BUSINESS ACQUISITION REPORT

Item 1. Identity of Company

1.1 Name and Address of Company

Cara Operations Limited
199 Four Valley Drive
Vaughan, Ontario L4K 0B8

1.2 Executive Officer

For further information, please contact Ken Grondin, Chief Financial Officer at (905) 760-2244.

Item 2. Details of Acquisition

2.1 Nature of Business Acquired

All amounts in this business acquisition report are stated in Canadian Dollars (CDN$) unless stated otherwise.

On January 23, 2018, Cara Operations Ltd. (the "Company" or "Cara") and Keg Restaurants Ltd. ("KRL") announced that Cara and KRL agreed to merge pursuant to the terms of a binding letter of intent. Cara and KRL subsequently announced that the merger (the "Transaction") successfully closed February 22, 2018.

Vancouver-based KRL is the owner/operator and franchisor of casual dining steakhouse restaurants operating under the trade name "The Keg Steakhouse & Bar" in Canada and in select markets in the United States. Over its 45 year history and under CEO David Aisenstat's leadership for the last 20 years, The Keg has established an enviable brand name and reputation as the leader in service, food and ambiance in full service restaurants.

With this merger, Mr. Aisenstat assumed oversight of Cara's higher-end casual brands, namely The Bier Markt, the Landing Group and Milestones restaurants. Mr. Aisenstat has also remained President and CEO of KRL and is expected to join the Cara Board of Directors as Vice-Chairman after confirmation at Cara's Annual General Meeting on May 11, 2018. Starting May 10, 2018, Bill Gregson who holds the position of President and CEO of Cara and is Chairman of the Cara Board of Directors will transition his CEO duties to Frank Hennessey and Mr. Gregson will take on the role of Executive Chairman of the Cara Board.

The Keg Royalties Income Fund (the "Fund") is a limited purpose, open-ended trust established under the laws of the Province of Ontario that, through The Keg Rights Limited Partnership, a subsidiary of the Fund, owns certain trademarks and other related intellectual property used by KRL. In exchange for use of those trademarks and other related intellectual property, KRL pays the Fund a royalty of 4% of gross sales of The Keg restaurants included in the royalty pool. As part of the Transaction, Cara and KRL agreed with the Fund that, notwithstanding the merger, KRL will continue to operate as it has previously under Mr. Aisenstat's leadership, without any change in management's focus on sales, growing The Keg restaurants and corresponding royalties to the Fund. The Fund has remained in its current form and is continuing to receive royalties from The Keg restaurants operated by KRL.

2.2 Date of Acquisition

February 22, 2018.

2.3 Consideration

Cara paid to KRL's shareholders, Fairfax Financial Holdings Limited ("Fairfax") and Mr. Aisenstat, an aggregate purchase price of approximately $200 million comprised of $105 million in cash and 3,801,284 Cara subordinate voting shares. Cara funded the cash portion of the purchase price by drawing on its existing credit facility. Of the subordinate voting shares issued, 3,400,000 were issued to Fairfax, a related party, as partial consideration that resulted in Fairfax beneficially owning 7,224,180 subordinate voting shares of Cara immediately following closing plus 19,903,378 multiple voting shares, representing 43.5% of Cara's total issued and outstanding shares and 56.9% voting control.

In addition to $200 million in up front consideration, Cara may be required to pay up to an additional $30 million of cash consideration upon the achievement of certain financial milestones within the first three fiscal years following closing. Of the potential $30 million in total cash consideration, $17 million has been recorded as a contingent liability on Cara's unaudited pro forma consolidated statements of financial position (balance sheet) as at December 31, 2017 in *merger reserve* within Shareholders' Equity / (Deficiency) with a corresponding increase in other long-term liabilities.

2.4 Effect on Financial Position

Cara elected not to account for the merger as a business combination under IFRS 3 Business Combinations, as the Transaction represented a combination of entities under common control of Fairfax. Accordingly, the combination was recorded on a book value basis.

For additional information on the effect of the Transaction on Cara's financial position, see the pro forma consolidated statement of financial position (balance sheet) and consolidated statement of earnings (including EPS) for the 53 weeks ended December 31, 2017 which are referred to in Item 3 below.

2.5 Prior Valuations

The Transaction, which constitutes a "related party transaction" as defined in Multilateral Instrument 61-101 – *Protection of Minority Security Holders in Special*

Transactions, was unanimously approved by the board of directors of Cara, on the recommendation of a special committee of the board that was comprised of directors that were independent of Fairfax. In making its recommendation, Cara's special committee received a fairness opinion from Scotiabank to the effect that, as of the date of such opinion and subject to the assumptions, limitations and qualifications set forth therein, the consideration payable by Cara, from a financial point of view, was fair to the shareholders of Cara, excluding Fairfax.

The transaction was also unanimously approved by the board of directors of KRL.

2.6 Parties to Transaction

The Transaction was deemed to be a related party transaction as it represented a combination of entities under common control of Fairfax.

2.7 Date of Business Acquisition Report

May 8, 2018 (75 days from February 22, 2018 acquisition date and 2 days before Cara's anticipated release of its 2018 first quarter results).

The pro forma financial reports included with this Business Acquisition Report combine Cara's financial results for the 53 weeks ended December 31, 2017 and KRL's financial results for the 52 weeks ended October 1, 2017; there is a 91-day difference between these year-end dates.

Item 3. Financial Statements and Other Information

Included with this business acquisition report are the following financial statements and other financial information of KRL and Cara as required by Part 8 of National Instrument 51-102 — *Continuous Disclosure Obligations,* subject to any exemptions therefrom:

(a) consolidated audited financial statements of KRL, including consolidated statements of financial position as at October 1, 2017 and October 2, 2016 and consolidated statements of comprehensive income, changes in shareholders' deficiency, and cash flows of KRL for the 52 weeks ended October 1, 2017 and 53 weeks ended October 2, 2016, together with the notes thereto;

(b) the Independent Auditors' Report on the consolidated financial statements for KRL for the 52 weeks ended October 1, 2017 and 53 weeks ended October 2, 2016;

(c) unaudited condensed interim consolidated financial statements of KRL, including consolidated statements of financial position as at December 31, 2017 and consolidated statements of comprehensive income, changes in shareholders' deficiency, and cash flows of KRL for the 13 weeks ended December 31, 2017 and January 1, 2017, together with the notes thereto;

(d) unaudited pro forma consolidated financial statements of Cara giving effect to the Transaction, together with the notes thereto, including:

(i) an unaudited pro forma consolidated statement of financial position (balance sheet) as at December 31, 2017 that gives effect to the Transaction as if it had taken place on December 26, 2016; and

(ii) an unaudited pro forma consolidated statement of earnings (including EPS) for the 53 weeks ended December 31, 2017 that gives effect to the Transaction as if it had taken place on December 26, 2016

Cara's 2017 audited consolidated financial statements provide additional information, including detailed financial statement note disclosure, that can be referenced. These statements were filed on sedar.com on March 9, 2018.

Index to Financial Statements

Notice to Reader

The attached consolidated financial statements of Keg Restaurants Ltd. for the years ended October 1, 2017 and October 2, 2016 are being refiled to correct the deferred income taxes amount on page 4. No other changes have been made to this document.

KEG RESTAURANTS LTD.

CONSOLIDATED FINANCIAL STATEMENTS

52 weeks ended October 1, 2017
53 weeks ended October 2, 2016

Provided as a supplement to the consolidated financial statements of
The Keg Royalties Income Fund

KPMG LLP
PO Box 10426 777 Dunsmuir Street
Vancouver BC V7Y 1K3
Canada
Telephone (604) 691-3000
Fax (604) 691-3031

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Keg Restaurants Ltd.

We have audited the accompanying consolidated financial statements of Keg Restaurants Ltd., which comprise the consolidated statement of financial position as at October 1, 2017 and October 2, 2016, the consolidated statements of comprehensive income, changes in shareholders' deficiency and cash flows for the 52 week and 53 week periods then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Keg Restaurants Ltd. as at October 1, 2017 and October 2, 2016, and its consolidated financial performance and its consolidated cash flows for the 52 and 53 weeks then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants

December 11, 2017
Vancouver, Canada

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Expressed in thousands of dollars)

	Note	October 1, 2017	October 2, 2016
ASSETS			
Current assets:			
Cash and cash equivalents		$ 10,044	$ 18,418
Accounts receivable	5, 17(a)	7,729	7,130
Inventories		5,429	5,121
Prepaid expenses and other assets		2,871	3,741
Distributions receivable from the Partnership	5, 17(c)	940	836
Current portion of other receivables	5, 17(b)	14,522	8,871
		41,535	44,117
Other receivables	5, 17(b)	991	1,187
Property, plant and equipment	6	89,331	71,052
Exchangeable unit investment in the Partnership	8	73,940	75,362
Class C unit investment in the Partnership	7	57,000	57,000
Intangible assets	4, 9	4,716	-
Deferred income taxes	15	24,080	24,706
		$ 291,593	$ 273,424
LIABILITIES AND SHAREHOLDERS' DEFICIENCY			
Current liabilities:			
Accounts payable and accrued liabilities	17(a), (c)	$ 29,266	$ 32,984
Current portion of unearned revenue	3(k)	60,554	54,460
Current portion of long-term debt	11(a)	4,000	4,000
Current portion of note payable	12	196	186
		94,016	91,630
Unearned revenue	3(k)	5,181	1,744
Long-term debt	11	30,725	24,779
Note payable	12	241	437
Note payable to The Keg Royalties Income Fund	10	57,000	57,000
Deferred gain on sale of Keg Rights	13	127,518	126,294
Shareholders' deficiency:			
Share capital	14	1	1
Accumulated other comprehensive income	2(c)	1,568	2,152
Deficit		(24,657)	(30,613)
		(23,088)	(28,460)
		$ 291,593	$ 273,424

Commitments and contingent liabilities (note 19)

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

Approved on behalf of the Board of Directors

"David Aisenstat"
David Aisenstat, Director

"Paul Rivett"
Paul Rivett, Director

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Expressed in thousands of dollars)

	Note	52 weeks ended October 1, 2017	53 weeks ended October 2, 2016
Revenue:			
Restaurant sales		$ 293,978	$ 286,198
Franchise fee income		16,293	15,749
Retail sales		12,483	10,854
		322,754	312,801
Operating expenses:			
Restaurant operating costs	21	(250,833)	(244,086)
Restaurant pre-opening costs	3(l)	(1,266)	(799)
Royalty expense	17(e)	(23,999)	(23,558)
Amortization of restaurant assets	6	(11,160)	(11,544)
Retail operating costs		(11,939)	(10,144)
Profit from operations		23,557	22,670
General and administrative expenses	22	(17,960)	(19,178)
Amortization of corporate and intangible assets	6	(569)	(519)
Executive bonus	18	(250)	(150)
Profit before undernoted		4,778	2,823
Interest income on Exchangeable Partnership units	8, 17(e)	5,584	5,314
Interest income on Class C Partnership units	7, 17(e)	4,275	4,275
Interest expense	23	(5,063)	(5,789)
Amortization of deferred gain	13	1,518	1,494
Loss on disposal of property, plant and equipment	6	(529)	(1,570)
Profit before changes in fair value adjustment and taxes		10,563	6,547
Change in fair value of Exchangeable Partnership units	8	(4,163)	13,656
Profit before income taxes		6,400	20,203
Income tax expense:			
Current	15	(12)	(32)
Deferred	15	(432)	(597)
		(444)	(629)
Profit for the period		5,956	19,574
Other comprehensive loss	2(c)	(584)	(179)
Total comprehensive income for the period		$ 5,372	$ 19,395

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' DEFICIENCY

(Expressed in thousands of dollars)

