were added to the Royalty Pool. The gross sales of these seven new restaurants have been estimated at \$25.2 million annually. Two permanently closed Keg restaurants with annual sales of \$4.6 million have been removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$20.6 million annually. The total number of restaurants in the Royalty Pool has increased to 86. The yield of the Fund units was determined to be 11.66% calculated using a weighted average unit price of \$9.26. 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 653,193 Fund units, being 6.52% of the Fund units on a fully diluted basis.

On January 1, 2004, KRL received 80% of this entitlement representing the equivalent of 522,554 Fund units, being 5.28% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2004 once the actual performance of the new restaurants has been confirmed. Including the initial portion of Additional Entitlement described above, KRL has the right to exchange its units in the capital of the Partnership for 1,739,314 Fund units, representing 17.58% of the Fund units on a fully diluted basis. If KRL were to receive 100% of the estimated Additional Entitlement for 2004, it would have the right to exchange its Partnership units for 1,869,952 Fund units, representing 18.66% of the Fund units on a fully diluted basis. 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.

OWNERSHIP OF THE FUND

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

	September 30, 2004 ⁽¹⁾		September 30, 2003	
	<u>#</u>	<u>%</u>	<u>#</u>	<u>%</u>
Fund units held by public unitholders	8,153,500	82.40	8,153,500	87.40
Exchangeable Partnership units held by KRL:				
Class A ⁽²⁾	905,944	9.16	905,944	9.71
Class B ⁽³⁾	<u>833,370</u>	<u>8.42</u>	<u>269,351</u>	<u>2.89</u>
	<u>1,739,314</u>	<u>17.58</u>	<u>1,175,295</u>	<u>12.60</u>
Total units	<u>9,892,814</u>	<u>100.00</u>	<u>9,328,795</u>	<u>100.00</u>

Notes:

⁽¹⁾ Information is current as of November 9, 2004.

⁽²⁾ Represents KRL's initial 10% ownership of the Fund, prior to the entitlement to Class B units.

⁽³⁾ Represents KRL's cumulative entitlement to the date indicated as a result of adding net sales to the Royalty Pool on an annual basis.

SYSTEM SALES

While the Fund's income is 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		39 weeks ended	
	Oct 3, 2004	Sept 28, 2003	Oct 3, 2004	Sept 28, 2003
Corporate Keg restaurants	\$ 41,746	\$ 38,384	\$ 128,743	\$ 120,323
Franchised Keg restaurants ⁽¹⁾	<u>38,924</u>	<u>33,889</u>	<u>108,776</u>	<u>98,473</u>
Total system sales	<u>\$ 80,670</u>	<u>\$ 72,273</u>	<u>\$ 237,519</u>	<u>\$ 218,796</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.

THIRD QUARTER

Total system sales for the 13 weeks ended October 3, 2004 were \$80.7 million compared to \$72.3 million for the 13 weeks ended September 28, 2003, an increase of \$8.4 million or 11.6%. During the 13 weeks ended October 3, 2004, no new restaurants were opened or closed. During the 13-week period of the prior year, no restaurants were opened or closed. As at October 3, 2004, there were a total of 87 restaurants as compared with the 86 restaurants at September 28, 2003.

The Keg's same store sales (sales of restaurants that operated during the entire period of both the current year and the prior year) increased by 6.4% in Canada and by 1.2% 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 quarter increased by 4.1%. The average exchange rate moved from 1.38 in KRL's fourth quarter of fiscal 2003 to 1.30 in KRL's fourth quarter of fiscal 2004, significantly reducing the Canadian dollar equivalent of the U.S. restaurant sales.