	Share capital	Accumulated other comprehensive income	Deficit	Total shareholders' deficiency
Balance, September 28, 2015	$ 1	$ 2,331	$ (50,187)	$ (47,855)
Comprehensive income (loss) for the period	-	(179)	19,574	19,395
Balance, October 2, 2016	$ 1	$ 2,152	$ (30,613)	$ (28,460)
Balance, October 3, 2016	$ 1	$ 2,152	$ (30,613)	$ (28,460)
Comprehensive income (loss) for the period	-	(584)	5,956	5,372
Balance, October 1, 2017	$ 1	$ 1,568	$ (24,657)	$ (23,088)

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars)

	Note	52 weeks ended October 1, 2017	53 weeks ended October 2, 2016
Cash provided by (used for):			
OPERATIONS:			
Profit for the period		$ 5,956	$ 19,574
Items not involving cash:			
Amortization		11,729	12,063
Amortization of deferred gain		(1,518)	(1,494)
Change in fair value of Exchangeable Partnership units	8	4,163	(13,656)
Loss on disposal of property, plant and equipment		529	1,570
Deferred income tax expense	15	432	597
Interest income on Exchangeable Partnership units	8, 17(e)	(5,584)	(5,314)
Interest income on Class C Partnership units	7, 17(e)	(4,275)	(4,275)
Interest expense	23	5,063	5,789
Current income tax expense	15	12	32
Interest received on Exchangeable Partnership units	8	5,480	5,374
Interest received on Class C Partnership units	7	4,275	4,275
Interest received on cash balances		121	92
Income taxes paid	15	(12)	(32)
Changes in non-cash operating working capital	25	167	1,253
		26,538	25,848
INVESTING:			
Additions to property, plant and equipment	6	(27,598)	(11,592)
Net costs on disposal of property, plant and equipment	6	(64)	(1,176)
Acquisition of franchised restaurants	4	(8,063)	-
Other receivables	17(b)	186	177
		(35,539)	(12,591)
FINANCING:			
Deferred financing charges		(195)	(15)
Repayment of note payable	12	(186)	(177)
Issuance of long-term debt	4, 11	10,000	-
Repayment of long-term debt	11	(4,000)	(4,000)
Interest paid		(5,029)	(5,659)
		590	(9,851)
Increase (decrease) in cash		(8,411)	3,406
Foreign currency translation adjustment		37	(1)
Cash and cash equivalents, beginning of period		18,418	15,013
Cash and cash equivalents, end of period		$ 10,044	$ 18,418
Non-cash transactions:			
Receipt of Additional Entitlement on Royalty Pool net sales roll-in	8, 13	$ 2,741	$ 1,082

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended October 1, 2017
53 weeks ended October 2, 2016

1. ORGANIZATION AND NATURE OF BUSINESS:

Keg Restaurants Ltd. ("KRL") was formed by the amalgamation of Resolut Corporation, Raleigh Corporation, Raleigh Investments Ltd., Raleigh Restaurants Inc. and Keg Restaurants Ltd. under the laws of Ontario. Its principal business activity is the operation and franchising of Keg steakhouse restaurants and bars in Canada and the United States ("US"). KRL is registered and domiciled in Canada and its principal business office is located at 10100 Shellbridge Way, Richmond, British Columbia. As at October 1, 2017, Fairfax Financial Holdings Limited owns a 51% controlling interest in KRL.

These consolidated financial statements include the accounts of KRL, and its wholly-owned subsidiaries Keg Brands Inc., St. Paul Street (Montreal) Restaurants Ltd. and Keg Restaurants U.S., Inc ("KUS"). All significant intercompany transactions and balances have been eliminated on consolidation.

2. BASIS OF PREPARATION:

(a) Statement of compliance:

These consolidated financial statements, including comparatives, have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements were authorized for issue by KRL's Board of Directors on December 11, 2017.

(b) Fiscal year end and interim periods:

KRL's fiscal year end falls on the Sunday closest to September 30th, in any year. As a result of the floating year-end date, approximately every fifth fiscal year contains 53 weeks of operations and one of the related interim quarters contains 14 weeks of operations.

(c) Functional and presentation currency:

These consolidated financial statements are presented in Canadian dollars, which is KRL's functional currency. The majority of KRL's operations are located in Canada and are conducted in Canadian dollars. KRL's US operations are conducted in US dollars and use the US dollar as their functional currency. The US entities' financial statements have been translated into Canadian dollars using the exchange rate in effect for asset and liability amounts and at the average rate for the period for amounts included in the determination of profit (loss).

Cumulative unrealized gains or losses arising from the translation of the assets and liabilities of the US operations into Canadian dollars are recorded as other comprehensive income. There are no other items included in accumulated other comprehensive income.

2. BASIS OF PREPARATION (CONTINUED):

(d) Use of estimates and judgements:

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities, revenue and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Significant estimates and judgements made by management in the application of IFRS that have a significant effect on the amounts recognized in these consolidated financial statements are as follows:

(i) Exchangeable unit investment in The Keg Rights Limited Partnership (the “Partnership”) (note 8):

The Exchangeable unit investment in the Partnership is comprised of Class A, B, and D units (“Exchangeable Partnership units” or “Exchangeable units”) and is measured at fair value through profit and loss. The value of additional Keg restaurants rolled into the Royalty Pool (note 13) is also recognized as part of KRL’s Exchangeable unit investment in the Partnership through the entitlement of additional Class D units (“Additional Entitlement”).

The value of the Additional Entitlement is determined on a formula that is designed to estimate the present value of the cash flows due to The Keg Royalties Income Fund (the “Fund”) as a result of the sales of new Keg restaurants being added to the Royalty Pool on an annual basis. As such, the calculation is dependent on a number of variables including the estimated long-term sales of the new Keg restaurants and a discount rate. The value of the Additional Entitlement as a result of adding the sales of new Keg restaurants to the Royalty Pool could differ materially from actual results.

(ii) Fair value adjustment of Exchangeable Partnership units (note 8):

KRL measures the Exchangeable Partnership units as a financial asset at fair value through profit or loss. KRL estimates the fair value of the Exchangeable Partnership units using the closing market price of the publicly traded units of the Fund (the “Fund units”) on the Toronto Stock Exchange (“TSX”). The Exchangeable Partnership units have similar distribution and voting rights as the Fund units and are exchangeable into Fund units on a one-for-one basis, thus, it is estimated that the fair value of an Exchangeable Partnership unit approximates the market value of a Fund unit. This valuation technique may not represent the actual value of the financial asset should the Exchangeable Partnership units be exchanged.

2. BASIS OF PREPARATION (CONTINUED):

(d) Use of estimates and judgements (continued):

(iii) Deferred income taxes:

The determination of deferred income taxes requires the use of judgements and estimates in determining the timing when taxable differences will reverse and the appropriate tax rates to be applied. If certain judgements or estimates prove to be inaccurate, or if certain tax rates or laws change, KRL's results of operations and financial position could be materially impacted.

(iv) Impairment of property, plant and equipment:

Property, plant and equipment are tested for impairment when events or changes in circumstances indicate the carrying amount may not be recoverable. An impairment test requires management to forecast the future cash flows expected to be derived from the assets and these cash flows must then be discounted by an appropriate discount rate selected by management. If actual cash flows differ from these forecasts or if KRL's cost of capital differs from the discount rate chosen, KRL's results of operations and financial position could be materially impacted.

(v) Unearned revenue:

Giftcards that remain unredeemed after two years are recognized as income as the likelihood of redemption subsequent to that period is remote based on historical redemption patterns. The amount of any giftcards previously included in income is expensed in the year of redemption. If redemption patterns differ significantly from historical patterns, KRL's results of operations and financial position could be materially impacted.

(vi) Provisions:

Provisions are recorded when a present legal or constructive obligation exists as a result of past events where it is probable that an outflow or resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount can be made. If the effect of time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects the current market assessment of the time value of money and, where appropriate, the risks specific to the liability. Risk is reflected by adjusting either the cash flows or the discount rate. If these judgements and estimates applied prove to be inaccurate, KRL's results of operations and financial position could be materiality impacted.

(vii) Consolidation:

Applying the criteria outlined in IFRS 10, judgement is required in determining whether KRL controls the Partnership. Making this judgement involves taking into consideration the concept of power over the Partnership, exposure to variable returns, and the ability to use power to direct the relevant activities of the Partnership so as to generate economic returns. Using these criteria, management has determined that KRL does not ultimately control the Partnership.

3. SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of measurement:

These consolidated financial statements have been prepared on the historical cost basis, except for the following material items in the statements of financial position:

- Exchangeable unit investment in the Partnership is measured at fair value through profit or loss.
- Embedded derivative of the Class C unit investments in the Partnership is measured at fair value through profit or loss.

(b) Cash and cash equivalents:

Cash consists of cash on hand and balances on deposit with banks. Amounts receivable from credit card companies are considered cash equivalents because they are both short term and highly liquid in nature.

(c) Receivables (note 5):

Accounts and other receivables are stated at amounts expected to be ultimately realized. A provision is made for receivables when recovery is considered uncertain.

(d) Inventories:

Inventories, which consist of food, beverages and tableware, are stated at the lower of cost (first-in, first-out) and net realizable value.

(e) Class C and Exchangeable unit investments in the Partnership (note 7 and note 8):

The Class C unit investment in the Partnership is accounted for as a financial asset at amortized cost with its embedded derivative being measured at a fair value of $nil.

The Exchangeable units are accounted for as a financial asset at fair value through profit or loss.

Comprehensive income includes distributions recorded as interest income as it is earned on the Class C and Exchangeable Partnership units held by KRL, and the impact of fair value adjustments on the Exchangeable Partnership units (note 2(d)(ii)).

The Partnership was established to hold the trademarks and trade names used in connection with the operation of Keg restaurants in Canada and the US (the "Keg Rights"). KRL and the Partnership also entered into a License and Royalty Agreement (the "License and Royalty Agreement") to allow KRL to use the Keg Rights for a term of 99 years, for which KRL pays the Partnership a royalty of 4% of gross sales of the Keg restaurants included in the Royalty Pool (note 13).

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(f) Investments in associates:

KRL's total investment in the Partnership is comprised of the following financial assets:

- Class C unit investment in the Partnership measured at amortized cost.
- Exchangeable unit investment in the Partnership measured at fair value through profit or loss.
- Investment of ten common shares in the The Keg G.P. Ltd. ("KGP") and one general partnership unit in the Partnership measured at amortized cost.

KRL's equity investment in the Partnership is represented by the investment in KGP. The value of the equity investment in the Partnership is nominal as substantially all of the cash flows from the Partnership are attributable to the Class C and Exchangeable Partnership units.

KRL has significant influence over the Partnership as it controls over 20% of the Partnership's voting rights. However, KRL does not control the Partnership as it does not have the power to govern its financial and operating activities or the relevant activities of the investment.

(g) Property, plant and equipment (note 6):

Property, plant and equipment are stated at cost less accumulated amortization and accumulated impairment write-downs.

Cost includes expenditures that are directly attributable to the acquisition of an asset. Subsequent costs are included in the asset's carrying value or recognized as a separate asset, as appropriate, only when it is probable that the future economic benefits associated with the item will flow to KRL and the costs can be measured reliably. The carrying value of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to consolidated statement of comprehensive income (loss) during the period in which they were incurred.

KRL allocates the amount initially recognized in respect of property, plant and equipment to its significant components and depreciates each such part. Residual values, methods of amortization and useful lives of the assets are reviewed annually and adjusted when appropriate.

Gains and losses on disposals of property, plant and equipment are determined by comparing the proceeds, net of disposal costs, with the carrying value of the asset and are included in the consolidated statement of comprehensive income (loss) during the period in which the disposal occurred.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(g) Property, plant and equipment (note 6) (continued):

Construction in progress is stated at cost and is not amortized until the project is complete. Construction in progress relates to the construction of new Keg restaurants and to significant improvements to existing Keg restaurants. When completed, the total cost of construction in progress is transferred to property, plant and equipment and is amortized over the life of each individual asset.

KRL reviews the carrying value of property, plant and equipment on an ongoing basis, taking into consideration any events or circumstances which might have impaired the carrying value. The primary indicators of impairment in value are a decline in sales and profitability levels on an individual restaurant basis. If the net recoverable amount of the property, plant and equipment is less than the carrying amount, the asset is written down to its estimated net recoverable amount. The net recoverable amount is determined as the greater of the estimated fair value less costs to sell or the value in use.

(h) Amortization of property, plant and equipment (note 6):

Amortization is calculated to allocate the cost of an asset, less any residual value, over its estimated useful life.

KRL allocates the amount initially recognized in respect of an item of property, plant and equipment to its significant components and amortizes each such component separately. Amortization of property, plant and equipment is calculated on a straight-line basis at the following rates:

Description	Rate
Leasehold improvements	Lesser of estimated useful life and expected lease term, including cancellable option periods, to a maximum of 20 years
Equipment and furnishings	3 to 6 years

(i) Intangible assets (note 9):

Intangible assets consist of reacquired franchise rights which are amortized on a straight-line basis over the remaining term of the respective franchise agreements. The amortization periods end between June 2021 and July 2028. Amortization of intangible assets are included in amortization of corporate and intangible assets on the statement of comprehensive income (loss).

(j) Deferral and amortization of gain on sale of Keg Rights (note 13):

The gain on the sale of Keg Rights is deferred and amortized on a straight-line basis over the 99-year term of the Licence and Royalty Agreement ending on May 30, 2101. Amortization is charged to comprehensive income (loss).

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(k) Revenue recognition and unearned revenue:

Revenue from restaurant operations is recognized when services are rendered and recorded net of discounts.

Franchise fees are recorded as they are earned which, in the case of initial franchise fees for the sale of a franchise, is at the time the restaurant is opened for business to the public.

Retail sales are derived from KRL's wholly owned subsidiary Keg Brands Inc., which sells Keg branded food and liquor products. Sales are recognized when products are delivered and collectability is reasonably assured.

Unearned revenue consists primarily of the aggregate amount of giftcards issued by KRL during the last two years, which remain unredeemed. Giftcards that remain unredeemed after two years are recognized as income as the likelihood of redemption subsequent to that period is remote based on historical redemption patterns. The amount of any giftcards previously included in income is expensed in the year of redemption. Gift certificates and giftcards issued by franchises are recorded only when redeemed at a corporately owned restaurant and the corresponding amount is subsequently recovered from the franchisee. The amount of unredeemed gift certificates and giftcards held by franchises are not expected to result in any loss to KRL.

The long-term portion of unearned revenue represents leasehold inducements that are being amortized as a reduction in rent over the term of the lease.

(l) Restaurant pre-opening costs:

Pre-opening costs are non-capital expenditures associated with opening new corporate restaurants, which are incurred prior to the restaurant opening for business. They include food and beverage costs, staff and management costs and other restaurant operating costs, as well as travel and accommodation costs for the training and management teams.

(m) Income taxes (note 15):

Income tax comprises current and deferred tax expense and is recognized in comprehensive income (loss).

Current tax expense is the expected tax payable on taxable income for the period, using enacted or substantively enacted tax rates at the reporting date, adjusted for amendments to taxes payable in respect of previous periods.

Deferred taxes are recognized in respect of temporary differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in comprehensive income in the period that includes the enactment date. The carrying amount of deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(m) Income taxes (note 15) (continued):

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off tax assets against tax liabilities and when they relate to income taxes levied by the same taxation authority and KRL intends to settle its tax assets and liabilities on a net basis or when tax assets and liabilities will be realized simultaneously.

Deferred tax primarily arises because of temporary differences on the Class C and Exchangeable unit investments in the Partnership and the deferred gain on sale of the Keg Rights.

(n) Long-term debt (note 11):

Long-term debt is initially recognized at fair value net of any financing fees, and subsequently at amortized cost with any difference between the proceeds (net of financing fees) and the redemption value recognized in the consolidated statement of comprehensive income (loss) over the term of the loan using the effective interest rate method.

(o) Financial instruments:

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

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

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

(i) Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is generally classified in this category if acquired principally for the purposes of selling or repurchasing in the short term. Derivatives are also included in this category unless they are designated as hedges. The Exchangeable unit investment in the Partnership is classified as a financial asset due to the Partnership's contractual obligation to distribute cash on the Exchangeable Partnership units held by KRL, and is measured at fair value through profit or loss due to conversion features discussed in note 8.

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(o) Financial instruments (continued):

(i) Financial assets and liabilities at fair value through profit or loss (continued):

Derivative financial instruments: The right to transfer Class C Partnership units in consideration of KRL's note payable to the Fund is classified as a derivative instrument. KRL has reviewed the net impact of this potential exchange requirement on its cash flows and has determined there is no significant value applicable to this feature.

(ii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Cash and cash equivalents, accounts receivable, distributions receivable from the Partnership, other receivables, and the Class C unit investment in the Partnership are included in this category. Loans and receivables are initially recognized at the amount expected to be received less a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized costs using the effective interest method and when material, an adjustment to discount the loans and receivables to fair value.

(iii) Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable and accrued liabilities, long-term debt, note payable to the Fund, and note payable. These items are initially recognized at the amount required to be paid, less a discount to reduce the payables to fair value or transactions costs incurred. Subsequently, these items are measured at amortized cost using the effective interest rate method. Financial liabilities are classified as current liabilities if payment is due within twelve months of the balance sheet date. Otherwise, they are presented as non-current liabilities.

The carrying value of current financial assets and liabilities approximate their fair value due to their short-term nature. The carrying value of the Class C unit investment in the Partnership, note payable to the Fund, long-term debt and note payable approximates fair value based on prevailing market interest rates.

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

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

The fair value of the Exchangeable unit investment in the Partnership is determined using Level 2 inputs.

(Tabular amounts expressed in thousands of dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(o) Financial instruments (continued):

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

	October 1, 2017	October 2, 2016
Financial assets:		
Loans and receivables:		
Cash and cash equivalents	$ 10,044	$ 18,418
Accounts receivable	7,729	7,130
Distributions receivable from the Partnership	940	836
Other receivables, including current portion	15,513	10,058
Class C unit investment in the Partnership	57,000	57,000
Fair value through profit or loss:		
Exchangeable unit investment in the Partnership	73,940	75,362
	$ 165,166	$ 168,804
Financial liabilities:		
Amortized cost:		
Accounts payable and accrued liabilities	$ 29,266	$ 32,984
Note payable to The Keg Royalties Income Fund	57,000	57,000
Long-term debt, including current portion	34,725	28,779
Note payable, including current portion	437	623
	$ 121,428	$ 119,386

(p) Impairment:

(i) Financial assets:

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate.

When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through comprehensive income (loss). The reversal is limited to an amount that does not result in the asset being valued at more than what its amortized cost would have been in the absence of impairment.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(p) Impairment (continued):

(ii) Non-financial assets:

Property, plant and equipment and intangible assets are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or "CGU"s). KRL defines a CGU as an individual corporate restaurant. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

An impairment loss is reversed if there is an indication that there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the intangible asset's carrying amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognized.

(q) Accounting standards and amendments issued but not yet adopted:

(i) On July 24, 2014, the IASB issued IFRS 9, *Financial Instruments*, and the IASB subsequently published amendments to IFRS 9. IFRS 9 introduces new requirements for the classification and measurement of financial assets. Under IFRS 9, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. IFRS 9 introduces additional changes relating to financial liabilities and includes finalized guidance on the classification and measurement of financial assets. The final standard also amends the impairment model by introducing a new 'expected credit loss' model for calculating impairment, and new general hedge accounting requirements.

The IASB has deferred the mandatory effective date of the existing chapters of IFRS 9 to annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. Earlier application is permitted. KRL does not anticipate any significant impact on its financial statements or business as a result of the adoption of this new standard during its fiscal year beginning on October 1, 2018.

(ii) On May 28, 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*. IFRS 15 will replace IAS 18, *Revenue*. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based, five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgemental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The new standard is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. KRL is currently evaluating IFRS 15 and the extent of the impact on its financial statements when adopted during its fiscal year beginning on October 1, 2018.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(q) Accounting standards and amendments issued but not yet adopted (continued):

(iii) In January 2016, the IASB issued IFRS 16, *Leases*, which supersedes IAS 17, *Leases*. IFRS 16 establishes principles for the recognition, measurement, presentation and disclosure of leases. The standard establishes a single model for lessees to bring leases on-balance sheet while lessor accounting remains largely unchanged and retains the finance and operating lease distinctions. IFRS 16 is effective for annual periods beginning on or after January 1, 2019 with earlier adoption permitted but only if also applying IFRS 15, *Revenue from Contracts with Customers*. KRL is currently in the preliminary stages of evaluating the impact of IFRS 16 on its financial statements and will adopt the standard during its fiscal year beginning on September 30, 2019. However, as KRL is a lessee with many leases, this standard is expected to have a significant impact on assets, liabilities and the consolidated statement of comprehensive income.

4. ACQUISITION OF FRANCHISED RESTAURANTS:

On August 28, 2017, KRL acquired certain assets of three franchised restaurants from an existing franchise group for a total purchase price of $8.06 million. This asset purchase was considered a business combination accounted for under IFRS 3. This acquisition resulted in a new intangible asset relating to reacquired franchise rights being recorded on KRL's consolidated statements of financial position with a total value of $4.77 million. This intangible asset is being amortized on a straight-line basis to the end of the respective franchise agreements which range from June 2021 to July 2028. In addition, $3.24 million of property and equipment and $0.05 million of inventory and other net working capital items were also acquired. There was no goodwill recorded as part of this transaction.

As a result of this transaction, KRL included restaurant sales of $1.49 million and $1.30 million of restaurant operating costs in it's consolidated statement of comprehensive income. If the acquisition had occurred on October 3, 2016, KRL's restaurant sales would have been $15.15 million higher, franchise fee income would have been $0.76 million lower and restaurant operating costs would have been approximately $14.35 million higher.

KRL utilized its existing revolving credit facility to facilitate the above acquisition (note 11).

(Tabular amounts expressed in thousands of dollars)

5. RECEIVABLES:

	Note	October 1, 2017	October 2, 2016
Accounts receivable	17(a)	$ 7,729	$ 7,130
Distributions receivable from the Partnership	17(c)	940	836
Other receivables, including current portion	17(b)	15,513	10,058
		$ 24,182	$ 18,024

KRL regularly assesses all receivables for indications of impairment, and more frequently when it is determined that the receivable or a portion thereof, is unlikely to be collected. KRL continues to make every effort to collect all past-due amounts, including establishing payment plans with existing franchisees if necessary.

	October 1, 2017	October 2, 2016
Past-due accounts receivable	$ 231	$ 190
Related party past-due accounts included above	$ -	$ -

KRL considers any accounts outstanding greater than 30 days to be overdue. The $231,000 past due amounts are considered fully collectable and KRL continues to make every effort to collect all past due amounts.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended October 1, 2017
53 weeks ended October 2, 2016

6. PROPERTY, PLANT AND EQUIPMENT:

Cost	Leasehold Improvements	Equipment and Furnishings	Construction in Progress	Total
Balance, September 27, 2015	151,431	57,948	9,171	218,550
Additions	1,166	1,971	8,455	11,592
Construction completion	9,360	2,962	(12,322)	-
Disposals	(3,485)	(2,491)	(24)	(6,000)
Foreign exchange translation	(562)	(219)	(1)	(782)
Balance, October 2, 2016	$ 157,910	$ 60,171	$ 5,279	$ 223,360
Additions	1,206	2,047	24,345	27,598
Construction completion	11,971	2,640	(14,611)	-
Disposals	(2,823)	(2,235)	-	(5,058)
Foreign exchange translation	(1,562)	(823)	(45)	(2,430)
Balance, October 1, 2017	$ 166,702	$ 61,800	$ 14,968	$ 243,470

Accumulated Amortization	Leasehold Improvements	Equipment and Furnishings	Construction in Progress	Total
Balance, September 27, 2015	100,666	45,817	-	146,483
Amortization	8,343	3,720	-	12,063
Disposals	(2,080)	(2,298)	-	(4,378)
Reversal of impairment provision on disposals	(1,229)	-	-	(1,229)
Foreign exchange translation	(437)	(194)	-	(631)
Balance, October 2, 2016	$ 105,263	$ 47,045	$ -	$ 152,308
Amortization	7,885	3,844	-	11,729
Disposals	(3,835)	(2,750)	-	(6,585)
Reversal of impairment provision on disposals	(1,289)	-	-	(1,289)
Foreign exchange translation	(1,275)	(749)	-	(2,024)
Balance, October 1, 2017	$ 106,749	$ 47,390	$ -	$ 154,139
Net book value, October 2, 2016	$ 52,647	$ 13,126	$ 5,279	$ 71,052
Net book value, October 1, 2017	$ 59,953	$ 14,410	$ 14,968	$ 89,331

6. PROPERTY, PLANT AND EQUIPMENT (CONTINUED):

There were no indicators of impairment related to property, plant and equipment noted during 2017 or 2016 and as a result, no provisions were recorded.