YEAR TO DATE

System sales for the 39 weeks ended October 3, 2004 were \$237.5 million compared to \$218.8 million for the 39 weeks ended September 28, 2003, an increase of \$18.7 million or 8.7%. During the 39 weeks ended October 3, 2004, two new franchised restaurants were opened and three corporate restaurants were closed. The three closures were of restaurants located in the Portland, Oregon area due to lease expiries, which had been planned as part of an ongoing property rationalization process. During the 39-week period of the prior year, one new corporate restaurant and one new franchised restaurant were opened, no restaurants were closed and one franchised restaurant was relocated.

YEAR TO DATE (CONTINUED)

The Keg's same store sales (sales of restaurants that operated during the entire 39-week period of both the current year and the prior year) increased by 3.0% in Canada and decreased by 0.9% in the United States. The decline in same store sales in the United States was completely attributable to the closure of lunch operations at three restaurants earlier in the year. After translating the sales of the U.S. restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 39-week period increased by 0.8%. The average exchange rate moved from 1.43 in KRL's 39-week period of fiscal 2003 to 1.33 in KRL's 39-week period of fiscal 2004, significantly reducing the Canadian dollar equivalent of the U.S. restaurant sales.

OPERATING RESULTS

THIRD QUARTER

Gross sales reported by the restaurants in the Royalty Pool increased from \$66,613,000 to \$73,505,000 for the comparable quarter. The increase of \$6,892,000 or 10.3% reflects the net impact of the addition of five net new restaurants to the Royalty Pool at the beginning of the year and the same store sales increases discussed above.

Royalty income increased by \$327,000 from \$2,677,000 in the third quarter of 2003 to \$3,004,000 in the third quarter of 2004 as a result of the increase in gross sales for the reasons explained above.

Operating expenses for the quarter ended September 30, 2004 were \$273,000 and included general and administrative expenses of \$94,000, interest on the long-term debt in the amount of \$150,000 and amortization on the deferred financing charges of \$29,000. General and administrative expenses decreased by \$2,000 over the comparable quarter in 2003. Interest costs have decreased by \$39,000 in the quarter as a result of a decrease in the average interest rate on the Fund debt from 5.09% in the third quarter of 2003 to 4.18% in the third quarter of 2004.

The non-controlling interest expense, which represents KRL's effective interest in the earnings of the Fund, has increased from \$1,369,000 for the three months ended September 30, 2003 to \$1,637,000 for the three months ended September 30, 2004. This increase is due to KRL's increased effective ownership in the Fund from 12.60% to 17.58% as a result of the new store roll-in on January 1, 2004.

Net earnings increased by \$97,000 from \$2,072,000 in the third quarter of 2003 to \$2,169,000 in the third quarter of 2004. Earnings per Fund unit were 26.6 cents compared to 25.4 cents for the comparable quarter in the prior year. Cash available for distribution during the quarter amounted to 26.7 cents per Fund unit versus the 25.8 cents per Fund unit available in the comparable quarter of the prior year. Distributions of 27 cents per Fund unit were declared in the third quarter of both 2004 and 2003. The difference between the Fund's earnings and distributable cash is due to non-cash items included in the Fund's operating expenses and the difference between the non-controlling interest in earnings and the cash required for distributions to the non-controlling interest.

THIRD QUARTER (CONTINUED)

It is currently anticipated that the monthly distributions to unitholders will continue to be 9.0 cents per unit for the remainder of the current fiscal year, which equates to an annualized distribution of \$1.08 per unit.

OPERATING RESULTS

YEAR TO DATE

Gross sales reported by the restaurants in the Royalty Pool increased from \$205,250,000 to \$221,487,000 for the comparable nine-month period. The increase of \$16,237,000 or 7.9% reflects the net impact of the addition of five net new restaurants to the Royalty Pool at the beginning of the year and the same store sales declines discussed above.

Royalty income increased by \$725,000 from \$8,231,000 for the first nine months of 2003 to \$8,956,000 for the first nine months in 2004 as a result of the increase in gross sales for the reasons explained previously.