The loss on disposal of property, plant and equipment for the 52 weeks ended October 1, 2017 included $30,000 (53 weeks ended October 2, 2016 – $549,000) in provisions for the future retirement of selected restaurant locations. These provisions are included in the $64,000 net costs on disposal of property, plant and equipment (53 weeks ended October 2, 2016 – $1,176,000 net proceeds on disposal of property, plant and equipment) shown on the consolidated statements of cash flows. The amounts represent the estimated costs KRL expects to incur in order to exit the locations, on a discounted cash flow basis. There is no remaining value attributable to the property, plant and equipment at these locations.

7. CLASS C UNIT INVESTMENT IN THE PARTNERSHIP:

The Class C unit investment in the Partnership is comprised of 5,700,000 Class C Partnership units held by KRL. The Class C Partnership units were issued to KRL as one of a series of transactions that occurred in conjunction with the Initial Public Offering ("IPO") of the Fund on May 31, 2002 (note 8).

KRL has the option at any time to transfer its 5,700,000 Class C Partnership units to The Keg Holdings Trust ("KHT"), a subsidiary of the Fund, in consideration for the assumption by KHT of an amount of the note payable equal to $10.00 for each Class C unit transferred. If KRL transferred all 5,700,000 Class C Partnership units, the entire $57,000,000 note payable to the Fund would be extinguished (note 10). The Class C units are entitled to preferential monthly distributions equal to $0.0625 per Class C unit issued and outstanding and these distributions are recorded as interest income in the statement of comprehensive income (loss).

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

8. EXCHANGEABLE UNIT INVESTMENT IN THE PARTNERSHIP:

The Exchangeable unit investment in the Partnership is comprised of the Exchangeable Partnership units held by KRL, and measured at fair value through profit or loss. The closing market price of a Fund unit as at October 1, 2017 was $20.54 (October 2, 2016 – $21.73).

The Class A Partnership units represent KRL's initial 10% effective ownership of the Fund at the date of IPO. The Class B and Class D Partnership units were received by KRL subsequent to the IPO date in return for adding net sales to the Royalty Pool on an annual basis (note 13).

	Note	October 1, 2017	Fair Value
Class A Partnership units	(i)	905,944	$ 18,608
Class B Partnership units	(ii)	176,700	3,629
Class D Partnership units	(iii)	2,517,170	51,703
		3,599,814	$ 73,940

	Note	October 2, 2016	Fair Value
Class A Partnership units	(i)	905,944	$ 19,686
Class B Partnership units	(ii)	176,700	3,840
Class D Partnership units	(iii)	2,385,447	51,836
		3,468,091	$ 75,362

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

	Total number of Exchangeable Partnership units	Fair Value
Exchangeable Partnership units, October 3, 2016	3,468,091	$ 75,362
January 1, 2017 initial estimate Class D unit entitlement (80%)	131,723	2,741
Fair value adjustment	-	(4,163)
Fair value of Exchangeable Partnership units, October 1, 2017	3,599,814	$ 73,940

8. EXCHANGEABLE UNIT INVESTMENT IN THE PARTNERSHIP (CONTINUED):

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

(i) The Class A units are entitled to a preferential proportionate distribution equal to the distribution on the Class C units, multiplied by the number of Class A units divided by the number of LP Partnership units ("LP units") issued and outstanding. KHT holds all of the 8,153,500 LP units issued and outstanding at October 1, 2017. In addition, the Class A units receive a residual distribution proportionately with the Class B units, Class D units, LP units and GP units relative to the aggregate number of each class issued and outstanding (or in the case of the Class B units and Class D units, the number issued and outstanding multiplied by the Class B and Class D current distribution entitlement, respectively). Class A units are exchangeable for Fund units on the basis of one Class A unit for one Fund unit and represent KRL's initial 10% effective ownership of the Fund prior to the entitlement of Class B and Class D units.

(ii) The Class B units were issued to KRL in return for adding net sales from new Keg restaurants to the Royalty Pool and are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership. The distribution entitlements of the Class B units were adjusted annually on January 1 until the January 1, 2008 roll-in when the Class B Termination Date was reached and the last of the Class B units became entitled. Class B units held by KRL are exchangeable for Fund units on the basis of one Class B unit for one Fund unit. Class B units held by KRL receive a distribution entitlement.

(iii) The Class D units were issued to KRL in return for adding net sales from new Keg restaurants to the Royalty Pool on an annual basis and are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership. The distribution entitlements of the Class D units are adjusted annually on January 1. Class D units held by KRL are exchangeable for Fund units on the basis of one Class D unit for one Fund unit and receive the same distribution entitlement as the Class B units. Class D units are issued subsequent to the Class B Termination Date and are identical to Class B units except that the Trustees of KHT can require KRL to surrender any or all of the issued Class D units for a price that is equal to the one originally used in the formula to calculate the number of units issued.

Distributions on Exchangeable Partnership units are recorded as interest income in the statement of comprehensive income (loss).

(Tabular amounts expressed in thousands of dollars)

9. INTANGIBLE ASSETS:

Intangible assets consist of reacquired franchise rights which are amortized over the remaining term of the respective franchise agreements (note 3(i)). Amortization of intangible assets are included in amortization of corporate and intangible assets on the statement of comprehensive income.

10. NOTE PAYABLE TO THE KEG ROYALTIES INCOME FUND:

On May 31, 2002, KRL issued a note payable to the Fund in exchange for cash of $57,000,000. KRL has the option at any time to transfer its 5,700,000 Class C Partnership units to KHT, a subsidiary of the Fund, in consideration for the assumption by KHT of an amount of the note payable equal to $10.00 for each Class C unit transferred.

Interest accrues at 7.5% per annum and is payable monthly. For the 52 weeks ended October 1, 2017, included in interest expense is $4,260,000 (53 weeks ended October 2, 2016 – $4,336,000) relating to this note.

The principal amount matures on May 31, 2042 and is subject to extension by the mutual agreement of KRL and the Fund. The note is secured by a general security agreement, including accounts receivable and inventories, that is subordinated to primary bank debt obligations and may not be assigned without the prior consent of KRL.

11. LONG-TERM DEBT:

	October 1, 2017	October 2, 2016
Canadian bank debt	$ 35,000	$ 29,000
Deferred financing charges	(275)	(221)
Current portion	(4,000)	(4,000)
	$ 30,725	$ 24,779

On September 28, 2013, KRL entered into an amended multi-option credit agreement with its Canadian banking syndicate for the expansion of restaurant operations. The revolving credit and term loan facilities, with a syndicate of two Canadian banks, are available to finance the construction of certain new corporate restaurants and major renovations in Canada.

On September 15, 2017, the maturity date of KRL's credit facilities was extended from July 2, 2018 to July 2, 2020 when the credit agreement was further amended to increase the capacity of the revolving credit facility to $35,000,000.

(Tabular amounts expressed in thousands of dollars)

11. LONG-TERM DEBT (CONTINUED):

As at October 1, 2017, these facilities are comprised of the following components:

(a) A $14,000,000 reducing term facility for KRL's existing Canadian debt.

(b) A $35,000,000 revolving facility for future restaurant expansion which is subject to annual repayment based on 25% of excess operating cash flow. Excess operating cash flow is defined in the credit agreement as operating cash flow for the financial year plus extraordinary or non-recurring items and any net decrease in working capital less interest paid, debt principal repayments, unfunded capital expenditures, income taxes paid and any net increase in working capital. Operating cash flow is defined as the sum of net income for the financial year, adjusted for gains or losses from dispositions not in the ordinary course of business, extraordinary or non-recurring items and equity income or losses from subsidiaries plus interest expense, income tax expense and depreciation and amortization. As at October 1, 2017, $21,000,000 of this facility has been drawn and is due on the July 2, 2020 maturity date. The remaining $14,000,000 is available for future restaurant expansion.

(c) A revolving demand operating facility of up to $3,000,000 available for general corporate purposes, including working capital, overdrafts and letters of credit. As at October 1, 2017, $28,000 of this facility has been used to issue letters of credit and $2,972,000 remains available.

All of the above facilities bear interest at a rate between bank prime plus 1.25% to bank prime plus 2.0% based on certain financial criteria. As at October 1, 2017, KRL meets the criteria for interest at bank prime plus 1.25%.

The above credit facilities are secured by a general security agreement and hypothecation over KRL's Canadian and US assets and a pledge of all equity interests in the Partnership. As at October 1, 2017, KRL was in compliance with all bank covenants associated with these facilities.

Future minimum principal payments as at October 1, 2017, under the various long-term debt facilities, are as follows:

Q1 2018 – Q4 2018	$ 4,000
Q1 2019 – Q4 2019	4,000
Q1 2020 – Q4 2020	27,000
	$ 35,000

(Tabular amounts expressed in thousands of dollars)

12. NOTE PAYABLE:

On November 30, 2012, KRL issued a promissory note in the amount of $2,132,000 to a company of which the minority shareholder of KRL formerly had an ownership interest. This note was issued in exchange for leasehold improvements at an office location in Vancouver, BC, and is repayable in 120 fixed monthly instalments of approximately $18,000, including an implicit interest rate of 5.0%.

The amount of the note was reduced by $600,000 on March 27, 2013 as settlement of the outstanding receivables from the same company. It was agreed that the last 36 monthly payments from November 1, 2019 to November 30, 2022 would no longer be required as part of this arrangement.

On August 1, 2014, the remaining balance of $996,000 was assumed by a company controlled by the minority shareholder of KRL in exchange for the lease and associated leasehold improvements at the office located in Vancouver, BC. Accordingly, a note receivable has been recorded from this company in an amount equal to the remaining note payable.

13. DEFERRED GAIN ON SALE OF KEG RIGHTS:

	October 1, 2017	October 2, 2016
Balance, beginning of period	$ 126,294	$ 126,706
December 31, 2015 final Class D unit entitlement	-	911
January 1, 2016 initial estimate Class D unit entitlement (80%)	-	754
December 31, 2016 final Class D unit entitlement	-	(583)
January 1, 2017 initial estimate Class D unit entitlement (80%)	2,742	-
Amortization	(1,518)	(1,494)
Balance, end of period	$ 127,518	$ 126,294

The deferred gain on sale of Keg Rights is adjusted to reflect changes in KRL's ownership interest in the Keg Rights resulting from the entitlement of Exchangeable Partnership units received as consideration for the addition of net new sales to the Royalty Pool on an annual basis.

Annually, on January 1, the Royalty Pool is adjusted to include the gross sales from new Keg restaurants that have opened on or before October 2 of the prior year, less gross sales from any Keg restaurants that have permanently closed during the prior 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 net royalty revenue added to the Royalty Pool, divided by the yield of the Fund units, divided by the weighted average unit price of the Fund units. KRL receives 80% of the estimated Additional Entitlement initially, with the balance received on December 31 each year when the actual full year performance of the new restaurants is known with certainty.

13. DEFERRED GAIN ON SALE OF KEG RIGHTS (CONTINUED):

The total number of Keg restaurants included in the Royalty Pool increased from the 80 Keg restaurants in existence on March 31, 2002, to 100 as of December 31, 2016. Sixty-two new Keg restaurants that opened during the period from April 1, 2002 through October 2, 2015, with annual gross sales of $311.3 million, were added to the Royalty Pool. Forty-two permanently closed Keg restaurants with annual sales of $130.7 million were removed from the Royalty Pool. This resulted in a net increase in Royalty Pool sales of $180.6 million annually and KRL receiving a cumulative Additional Entitlement equivalent to 5,762,147 Fund units as of December 31, 2016.

On January 1, 2017, an estimated $6.3 million in annual net sales were added to the Royalty Pool. One new restaurant that opened during the period from October 3, 2015 through October 2, 2016, with estimated gross sales of $8.0 million annually, was added to the Royalty Pool. One permanently closed Keg restaurant with annual sales of $1.7 million was removed from the Royalty Pool. The total number of restaurants in the Royalty Pool remained the same at 100. The pre-tax yield of the Fund units was determined to be 6.79% calculated using a weighted average unit price of $20.82.

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 164,654 Fund units, being 1.10% of the Fund units on a fully diluted basis.

On January 1, 2017, KRL received 80% of this entitlement, representing the equivalent of 131,723 Fund units, being 0.88% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the initial portion of the Additional Entitlement described above, KRL will have the right to exchange its units in the capital of the Partnership for 3,599,814 Fund units, representing 24.07% of the Fund units on a fully diluted basis.

The balance of the Additional Entitlement will be adjusted on December 31, 2017, to be effective January 1, 2017, once the actual performance of the new restaurant has been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2017, it would have the right to exchange its Partnership units for 3,632,745 Fund units, representing 24.24% of the Fund units on a fully diluted basis.

(Tabular amounts expressed in thousands of dollars)

52 weeks ended October 1, 2017
53 weeks ended October 2, 2016

14. SHARE CAPITAL:

Authorized:

1,000 common shares with a par value of $1 per share.

Issued:	October 1, 2017	October 2, 2016
100 common shares	$ 1	$ 1

15. INCOME TAXES:

(a) The components of income tax recognized in profit or loss are as follows:

	52 weeks ended October 1, 2017	53 weeks ended October 2, 2016
Current tax expense	$ (12)	$ (32)
Deferred tax expense	(432)	(597)
	$ (444)	$ (629)

(b) The provision for income taxes as reported differs from the amount that would be computed by applying the combined Federal and Provincial statutory income tax rates to the profit before income taxes. The reason for the differences is as follows:

	52 weeks ended October 1, 2017	53 weeks ended October 2, 2016
Profit before income taxes	$ 6,400	$ 20,203
Combined Canadian federal and provincial rates	26.47%	26.47%
Computed "expected" tax expense	1,694	5,348
Increased (reduced) by:		
Difference between statutory tax rates	(43)	5
Effect of tax rates in foreign jurisdictions	143	(20)
Permanent differences	(89)	(2,173)
Changes in unrecognized temporary differences	(1,171)	(3,779)
Other items	(90)	1,248
Total income tax expense per statement of comprehensive income	$ 444	$ 629

(Tabular amounts expressed in thousands of dollars)

15. INCOME TAXES (CONTINUED):

(c) Deferred taxes that have been recognized are comprised as follows:

	October 1, 2017	October 2, 2016
Deferred tax assets:		
Non-capital losses	$ 5,451	$ 5,489
Deferred gain	33,754	33,435
Unearned revenue and other items deductible in future periods for income tax purposes	1,750	1,025
Total deferred tax assets	40,955	39,949
Deferred tax liabilities:		
Property, plant and equipment	(2,150)	(715)
Intangible and other assets	(14,725)	(14,528)
Net deferred tax assets	$ 24,080	$ 24,706

(d) Deferred taxes that have not been recognized as deferred tax assets are comprised as follows:

	October 1, 2017	October 2, 2016
Property, plant and equipment	$ 15,198	$ 18,202
Non-capital losses	7,405	10,582
Other items	7,269	6,753
	$ 29,872	$ 35,537

(e) As at October 1, 2017, KRL has non-capital losses carried forward for Canadian tax purposes totalling approximately $6,446,000 (October 2, 2016 – $10,629,000). KRL recognizes the benefit of tax losses only to the extent of anticipated future taxable income in relevant jurisdictions. The gross amount of tax non-capital losses carried forward will start to expire in 2034.

(f) As at October 1, 2017, KRL has operating losses carried forward for US tax purposes totalling approximately $17,934,000 (US$14,370,000) (October 2, 2016 – $18,452,000 (US$14,067,000)) for which $11,012,000 (US$8,824,000) have been recognized as deferred tax assets. The use of these losses against future taxable income is restricted due to KRL's change in controlling interest during 2014. KRL recognizes the benefit of tax losses only to the extent of anticipated future taxable income in relevant jurisdictions. The gross amount of tax losses carried forward are subject to loss limitation rules and will start to expire in 2023.

(Tabular amounts expressed in thousands of dollars)

16. CAPITAL DISCLOSURES:

KRL's objectives in managing its liquidity and capital are:

- To safeguard KRL's ability to continue as a going concern;
- To provide financial capacity and flexibility to meet its strategic objectives;
- To provide adequate return to its shareholder commensurate with the level of risk; and
- Return excess cash through dividends.

	October 1, 2017	October 2, 2016
Liquidity:		
Cash and cash equivalents	$ 10,044	$ 18,418
Undrawn credit facilities	16,972	10,072
Total liquidity	$ 27,016	$ 28,490
Capitalization:		
Long-term debt, including current portion	$ 34,725	$ 28,779
Note payable, including current portion	437	623
Note payable to the The Keg Royalties Income Fund	57,000	57,000
Shareholders' deficiency	(23,088)	(28,460)
Total capitalization	$ 69,074	$ 57,942

KRL maintains financial policies and manages its liquidity and capital structure and makes adjustments to it in light of changes to economic conditions, the underlying risks inherent in its operations and capital requirements to maintain and grow its operations. KRL also has a history of generating positive cash flows from operations in the past four years, unused borrowing capacity and cash reserves of $10,044,000 which are available for use if needed.

KRL is not subject to any statutory capital requirements and has no commitments to sell or otherwise issue shares.

The undrawn credit facilities in the amount of $16,972,000 are subject to certain financial covenants and a restriction on distributions between KRL and KUS. There is also a restriction on distributions between KRL and its shareholders.

(Tabular amounts expressed in thousands of dollars)

17. RELATED PARTY TRANSACTIONS AND BALANCES:

(a) As at October 1, 2017, $nil owing from companies owned or partially owned by the minority shareholder of KRL, are included in accounts receivable (October 2, 2016 – $4,000). All of these receivables are current as of October 1, 2017 and KRL expects to collect these amounts in full. KRL also has $16,000 in amounts owing to these companies included in accounts payable and accrued liabilities at October 1, 2017 (October 2, 2016 – $4,000).

(b) Other receivables, including the current portion, as at October 1, 2017 are $15,513,000 (October 2, 2016 – $10,058,000).

Other receivables include the following:	October 1, 2017	October 2, 2016
Non-interest bearing employee demand note	$ 750	$ 750
Note receivable from a company owned by the minority shareholder, including interest	5,499	-
Note receivable from a company owned by the minority shareholder	437	623
Receivables from a company owned by the minority shareholder	8,827	8,685
Current portion	(14,522)	(8,871)
	$ 991	$ 1,187

(c) As at October 1, 2017, KRL has a $2,376,000 royalty fee payable, including GST, to the Fund (October 2, 2016 – $2,298,000) and a $363,000 interest payable amount due to the Fund on the Keg Loan (October 2, 2016 – $374,000) included in accounts payable and accrued liabilities.

As at October 1, 2017, KRL has $940,000 in distributions receivable from the Partnership (October 2, 2016 – $836,000) related to its ownership of the Class C and Exchangeable Partnership units.

(d) KRL performs accounting services for a company owned by the minority shareholder of KRL. For the 52 weeks ended October 1, 2017, KRL earned $295,000 for these services (53 weeks ended October 2, 2016 – $365,000). These amounts have been fully recognized by KRL as other income.

(e) KRL incurs royalty expense with respect to the licence and royalty agreement between KRL and the Partnership. As a result of the common directors on the board of KRL and on the board of KGP, the general partner of the Partnership, the royalty expense is treated as a related party transaction. KRL incurred royalty expense of $23,999,000 for the 52 weeks ended October 1, 2017 (53 weeks ended October 2, 2016 – $23,558,000).

KRL also records investment income on its Exchangeable and Class C units of the Partnership, which is presented as interest income in the consolidated statements of comprehensive income. During the 53 weeks ended October 1, 2017, KRL recorded investment income of $5,584,000 and $4,275,000, respectively (53 weeks ended October 2, 2016 – $5,314,000 and $4,275,000, respectively).

(Tabular amounts expressed in thousands of dollars)

18. COMPENSATION OF KEY MANAGEMENT PERSONNEL:

KRL defines key management personnel as the executive leadership team who have the authority and responsibility for overseeing, planning, directing and controlling the activities of KRL. For the 52 weeks ended October 1, 2017, total compensation for key management personnel was $2,311,000 (53 weeks ended October 2, 2016 – $2,292,000) comprised of salaries and short-term benefits.

Included in the above amounts for the 52 weeks ended October 1, 2017, an entity controlled by the minority shareholder charged KRL a management fee of $750,000 (53 weeks ended October 2, 2016 – $750,000) for the services of Mr. Aisenstat, in respect of his duties as President and CEO of KRL. Also included in the above amounts for the 52 weeks ended October 1, 2017, is a $250,000 executive bonus (53 weeks ended October 2, 2016 – $150,000), which is a discretionary amount attributable to certain Executive members and is based on several criteria, including the profitability of KRL and the performance of the Fund.

19. COMMITMENTS AND CONTINGENT LIABILITIES:

(a) Operating leases:

Minimum rentals under head leases extending to the year 2032 (excluding CPI adjustment factors and rentals based on sales) are approximately as follows:

	Total	Sub-lease reimbursement	Net
2018	$ 19,946	$ (1,728)	$ 18,218
2019	18,698	(1,214)	17,484
2020	17,160	(750)	16,410
2021	16,274	(494)	15,780
2022	15,170	(245)	14,925
Thereafter	49,492	(159)	49,333

Under the terms of certain lease agreements, KRL is contingently liable to the landlord for any default in payment by sub-lessees. At October 1, 2017, all sub-lease accounts were current.

For the 52 weeks ended October 1, 2017 and the 53 weeks ended October 2, 2016, actual operating lease expense incurred by KRL was as follows:

	Total	Sub-lease reimbursement	Net
2016	$ 18,466	$ (2,328)	$ 16,138
2017	18,822	(2,284)	16,538

19. COMMITMENTS AND CONTINGENT LIABILITIES (CONTINUED):

(b) Contingent liabilities and provisions:

(i) KRL has been named as a defendant in various lawsuits that are currently pending. In those cases where an unfavourable outcome is probable and a reliable estimate can be made, a provision for anticipated costs has been accrued. In determining the estimated exposure for pending lawsuits, KRL relies upon their understanding of the claim, including activities undertaken by the other party, as well as discussions with legal counsel. In the opinion of management, the remaining lawsuits are without substantial merit and no provision has been made for them.

(ii) KRL has issued letters of credit, in the normal course of business, totalling CDN$28,000 and US$15,000. At October 1, 2017 these amounts are covered by the $3,000,000 operating credit facility described in note 11(c) and a US$15,000 guaranteed investment certificate, respectively.

(iii) As of October 1, 2017, KRL has guaranteed lease obligations of certain franchises in the amount of $1,158,000 with lease terms extending until 2020. The principals of these franchises have given KRL personal guarantees and full indemnities for any and all costs related to the leases.

20. FINANCIAL RISK MANAGEMENT:

KRL is primarily exposed to credit risk, liquidity risk, interest rate risk and foreign currency exchange rate risk as they relate to KRL's identified financial instruments.