Operating expenses for the nine months ended September 30, 2004 were \$815,000 and included general and administrative expenses of \$263,000, interest on the long-term debt in the amount of \$466,000 and amortization on the deferred financing charges of \$86,000. General and administrative expenses decreased by \$20,000 over the comparable period in 2003. Interest costs have decreased by \$93,000 in the period primarily as a result of a decrease in the average interest rate on the Fund debt from 5.14% in the first three quarters of 2003 to 4.32% in the first three quarters of 2004.

The non-controlling interest expense, which represents KRL's effective interest in the earnings of the Fund, has increased from \$4,133,000 for the nine months ended September 30, 2003 to \$4,744,000 for the nine months ended September 30, 2004. This increase is due to KRL's increased effective ownership in the Fund from 12.60% to 17.58% as a result of the new store roll-in on January 1, 2004.

Net earnings increased by \$229,000 from \$6,371,000 in the first three quarters of 2003 to \$6,600,000 in the first three quarters of 2004. Earnings per Fund unit were 80.9 cents compared to 78.1 cents for the comparable period in the prior year. Cash available for distribution during the period amounted to 82.0 cents per Fund unit versus the 79.1 cents per Fund unit available in the comparable period of the prior year. Distributions of 81.0 cents per Fund unit were paid in the first nine months of both 2004 and 2003.

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 Keg Holdings Trust, a subsidiary of the Fund, has a \$14 million non-revolving term loan facility, which was 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. Certain conditions must be maintained for the term loan to be in good standing, all of which have been met.

The Partnership also has a \$1 million operating line of credit (previously \$2 million but subsequently reduced to \$1 million on October 28, 2004), which 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 and to help finance, if necessary, 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 intangible assets. Intangible assets consisting of the Keg Rights are recorded at cost. The Keg Rights are not amortized as they have an indefinite life. Management of The Keg GP Ltd., as the general partner of the Partnership and administrator of the Fund, reviews the carrying value for the intangible assets at least annually, taking into consideration any events or circumstances which might have impaired the carrying value. If a permanent decline in the carrying amount is determined, the intangible assets are written down to their estimated net recoverable amount. Management believes that there has been no decline in the carrying value of the intangible assets as of September 30, 2004.

FINANCIAL INSTRUMENTS

The Fund's financial instruments consist of cash, accounts receivable, loan receivable, accounts payable and accrued liabilities and the term loan. Management estimates that the fair value of these financial instruments approximate their carrying values. It is Management's opinion that the Fund is not exposed to significant interest or credit risks arising from these financial instruments.

SUBSEQUENT EVENT

On October 28, 2004 the Fund amended the terms of the credit facilities of its subsidiaries (see "Liquidity & Capital Resources" above). The maturity date on the \$14 million non-revolving term loan was extended to October 28, 2007 and the interest rate was increased from bank prime plus 0.375% to bank prime plus 0.50%. Availability under the operating line of credit was reduced from \$2 million to \$1 million with the interest rate remaining at bank prime plus 0.25%. The Trustees of the Fund believe that a \$1 million facility is sufficient to meet the current financing requirements of the Fund as the operating line has not been utilized to the extent originally anticipated at the time of the Fund's IPO. The reduction in the operating line of credit will also result in the elimination of standby fee charges on the portion of the line that was not utilized.

OUTLOOK

Management of KRL 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 believes that the strong same store sales growth KRL has delivered in the past will 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 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 the three target markets, specifically Phoenix, Arizona, Denver, Colorado and Dallas, Texas. KRL management also 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 years.

Management of KRL expects to add one new corporate restaurant, two new franchised restaurants and to relocate one corporate restaurant during the balance of 2004. Management of KRL 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 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 bylaws 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 and 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, and accordingly, the amount of the royalty and impact the 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.

THE RESTAURANT INDUSTRY (CONTINUED)

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 two cases of BSE found in North America during 2003. 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 expects the demand for beef to remain strong among consumers and its supply to continue uninterrupted.