(a) Credit risk:

Credit risk is defined as the risk of financial loss to KRL if a counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from KRL's accounts receivable, distributions receivable and other receivables. The effective monitoring and controlling of credit risk is a core competency of KRL. Each potential franchisee must complete a thorough interview process and pass mandatory credit evaluations. Franchise receivables represent the most significant balances in accounts receivable at any given time. Other receivables are from companies owned or partially owned by the minority shareholder of KRL and are not considered a significant credit risk. KRL's maximum exposure to credit risk is the combined value of its accounts receivable, distributions receivable and other receivables, including current portion, in the amount of $24,182,000 (October 2, 2016 – $18,024,000).

The amount of past-due accounts is $231,000 of which $nil is due from related parties (notes 5 and 17(a)). There has been no provision for impaired accounts receivable determined necessary as at October 1, 2017. KRL continues to make every effort to collect all past due amounts.

(Tabular amounts expressed in thousands of dollars)

20. FINANCIAL RISK MANAGEMENT (CONTINUED):

(b) Liquidity risk:

Liquidity risk results from KRL's potential inability to meet its financial liabilities. KRL constantly monitors its operations and cash flows to ensure that current and future obligations will be met. KRL believes that its current sources of liquidity are sufficient to cover its currently known short and long-term cash obligations.

As at October 1, 2017 KRL has a working capital deficiency of $52,481,000 (October 2, 2016 – $47,513,000). This deficiency arose primarily as a result of the unearned revenue balance of $60,554,000 (October 2, 2016 – $54,460,000). The unearned revenue balance is not expected to result in a direct cash outflow for KRL as it represents gift cards that were sold by KRL, which will be settled through the future provision of services. In addition, $4,000,000 of debt is due to be repaid within the next fiscal year (note 11). While these factors create a liquidity risk, KRL has generated positive cash flows from operations in each of the past three fiscal years, has unused borrowing capacity, and as a result believes that it will have sufficient resources to satisfy all of its financial liabilities as they come due.

KRL's capital resources are comprised of cash and cash flow from operating activities. The maturities of KRL's financial liabilities are due in the following fiscal years:

	Value	Maturity
Accounts payable and accrued liabilities	$ 29,266	< 1 year
Current portion of long-term debt	4,000	< 1 year
Long-term debt	31,000	2018 to 2020
Note payable to The Keg Royalties Income Fund	57,000	2042

(c) Interest rate risk:

KRL's interest rate risk exposure is mainly related to its $35,000,000 floating rate debt. The $35,000,000 debt balance requires interest payments at between bank prime plus 1.25% to bank prime plus 2.00%, based on certain financial criteria, and net earnings would change by approximately $350,000 during a 52 week period if the prime rate changed by 1.00%. As at October 1, 2017, KRL meets the criteria for interest at bank prime plus 1.25%.

(d) Foreign currency exchange rate risk:

KRL is exposed to foreign currency exchange rate risk as a result of its operations in the US. To manage its foreign currency exchange rate risk, KRL's subsidiary in the US, KUS, conducts all of its operations in US dollars. Based on the US dollar sales and profit of KUS for the 52 weeks ended October 1, 2017, a 100 basis point change in the US dollar exchange rate would result in an approximate $507,000 (US$386,000) and $31,000 (US$24,000) change in sales and profit, respectively.

(Tabular amounts expressed in thousands of dollars)

21. RESTAURANT OPERATING COSTS:

The components of restaurant operating costs are as follows:

	52 weeks ended October 1, 2017	53 weeks ended October 2, 2016
Product costs	$ 99,705	$ 99,251
Restaurant labour costs	89,513	85,580
Operating supplies	7,919	7,694
Local marketing and promotion expenses	9,063	8,326
Other trade costs	20,915	20,054
Facility costs	23,718	23,181
	$ 250,833	$ 244,086

22. GENERAL AND ADMINISTRATIVE EXPENSES:

The components of general and administrative expenses are as follows:

	52 weeks ended October 1, 2017	53 weeks ended October 2, 2016
Corporate salaries and administrative costs	$ 13,316	$ 13,783
Marketing and advertising	7,172	7,385
Other income, net	(2,528)	(1,990)
	$ 17,960	$ 19,178

23. INTEREST EXPENSE:

The components of interest expense are as follows:

	Note	52 weeks ended October 1, 2017	53 weeks ended October 2, 2016
Interest on note payable to The Keg Royalties Income Fund	10	$ 4,260	$ 4,336
Interest on long-term debt		1,274	1,384
Deferred financing charges		142	162
Interest on bank balances and minority shareholder note receivable	15	(613)	(93)
		$ 5,063	$ 5,789

(Tabular amounts expressed in thousands of dollars)

24. SEGMENT DISCLOSURES:

KRL's principal business activity is the operation and franchising of Keg steakhouse restaurants and bars in Canada and the US; as a result, KRL is considered to operate in two reportable operating segments. The following segmented information is regularly reported to KRL's Executive Committee (KRL's chief operating decision-makers):

Geographic information:	52 weeks ended October 1, 2017	53 weeks ended October 2, 2016
Restaurant sales:		
Canada	$ 243,293	$ 234,097
United States	50,685	51,291
	$ 293,978	$ 286,198
Amortization and asset impairment:		
Canada	$ 9,878	$ 9,338
United States	1,851	2,725
	$ 11,729	$ 12,063
Net interest expense:		
Canada	$ 5,063	$ 5,789
United States	-	-
	$ 5,063	$ 5,789
Profit for the period:		
Canada	$ 2,809	$ 17,172
United States	3,147	2,402
	$ 5,956	$ 19,574

	October 1, 2017	October 2, 2016
Current assets:		
Canada	$ 34,174	$ 38,908
United States	7,361	5,209
	$ 41,535	$ 44,117
Current liabilities:		
Canada	$ 89,673	$ 87,497
United States	4,343	4,133
	$ 94,016	$ 91,630
Property, plant and equipment:		
Canada	$ 81,321	$ 62,402
United States	8,010	8,650
	$ 89,331	$ 71,052

(Tabular amounts expressed in thousands of dollars)

25. CHANGE IN NON-CASH OPERATING WORKING CAPITAL:

	Note	52 weeks ended October 1, 2017	53 weeks ended October 2, 2016
Change in non-cash operating working capital:			
Accounts receivable	5, 17(a)	$ (599)	$ (453)
Inventories		(71)	(122)
Prepaid expenses and other assets		980	(2,090)
Other receivables	17(b)	(5,642)	(2,628)
Accounts payable and accrued liabilities	17(c)	(3,731)	1,737
Unearned revenue		9,230	4,809
		$ 167	$ 1,253

KEG RESTAURANTS LTD.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

13 weeks ended December 31, 2017

13 weeks ended January 1, 2017

Provided as a supplement to the consolidated financial statements of The Keg Royalties Income Fund

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Expressed in thousands of dollars - unaudited)

	Note	December 31, 2017	October 1, 2017
ASSETS			
Current assets:			
Cash and cash equivalents		$ 29,487	$ 10,044
Accounts receivable	7(a)	26,434	7,729
Inventories		6,440	5,429
Prepaid expenses and other assets		4,541	2,871
Distributions receivable from the Partnership	7(c)	1,058	940
Current portion of other receivables	7(b)	15,107	14,522
		83,067	41,535
Other receivables	7(b)	941	991
Property, plant and equipment		90,649	89,331
Exchangeable unit investment in the Partnership	3	72,761	73,940
Class C unit investment in the Partnership	4	57,000	57,000
Intangible assets		4,552	4,716
Deferred income taxes		22,982	24,080
		$ 331,952	$ 291,593
LIABILITIES AND SHAREHOLDERS' DEFICIENCY			
Current liabilities:			
Accounts payable and accrued liabilities		$ 28,760	$ 29,266
Current portion of unearned revenue		94,551	60,554
Current portion of long-term debt	5	4,000	4,000
Current portion of note payable		198	196
		127,509	94,016
Unearned revenue		5,856	5,181
Long-term debt	5	35,754	30,725
Note payable		191	241
Note payable to The Keg Royalties Income Fund	4	57,000	57,000
Deferred gain on sale of Keg Rights	6	127,971	127,518
Shareholders' deficiency:			
Share capital		1	1
Accumulated other comprehensive income		1,634	1,568
Deficit		(23,964)	(24,657)
		(22,329)	(23,088)
		$ 331,952	$ 291,593

Subsequent events (note 14)

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

Approved on behalf of the Board of Directors

"David Aisenstat"
David Aisenstat, Director

"Paul Rivett"
Paul Rivett, Director

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Expressed in thousands of dollars - unaudited)

	Note	13 weeks ended December 31, 2017	13 weeks ended January 1, 2017
Revenue:			
Restaurant sales		$ 83,318	$ 72,526
Franchise fee income		4,136	3,977
Retail sales		1,737	1,892
		89,191	78,395
Operating expenses:			
Restaurant operating costs	8	(69,524)	(60,843)
Restaurant pre-opening costs		(597)	(130)
Royalty expense	7(e)	(6,226)	(5,931)
Amortization of restaurant assets		(3,300)	(2,695)
Retail operating costs		(1,665)	(1,871)
Profit from operations		7,879	6,925
General and administrative expenses	9	(5,459)	(4,799)
Amortization of corporate assets		(130)	(131)
Amortization of intangible assets		(163)	-
Profit before undernoted		2,127	1,995
Interest income on Exchangeable Partnership units	3, 7(f)	1,448	1,339
Interest income on Class C Partnership units	4, 7(f)	1,069	1,069
Interest expense	10	(1,160)	(1,413)
Amortization of deferred gain	6	381	375
Loss on disposal of property, plant and equipment		(41)	(120)
Profit before changes in fair value and taxes		3,824	3,245
Change in fair value of Exchangeable Partnership units	3	(2,013)	(2,148)
Profit before income taxes		1,811	1,097
Deferred income taxes		(1,118)	(561)
Profit for the period		693	536
Other comprehensive income		66	302
Total comprehensive income for the period		$ 759	$ 838

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

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' DEFICIENCY

(Expressed in thousands of dollars - unaudited)

	Share capital	Accumulated other comprehensive income	Deficit	Total shareholders' deficiency
Balance, October 3, 2016	$ 1	$ 2,152	$ (30,613)	$ (28,460)
Comprehensive income for the period	-	302	536	838
Balance, January 1, 2017	$ 1	$ 2,454	$ (30,077)	$ (27,622)
Balance, October 2, 2017	$ 1	$ 1,568	$ (24,657)	$ (23,088)
Comprehensive income for the period	-	66	693	759
Balance, December 31, 2017	$ 1	$ 1,634	$ (23,964)	$ (22,329)

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

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars - unaudited)

	Note	13 weeks ended December 31, 2017	13 weeks ended January 1, 2017
Cash provided by (used for):			
OPERATIONS:			
Profit for the period		$ 693	$ 536
Items not involving cash:			
Amortization of restaurant and corporate assets		3,430	2,826
Amortization of deferred gain	6	(381)	(375)
Amortization of intangible assets		163	-
Change in fair value of Exchangeable Partnership units	3	2,013	2,148
Loss on disposal of property, plant and equipment		41	120
Deferred income taxes		1,118	561
Interest income on Exchangeable Partnership units	3, 7(f)	(1,448)	(1,339)
Interest income on Class C Partnership units	4, 7(f)	(1,069)	(1,069)
Interest expense		1,160	1,413
Interest received on Exchangeable Partnership units	3, 7(f)	1,330	1,252
Interest received on Class C Partnership units	4, 7(f)	1,069	1,069
Interest received on cash balances		4	21
Changes in non-cash operating working capital	13	12,171	16,980
		20,294	24,143
INVESTING:			
Additions to property, plant and equipment		(4,758)	(4,555)
Other receivables		48	46
		(4,710)	(4,509)
FINANCING:			
Repayment of note payable		(48)	(46)
Issuance of long-term debt	5	6,000	-
Repayment of long-term debt	5	(1,000)	(1,000)
Interest paid		(1,108)	(1,400)
		3,844	(2,446)
Increase in cash		19,428	17,188
Foreign currency translation adjustment		15	37
Cash and cash equivalents, beginning of period		10,044	18,418
Cash and cash equivalents, end of period		$ 29,487	$ 35,643
Non-cash transactions:			
Receipt of Additional Entitlement on Royalty Pool net sales roll-in	3	$ 834	$ 2,742

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

13 weeks ended December 31, 2017
13 weeks ended January 1, 2017

1. ORGANIZATION AND NATURE OF BUSINESS:

Keg Restaurants Ltd. (“KRL”) was formed by the amalgamation of Resolut Corporation, Raleigh Corporation, Raleigh Investments Ltd., Raleigh Restaurants Inc. and Keg Restaurants Ltd. under the laws of Ontario. Its principal business activity is the operation and franchising of Keg steakhouse restaurants and bars in Canada and the United States (“US”). KRL is registered and domiciled in Canada and its principal business office is located at 10100 Shellbridge Way, Richmond, British Columbia. As at December 31, 2017, Fairfax Financial Holdings Limited owns a 51% controlling interest in KRL.