FLUCTUATIONS IN FOREIGN EXCHANGE RATES

KRL presently has 18 restaurants located in the United States, 17 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.

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.kegsteakhouse.com

THE KEG ROYALTIES INCOME FUND

CONSOLIDATED
FINANCIAL STATEMENTS
For the three and nine months ended September 30, 2004

CONSOLIDATED BALANCE SHEETS

(Expressed in thousands of dollars)

	September 30, <u>2004</u> (unaudited)	December 31, <u>2003</u> (audited)
ASSETS		
Current assets:		
Cash	\$ 3	\$ -
Due from Keg Restaurants Ltd. (note 6)	1,567	1,633
Prepaid expenses and deposits	<u>68</u>	<u>35</u>
	1,638	1,668
Loan receivable from Keg Restaurants Ltd.	57,000	57,000
Intangible assets (note 7)	117,174	113,547
Deferred financing charges	<u>77</u>	<u>163</u>
	<u>\$ 175,889</u>	<u>\$ 172,378</u>
LIABILITIES AND UNITHOLDERS' EQUITY		
Current liabilities:		
Bank indebtedness	\$ -	\$ 197
Accounts payable and accrued liabilities (note 9(b))	287	198
Interest payable on term loan	7	7
Distributions payable to Fund unitholders	-	734
Distributions payable to non-controlling interest	<u>-</u>	<u>541</u>
	294	1,677
Term loan	14,000	14,000
Non-controlling interest (note 8)	87,186	83,021
Unitholders' equity	<u>74,409</u>	<u>73,680</u>
	<u>\$ 175,889</u>	<u>\$ 172,378</u>

Subsequent event (note 10)

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board of Trustees



C.C. Woodward, Trustee



George Tidball, Trustee

CONSOLIDATED STATEMENTS OF EARNINGS

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

	July 1 to Sept 30, <u>2004</u>	July 1 to Sept 30, <u>2003</u>	January 1 to Sept 30, <u>2004</u>	January 1 to Sept 30, <u>2003</u>
Gross sales reported by Keg restaurants in the Royalty Pool (note 3)	\$ <u>73,505</u>	\$ <u>66,613</u>	\$ <u>221,487</u>	\$ <u>205,250</u>
Revenue:				
Royalty income (note 3)	\$ 3,004	\$ 2,677	\$ 8,956	\$ 8,231
Interest income	<u>1,075</u>	<u>1,078</u>	<u>3,203</u>	<u>3,201</u>
	4,079	3,755	12,159	11,432
Expenses:				
General and administrative	94	96	263	283
Interest and financing fees	150	189	466	559
Amortization of deferred financing charges.....	<u>29</u>	<u>29</u>	<u>86</u>	<u>86</u>
	273	314	815	928
Earnings before non-controlling interest	3,806	3,441	11,344	10,504
Non-controlling interest (note 8)	<u>1,637</u>	<u>1,369</u>	<u>4,744</u>	<u>4,133</u>
Net earnings for the period	\$ <u>2,169</u>	\$ <u>2,072</u>	\$ <u>6,600</u>	\$ <u>6,371</u>
Basic and diluted earnings per Fund Unit (8,153,500 units)	\$ <u>0.27</u>	\$ <u>0.25</u>	\$ <u>0.81</u>	\$ <u>0.78</u>

CONSOLIDATED STATEMENTS OF UNITHOLDER'S EQUITY

(Expressed in thousands of dollars - unaudited)

	July 1 to Sept 30, <u>2004</u>	July 1 to Sept 30, <u>2003</u>	January 1 to Sept 30, <u>2004</u>	January 1, to Sept 30, <u>2003</u>
Balance, beginning of period	\$ 74,441	\$ 74,432	\$ 73,680	\$ 73,803
Net earnings for the period	2,169	2,072	6,600	6,371
Distributions declared to Fund unitholders (note 5)	<u>(2,201)</u>	<u>(2,201)</u>	<u>(5,871)</u>	<u>(5,871)</u>
Balance, end of period	\$ <u>74,409</u>	\$ <u>74,303</u>	\$ <u>74,409</u>	\$ <u>74,303</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars - unaudited)