These condensed consolidated interim financial statements include the accounts of KRL, and its wholly-owned subsidiaries Keg Brands Inc., St. Paul Street (Montreal) Restaurants Ltd. and Keg Restaurants U.S., Inc (“KUS”). All significant intercompany transactions and balances have been eliminated on consolidation.

2. BASIS OF PREPARATION:

Statement of compliance:

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34, *Interim Financial Reporting*, as issued by the International Accounting Standards Board (“IASB”).

These statements represent a “condensed set of financial statements” and, accordingly, do not include all of the information required for annual financial statements. These statements should be read in conjunction with KRL’s most recent audited annual financial statements, as at and for the 52 weeks ended, October 1, 2017. These statements follow the same accounting policies and methods of their application as described in the most recent annual financial statements.

These condensed consolidated interim financial statements were authorized for issue by KRL’s Board of Directors on February 12, 2018.

3. EXCHANGEABLE UNIT INVESTMENT IN THE PARTNERSHIP:

The Exchangeable unit investment in The Keg Rights Limited Partnership (the “Partnership”) is comprised of the Exchangeable Partnership units held by KRL, and measured at fair value through profit or loss. The closing market price of a Fund unit as at December 31, 2017 was $19.99 (October 1, 2017 – $20.54).

The Class A Partnership units represent KRL’s initial 10% effective ownership of the Fund at the date of IPO. The Class B and Class D Partnership units were received by KRL subsequent to the IPO date in return for adding net sales to the Royalty Pool on an annual basis.

	Note	December 31, 2017	Fair Value
Class A Partnership units	(a)	905,944	$ 18,110
Class B Partnership units	(b)	176,700	3,532
Class D Partnership units	(c)	2,557,212	51,119
		3,639,856	$ 72,761

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

3. EXCHANGEABLE UNIT INVESTMENT IN THE PARTNERSHIP (CONTINUED):

	Note	October 1, 2017	Fair Value
Class A Partnership units	(a)	905,944	$ 18,608
Class B Partnership units	(b)	176,700	3,629
Class D Partnership units	(c)	2,517,170	51,703
		3,599,814	$ 73,940

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

	Total number of Exchangeable Partnership units	Fair Value
Exchangeable Partnership units, October 2, 2017	3,599,814	$ 73,940
December 31, 2017 final Class D entitlement adjustment	40,042	834
Fair value adjustment	-	(2,013)
Fair value of Exchangeable Partnership units, December 31, 2017	3,639,856	$ 72,761

	Total number of Exchangeable Partnership units	Fair Value
Exchangeable Partnership units, October 3, 2016	3,468,091	$ 75,362
January 1, 2017 initial estimate Class D unit entitlement (80%)	131,723	2,742
Fair value adjustment	-	(2,148)
Fair value of Exchangeable Partnership units, January 1, 2017	3,599,814	$ 75,956

	Total number of Exchangeable Partnership units	Fair Value
Exchangeable Partnership units, October 3, 2016	3,468,091	$ 75,362
January 1, 2017 initial estimate Class D unit entitlement (80%)	131,723	2,741
Fair value adjustment	-	(4,163)
Fair value of Exchangeable Partnership units, October 1, 2017	3,599,814	$ 73,940

3. EXCHANGEABLE UNIT INVESTMENT IN THE PARTNERSHIP (CONTINUED):

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

(a) The Class A units are entitled to a preferential proportionate distribution equal to the distribution on the Class C units, multiplied by the number of Class A units divided by the number of LP Partnership units ("LP units") issued and outstanding. The Keg Holdings Trust ("KHT") holds all of the 8,153,500 LP units issued and outstanding at December 31, 2017. In addition, the Class A units receive a residual distribution proportionately with the Class B units, Class D units, LP units and GP units relative to the aggregate number of each class issued and outstanding (or in the case of the Class B units and Class D units, the number issued and outstanding multiplied by the Class B and Class D current distribution entitlement, respectively). Class A units are exchangeable for Fund units on the basis of one Class A unit for one Fund unit and represent KRL's initial 10% effective ownership of the Fund prior to the entitlement of Class B and Class D units.

(b) The Class B units were issued to KRL in return for adding net sales from new Keg restaurants to the Royalty Pool and are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership. The distribution entitlements of the Class B units were adjusted annually on January 1 until the January 1, 2008 roll-in when the Class B Termination Date was reached and the last of the Class B units became entitled. Class B units held by KRL are exchangeable for Fund units on the basis of one Class B unit for one Fund unit. Class B units held by KRL receive a distribution entitlement.

(c) The Class D units were issued to KRL in return for adding net sales from new Keg restaurants to the Royalty Pool on an annual basis and are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership. The distribution entitlements of the Class D units are adjusted annually on January 1. Class D units held by KRL are exchangeable for Fund units on the basis of one Class D unit for one Fund unit and the same distribution entitlement as the Class B units. Class D units are issued subsequent to the Class B Termination Date and are identical to Class B units except that the Trustees of KHT can require KRL to surrender any or all of the issued Class D units for a price that is equal to the one originally used in the formula to calculate the number of units issued.

Distributions on Exchangeable Partnership units are recorded as interest income in the condensed consolidated statement of comprehensive income (loss).

(Tabular amounts expressed in thousands of dollars - unaudited)

4. CLASS C UNIT INVESTMENT IN THE PARTNERSHIP:

The Class C unit investment in the Partnership is comprised of 5,700,000 Class C Partnership units held by KRL. The Class C Partnership units were issued to KRL as one of a series of transactions that occurred in conjunction with the Initial Public Offering ("IPO") of the Fund on May 31, 2002.

KRL has the option at any time to transfer its 5,700,000 Class C Partnership units to KHT, a subsidiary of the The Keg Royalties Income Fund ("Fund"), in consideration for the assumption by KHT of an amount of the note payable equal to $10.00 for each Class C unit transferred. If KRL transferred all 5,700,000 Class C Partnership units, the entire $57,000,000 note payable to the Fund would be extinguished. The Class C units are entitled to preferential monthly distributions equal to $0.0625 per Class C unit issued and outstanding and these distributions are recorded as interest income in the condensed consolidated statement of comprehensive income.

5. LONG-TERM DEBT:

	December 31, 2017	October 1, 2017
Canadian bank debt	$ 40,000	$ 35,000
Deferred financing charges	(246)	(275)
Current portion	(4,000)	(4,000)
	$ 35,754	$ 30,725

6. DEFERRED GAIN ON SALE OF KEG RIGHTS:

	December 31, 2017	October 1, 2017
Balance, beginning of period	$ 127,518	$ 126,294
January 1, 2017 initial estimate Class D unit entitlement (80%)	-	2,742
December 31, 2017 final Class D unit entitlement	834	-
Amortization	(381)	(1,518)
Balance, end of period	$ 127,971	$ 127,518

The deferred gain on sale of Keg Rights is adjusted to reflect changes in KRL's ownership interest in the Keg Rights resulting from the entitlement of Exchangeable Partnership units received as consideration for the addition of net new sales to the Royalty Pool on an annual basis.

6. DEFERRED GAIN ON SALE OF KEG RIGHTS (CONTINUED):

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 net royalty revenue added to the Royalty Pool, divided by the yield of the Fund units, divided by the weighted average unit price of the Fund units. KRL receives 80% of the estimated Additional Entitlement initially, with the balance received on December 31st of each year when the actual full year performance of the new restaurants is known with certainty.

The total number of Keg restaurants included in the Royalty Pool increased from the 80 Keg restaurants in existence on March 31, 2002, to 100 as of December 31, 2016. Sixty-two new Keg restaurants that opened during the period from April 1, 2002 through October 2, 2015, with annual gross sales of $311.3 million, were added to the Royalty Pool. Forty-two permanently closed Keg restaurants with annual sales of $130.7 million were removed from the Royalty Pool. This resulted in a net increase in Royalty Pool sales of $180.6 million annually and KRL receiving a cumulative Additional Entitlement equivalent to 5,762,147 Fund units as of December 31, 2016.

On January 1, 2017, an estimated $6,290,000 in annual net sales were added to the Royalty Pool. One new restaurant that opened during the period from October 3, 2015 through October 2, 2016, with estimated gross sales of $8,000,000 annually, was added to the Royalty Pool. One permanently closed Keg restaurant with annual sales of $1,710,000 was removed from the Royalty Pool. The total number of restaurants in the Royalty Pool remained the same at 100. The pre-tax yield of the Fund units was determined to be 7.36% calculated using a weighted average unit price of $20.82.

On January 1, 2017, KRL received 80% of this entitlement, representing the equivalent of 131,723 Fund units, being 0.88% of the Fund units on a fully diluted basis. KRL also received a proportionate increase in monthly distributions from the Partnership. On December 31, 2017, but effective January 1, 2017, KRL received the balance of the 2017 Additional Entitlement. The actual sales generated by the one new restaurant added to the Royalty Pool on January 1, 2017, were confirmed to be $8,818,000, approximately $818,000 or 10.2% more than the amount originally estimated. This resulted in KRL receiving an additional entitlement equivalent to 40,042 Fund units, and KRL having the right to exchange its units in the capital of the Partnership for 3,639,856 Fund units, representing 24.28% of the Fund units on a fully diluted basis.

(Tabular amounts expressed in thousands of dollars - unaudited)

7. RELATED PARTY TRANSACTIONS AND BALANCES:

(a) As at December 31, 2017, $2,000 owing from companies owned by the minority shareholder of KRL, are included in accounts receivable (October 1, 2017 – $nil). All of these receivables are current as of December 31, 2017 and KRL expects to collect these amounts in full. KRL also has $14,000 in amounts owing to these companies included in accounts payable and accrued liabilities at December 31, 2017 (October 1, 2017 – $16,000).

(b) Other receivables, including the current portion, as at December 31, 2017 are $16,048,000 (October 1, 2017 – $15,513,000).

Other receivables include the following:	December 31, 2017	October 1, 2017
Non-interest bearing employee demand note	$ 750	$ 750
Note receivable from a company owned by the minority shareholder, including interest	5,914	5,499
Note receivable from a company owned by the minority shareholder	389	437
Receivables from a company owned by the minority shareholder	8,995	8,827
Current portion	(15,107)	(14,522)
	$ 941	$ 991

(c) As at December 31, 2017, KRL has a $2,863,000 royalty fee payable, including GST, to the Fund (October 1, 2017 – $2,376,000) and a $363,000 interest payable amount due to the Fund on the Keg Loan (October 1, 2017 – $363,000) included in accounts payable and accrued liabilities.

As at December 31, 2017, KRL has $1,058,000 in distributions receivable from the Partnership (October 1, 2017 – $940,000) related to its ownership of the Class C and Exchangeable Partnership units. These amounts were received from the Partnership when due, subsequent to the above periods.

(d) KRL performs accounting services for a company owned by the minority shareholder of KRL. For the 13 weeks ended December 31, 2017, KRL earned $79,000 for these services (13 weeks ended January 1, 2017 – $90,000), which has been recognized by KRL as other income, net of the costs to provide these services.