	July 1 to Sept 30, <u>2004</u>	July 1 to Sept 30, <u>2003</u>	January 1 to Sept 30, <u>2004</u>	January 1 to Sept 30, <u>2003</u>
Cash provided by (used for):				
OPERATIONS:				
Net earnings for the period	\$ 2,169	\$ 2,072	\$ 6,600	\$ 6,371
Items not involving cash:				
Amortization of deferred financing charges.....	29	29	86	86
Non-controlling interest	1,637	1,369	4,744	4,133
Change in non-cash operating working capital (note 9(a))	<u>21</u>	<u>(64)</u>	<u>10</u>	<u>(72)</u>
	3,856	3,406	11,440	10,518
FINANCING:				
Distributions paid to Fund unitholders (note 5)	(2,201)	(2,201)	(6,604)	(6,604)
Distributions paid to non-controlling interest	<u>(1,548)</u>	<u>(1,365)</u>	<u>(4,636)</u>	<u>(4,127)</u>
	<u>(3,749)</u>	<u>(3,566)</u>	<u>(11,240)</u>	<u>(10,731)</u>
Increase in cash (bank indebtedness).....	107	(160)	200	(213)
Bank indebtedness, beginning of period.....	<u>(104)</u>	<u>(93)</u>	<u>(197)</u>	<u>(40)</u>
Cash (bank indebtedness), end of period	<u>\$ 3</u>	<u>\$ (253)</u>	<u>\$ 3</u>	<u>\$ (253)</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 and nine months ended September 30, 2004 and 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 year ended December 31, 2003. 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, 2003.

2. CHANGE IN ACCOUNTING POLICY:

Effective January 1, 2004, the Fund prospectively adopted new recommendations of the Canadian Institute of Chartered Accountants on what constitutes Canadian generally accepted accounting principles and its sources. The Class B units issued by The Keg Rights Limited Partnership (the "Partnership"), a subsidiary of the Fund, which are held by Keg Restaurants Ltd. ("KRL") are entitled to receive distributions from the Partnership and are exchangeable for Fund units. As a result of this change, these units are recorded at their fair value at the date of determination of their respective annual entitlement. The increase in value of these Class B units has been accounted for as an additional cost of the purchase of the trademarks, trade names, operating procedures and systems and other intellectual property (collectively, the "Keg Rights") from KRL and accordingly has been reflected as an increase in the value of intangible assets. The effect of this change on the current year's financial statements is to increase the value of intangible assets and non-controlling interest by \$3,627,169 (note 7). There is no impact to net earnings as a result of this change.

3. GROSS SALES:

The gross sales reported by the 86 Keg restaurants on which KRL pays a royalty (the "Royalty Pool") are from January 1, 2004 to September 30, 2004 (January 1, 2003 to September 30, 2003 – 81 Keg restaurants).

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 three restaurant closures for the period from January 1, 2004 to September 30, 2004 (January 1, 2003 to September 30, 2003 – one restaurant closure).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and nine months ended September 30, 2004 and 2003

3. GROSS SALES (CONTINUED):

	July 1 to Sept 30, <u>2004</u>	July 1 to Sept 30, <u>2003</u>	January 1 to Sept 30, <u>2004</u>	January 1 to Sept 30, <u>2003</u>
System sales reported by Keg restaurants in the Royalty Pool	\$ <u>73,505</u>	\$ <u>66,613</u>	\$ <u>221,487</u>	\$ <u>205,250</u>
Royalty income at 4% of system sales reported above	\$ 2,940	\$ 2,665	\$ 8,859	\$ 8,210
Make-whole payment, based on 4% of lost system sales.....	<u>64</u>	<u>12</u>	<u>97</u>	<u>21</u>
Total royalty income.....	<u>\$ 3,004</u>	<u>\$ 2,677</u>	<u>\$ 8,956</u>	<u>\$ 8,231</u>

4. DISTRIBUTABLE CASH:

	July 1 to Sept 30, <u>2004</u>	July 1 to Sept 30, <u>2003</u>	January 1 to Sept 30, <u>2004</u>	January 1 to Sept 30, <u>2003</u>
Earnings for the period	\$ 2,169	\$ 2,072	\$ 6,600	\$ 6,371
Amortization of deferred financing charges.....	29	29	86	86
Non-controlling interest	<u>1,637</u>	<u>1,369</u>	<u>4,744</u>	<u>4,133</u>
	3,835	3,470	11,430	10,590
Distributable cash required for non-controlling interest	<u>(1,661)</u>	<u>(1,371)</u>	<u>(4,747)</u>	<u>(4,140)</u>
Distributable cash available for Fund unitholders.....	<u>\$ 2,174</u>	<u>\$ 2,099</u>	<u>\$ 6,683</u>	<u>\$ 6,450</u>
Distributions declared to Fund unitholders (8,153,500 units)	<u>\$ 2,201</u>	<u>\$ 2,201</u>	<u>\$ 5,871</u>	<u>\$ 5,871</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.

5. UNITHOLDER DISTRIBUTIONS:

The \$733,815 difference between the \$5,870,520 in distributions declared and the \$6,604,335 in distributions paid to Fund unitholders during the period from January 1, 2004 to September 30, 2004 is due to the declaration of the January 2004 distribution on December 31, 2003. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and nine months ended September 30, 2004 and 2003

6. DUE FROM KEG RESTAURANTS LTD.:

	Sept 30, <u>2004</u>	Dec 31, <u>2003</u>
Royalty fee, including GST	\$ 1,216	\$ 1,270
Interest on note receivable from Keg Restaurants Ltd.	<u>351</u>	<u>363</u>
	<u>\$ 1,567</u>	<u>\$ 1,633</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. INTANGIBLE ASSETS:

On May 31, 2002, the Partnership acquired the Keg Rights from KRL for \$113,546,820 of which \$30,487,380 was paid in cash, \$9,059,440 was paid by the issuance of 905,944 Class A Partnership units ("Class A Units"), \$17,000,000 was paid by the issuance of 3,376,700 Class B Partnership units ("Class B Units") and \$57,000,000 was paid by the issuance of 5,700,000 Class C Partnership units ("Class C Units").

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 3).

On January 1, 2004, the number of Keg restaurants in the Royalty Pool was increased by seven restaurants opened during the period from October 3, 2002 to October 2, 2003 less two restaurants which had permanently closed (2003 – net increase of one restaurant). In exchange for adding these restaurants to the Royalty Pool, and assuming 100% of the estimated entitlement for these restaurants is received, KRL's additional entitlement will be equivalent to 653,193 Fund units (2003 – 310,815 Fund units). KRL will also receive a proportionate increase in monthly distributions from the Partnership. On January 1, 2004, KRL received 80% of this entitlement, representing the equivalent of 522,554 Fund units. The yield of the Fund units was determined to be 11.66% (2003 – 11.25%) calculated using a weighted average unit price of \$9.26 (2003 - \$9.60).

As described in note 2, the Fund has adopted a policy of accounting for the entitlement of the Class B Units based on the fair value of these units at the date of determination of the entitlement which results in an increase in intangible assets and non-controlling interest.

	Sept 30, <u>2004</u>
Intangible assets (Keg Rights):	
Initial consideration	\$ 113,547
2003 adjustment to Royalty Pool	1,419
2004 initial adjustment to Royalty Pool	<u>2,208</u>
	<u>\$ 117,174</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and nine months ended September 30, 2004 and 2003

8. NON-CONTROLLING INTEREST:

Non-controlling interest relates to KRL's interest in the Partnership, as follows:

	Sept 30, <u>2004</u>	Dec 31, <u>2003</u>
905,944 Class A Units	\$ 9,059	\$ 9,059
833,370 Entitled Class B Units (December 31, 2003 – 310,815 units).....	7,823	1,565
2,543,330 Non-entitled Class B Units (December 31, 2003 – 3,065,885 units)	12,804	15,435
5,700,000 Class C Units	<u>57,000</u>	<u>57,000</u>
	86,686	83,059
Non-controlling interest in earnings of the Partnership, net of distributions declared, beginning of period	(38)	(9)
Non-controlling interest in earnings of the Partnership	4,744	5,571
Distributions declared to non-controlling interest.....	(4,094)	(5,600)
Distributions included in accounts payable and accrued liabilities on Class B Units that receive entitlement on December 31, 2004 (note 9(b)).....	<u>(112)</u>	<u>-</u>
	<u>500</u>	<u>(38)</u>
Balance, end of period	<u>\$ 87,186</u>	<u>\$ 83,021</u>

As described in note 7, KRL added seven new restaurants (2003 – three restaurants) to the Royalty Pool and two permanently closed restaurants were removed from the Royalty Pool (2003 – two restaurants) on January 1, 2004.

In accordance with the terms of the Partnership agreements, the Fund provided entitlements for KRL to receive distributions on an estimated 653,193 (2003 – 310,815) Class B Units in exchange for the addition of these restaurants to the Royalty Pool, 80% of which was received by KRL on January 1, 2004. As described in note 2, the Fund has adopted a policy of accounting for the entitlement of Class B Units as an increase in the value of the entitled units based on their estimated fair value at the determination date of the entitlement which results in an increase in intangible assets and non-controlling interest.

9. SUPPLEMENTARY CASH FLOW INFORMATION:

	July 1 to Sept 30, <u>2004</u>	July 1 to Sept 30, <u>2003</u>	January 1 to Sept 30, <u>2004</u>	January 1 to Sept 30, <u>2003</u>
(a) Change in non-cash operating working capital:				
Accounts receivable	\$ -	\$ -	\$ -	\$ 1
Due from Keg Restaurants Ltd. (note 6) ..	(5)	(54)	66	117
Prepaid expenses and deposits	16	1	(33)	(60)
Accounts payable and accrued liabilities ..	<u>10</u>	<u>(11)</u>	<u>(23)</u>	<u>(130)</u>
	<u>\$ 21</u>	<u>\$ (64)</u>	<u>\$ 10</u>	<u>\$ (72)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three and nine months ended September 30, 2004 and 2003

9. SUPPLEMENTARY CASH FLOW INFORMATION (CONTINUED):

	July 1 to Sept 30, <u>2004</u>	July 1 to Sept 30, <u>2003</u>	January 1 to Sept 30, <u>2004</u>	January 1 to Sept 30, <u>2003</u>
(b) Supplementary information:				
Interest received	\$ 1,086	\$ 1,078	\$ 3,215	\$ 3,213
Interest paid	150	189	466	559
Non-cash transactions:				
Increase in the value of intangible assets and non-controlling interest as a result of the fair value adjustment for the Entitled Class B Units (notes 7 and 8) ..	-	-	3,627	-
Distributions included in accounts payable and accrued liabilities on Class B Units that receive entitlement on December 31, 2004 (note 8).....	112	-	112	-

10. SUBSEQUENT EVENT:

On October 28, 2004, the Fund and its subsidiaries entered into an amended credit facility with a major Canadian Chartered Bank to extend the term of the \$14,000,000 term loan until October 28, 2007 and reduce the operating line of credit from \$2,000,000 to \$1,000,000. The term loan bears interest at bank prime plus 0.50% and the operating line of credit bears interest at bank prime plus 0.25% and is repayable on demand. A general security agreement over the assets of the Fund is provided as security.