(e) KRL incurs royalty expense with respect to the licence and royalty agreement between KRL and the Partnership. As a result of the common directors on the board of KRL and on the board of The Keg GP, the general partner of the Partnership, the royalty expense is treated as a related party transaction. KRL incurred royalty expense of $6,226,000 for the 13 weeks ended December 31, 2017 (13 weeks ended January 1, 2017 – $5,931,000).

(f) KRL also records investment income on its investment in Exchangeable and Class C units of the Partnership, which is presented as interest income in the condensed consolidated statements of comprehensive income. During the 13 weeks ended December 31, 2017, KRL recorded investment income of $1,448,000 and $1,069,000, respectively (13 weeks ended January 1, 2017 – $1,339,000 and $1,069,000, respectively).

(Tabular amounts expressed in thousands of dollars - unaudited)

8. RESTAURANT OPERATING COSTS:

The components of restaurant operating costs are as follows:

	13 weeks ended December 31, 2017	13 weeks ended January 1, 2017
Product costs	$ 26,986	$ 23,890
Restaurant labour costs	25,543	22,008
Operating supplies	2,333	1,934
Local marketing and promotion expenses	2,343	2,080
Other trade costs	5,865	5,057
Facility costs	6,454	5,874
	$ 69,524	$ 60,843

9. GENERAL AND ADMINISTRATIVE EXPENSES:

The components of general and administrative expenses are as follows:

	13 weeks ended December 31, 2017	13 weeks ended January 1, 2017
Corporate salaries and administrative costs	$ 3,431	$ 3,142
Marketing and advertising	2,439	2,046
Other	(411)	(389)
	$ 5,459	$ 4,799

10. INTEREST EXPENSE:

The components of interest expense are as follows:

	13 weeks ended December 31, 2017	13 weeks ended January 1, 2017
Interest on note payable to The Keg Royalties Income Fund	$ 1,066	$ 1,063
Interest and financing charges on long-term debt	494	333
Deferred financing charges	29	38
Interest on bank balances and minority shareholder note receivable	(429)	(21)
	$ 1,160	$ 1,413

11. FINANCIAL INSTRUMENTS:

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

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

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

(a) Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is generally classified in this category if acquired principally for the purposes of selling or repurchasing in the short term. Derivatives are also included in this category unless they are designated as hedges. The Exchangeable unit investment in the Partnership is classified as a financial asset due to the Partnership's contractual obligation to distribute cash on the Exchangeable Partnership units held by KRL, and is measured at fair value through profit or loss due to certain conversion features discussed in note 3.

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

(b) Derivative financial instruments: The right to transfer Class C Partnership units in consideration of KRL's note payable to the Fund is classified as a derivative instrument (note 4). KRL has reviewed the net impact of this potential exchange requirement on its cash flows and has determined there is no significant value applicable to this feature.

(c) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Cash and cash equivalents, accounts receivable, distributions receivable from the Partnership, other receivables, and the Class C unit investment in the Partnership are included in this category. Loans and receivables are initially recognized at the amount expected to be received less a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized costs using the effective interest method and when material, an adjustment to discount the loans and receivables to fair value.

(d) Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable and accrued liabilities, long-term debt, note payable and note payable to the Fund. These items are initially recognized at the amount required to be paid, less a discount to reduce the payables to fair value or transactions costs incurred. Subsequently, these items are measured at amortized cost using the effective interest rate method. Financial liabilities are classified as current liabilities if payment is due within twelve months of the balance sheet date. Otherwise, they are presented as non-current liabilities.

(Tabular amounts expressed in thousands of dollars - unaudited)

11. FINANCIAL INSTRUMENTS (CONTINUED):

The carrying value of current financial assets and liabilities approximate their fair value due to their short-term nature. The carrying value of the Class C unit investment in the Partnership, note payable to the Fund, long-term debt and note payable approximates fair value based on prevailing market interest rates.

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

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

The fair value of the Exchangeable unit investment in the Partnership is determined using Level 2 inputs.

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

	December 31, 2017	October 1, 2017
Financial assets:		
Loans and receivables:		
Cash and cash equivalents	$ 29,487	$ 10,044
Accounts receivable	26,434	7,729
Distributions receivable from the Partnership	1,058	940
Other receivables, including current portion	16,048	15,513
Class C unit investment in the Partnership	57,000	57,000
Fair value through profit and loss:		
Exchangeable unit investment in the Partnership	72,761	73,940
	$ 202,788	$ 165,166
Financial liabilities:		
Amortized cost:		
Accounts payable and accrued liabilities	$ 28,760	$ 29,266
Note payable to The Keg Royalties Income Fund	57,000	57,000
Long-term debt, including current portion	39,754	34,725
Note payable, including current portion	389	437
	$ 125,903	$ 121,428

(Tabular amounts expressed in thousands of dollars - unaudited)

12. SEGMENT DISCLOSURES:

KRL's principal business activity is the operation and franchising of Keg steakhouse restaurants and bars in Canada and the US; as a result, KRL is considered to operate in two reportable operating segments. The following segmented information is regularly reported to KRL's Executive Committee (KRL's chief operating decision-makers):

Geographic information:	13 weeks ended December 31, 2017	13 weeks ended January 1, 2017
Restaurant sales:		
Canada	$ 70,535	$ 59,543
United States	12,783	12,983
	$ 83,318	$ 72,526
Amortization of restaurant and corporate assets:		
Canada	$ 2,970	$ 2,369
United States	460	457
	$ 3,430	$ 2,826
Net interest expense:		
Canada	$ 1,160	$ 1,413
United States	-	-
	$ 1,160	$ 1,413
Profit (loss) for the period:		
Canada	$ 208	$ (193)
United States	485	729
	$ 693	$ 536

	December 31, 2017	October 1, 2017
Current assets:		
Canada	$ 75,201	$ 34,174
United States	7,866	7,361
	$ 83,067	$ 41,535
Current liabilities:		
Canada	$ 122,298	$ 89,673
United States	5,211	4,343
	$ 127,509	$ 94,016
Property, plant and equipment:		
Canada	$ 81,791	$ 81,321
United States	8,858	8,010
	$ 90,649	$ 89,331

(Tabular amounts expressed in thousands of dollars - unaudited)

13. CHANGES IN NON-CASH OPERATING WORKING CAPITAL:

	Note	13 weeks ended December 31, 2017	13 weeks ended January 1, 2017
Changes in non-cash operating working capital:			
Accounts receivable and other receivables	7(a), 7(b)	$ (18,705)	$ (16,920)
Inventories		(1,011)	(397)
Prepaid expenses and other assets		(1,670)	(364)
Other receivables		(582)	(1,051)
Accounts payable and accrued liabilities		(533)	2,334
Unearned revenue		34,672	33,378
		$ 12,171	$ 16,980

14. SUBSEQUENT EVENT:

(a) On January 1, 2018, an estimated $20,159,000 in annual net sales were added to the Royalty Pool. Five new restaurants that opened during the period from October 3, 2016 through October 2, 2017, with estimated gross sales of $28,250,000 annually, were added to the Royalty Pool. Two permanently closed restaurants with annual sales of $8,091,000 were removed from the Royalty Pool. The total number of restaurants in the Royalty Pool increased to 103. The pre-tax yield of the Fund units was determined to be 7.54% calculated using a weighted average unit price of $20.28.

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 487,765 Fund units, being 3.15% of the Fund units on a fully diluted basis.

On January 1, 2018, KRL received 80% of this entitlement, representing the equivalent of 390,212 Fund units, being 2.54% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the initial portion of the Additional Entitlement described above, KRL will have the right to exchange its units in the capital of the Partnership for 4,030,068 Fund units, representing 26.20% of the Fund units on a fully diluted basis.

The balance of the Additional Entitlement will be adjusted on December 31, 2018, to be effective January 1, 2018, once the actual performance of the new restaurants have been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2018, it would have the right to exchange its Partnership units for 4,127,621 Fund units, representing 26.66% of the Fund units on a fully diluted basis.

(b) On January 23, 2018, Cara Operations Limited ("Cara"), KRL and the Fund announced that Cara and KRL have agreed to merge pursuant to the terms of a binding letter of intent. The transaction is expected to close as soon as all conditions precedent have been satisfied which is expected to occur during the KRL's next quarter ended April 1, 2018.

Pro Forma Consolidated Statement of Financial Position (Balance Sheet) - Unaudited
As at December 31, 2017

(in thousands of Canadian dollars, except where otherwise indicated)

	Cara Actual	KRL Actual	Pro Forma Adjustments		Pro Forma Consolidated
Fiscal Year-End	*53 weeks ended Dec. 31, 2017*	*52 weeks ended Oct. 1, 2017*			*Combined*
Assets					
Current Assets					
Cash and cash equivalents	$ 41,971	$ 10,044	$ 12,757	**a**	$ 64,772
Accounts receivable	60,991	7,729	940	**b**	69,660
Inventories	26,321	5,429	-		31,750
Prepaid expenses and other assets	8,573	2,871	-		11,444
Distributions receivable from the Partnership	-	940	(940)	**b**	-
Current portion of other receivables	-	14,522	(14,522)	**a**	-
Total Current Assets	$ 137,856	$ 41,535	$ (1,765)		$ 177,626
Long-term receivables	40,033	-	991	**c**	41,024
Property, plant and equipment	336,210	89,331	-		425,541
Brands and other assets	614,968	4,716	-		619,684
Goodwill	191,111	-	-		191,111
Deferred tax asset	23,361	24,080	-		47,441
Exchangeable unit investment in the Partnership	-	73,940	(73,940)	**d**	-
Class C unit investment in the Partnership	-	57,000	(57,000)	**d**	-
Investment in the Keg Limited Partership	-	-	130,940	**d**	130,940
Other receivables	-	991	(991)	**c**	-
Total Assets	**$ 1,343,539**	**$ 291,593**	**$ (1,765)**		**$ 1,633,367**
Liabilities					
Current Liabilities					
Accounts payable and accrued liabilities	$ 86,131	$ 29,266	$ 196	**e**	$ 115,593
Provisions	6,959	-	-		6,959
Gift card liability	57,495	-	60,554	**f**	118,049
Income taxes payable	4,107	-	-		4,107
Current portion of long-term debt	2,916	4,000	-		6,916
Current portion of note payable	-	196	(196)	**e**	-
Current portion of unearned revenue	-	60,554	(60,554)	**f**	-
Total Current Liabilities	$ 157,608	$ 94,016	$ -		$ 251,624
Long-term debt	401,700	30,725	105,241	**g**	537,666
Provisions	8,171	-	-		8,171
Other long-term liabilities	67,842	-	22,181	**h**	90,023
Deferred tax liability	100,798	-	-		100,798
Unearned revenue	-	5,181	(5,181)	**h**	-
Note payable	-	241	(241)	**g**	-
Note payable to The Keg Royalty Income Fund	-	57,000	-		57,000
Deferred gain on sale of Keg Rights	-	127,518	-		127,518
Total Liabilities	**$ 736,119**	**$ 314,681**	**$ 122,000**		**$ 1,172,800**
Shareholders' Equity / (Deficiency)					
Share capital	$ 690,968	$ 1	$ 94,728	**i**	$ 785,697
Contributed surplus	11,957	-	-		11,957
Accumulated other comprehensive income	-	1,568	-		1,568
Deficit	(95,505)	(24,657)	(1,765)		(121,927)
Merger reserve	-	-	(216,728)	**j**	(216,728)
Total Shareholders' Equity / (Deficiency)	**$ 607,420**	**$ (23,088)**	**$ (123,765)**		**$ 460,567**
Total Liabilities and Equity	**$ 1,343,539**	**$ 291,593**	**$ (1,765)**	**a**	**$ 1,633,367**

See accompanying notes to the pro forma consolidated financial statements.

Pro Forma Consolidated Statements of Earnings (Unaudited)
For the 53 weeks ended December 31, 2017

(in thousands of Canadian dollars, except where otherwise indicated)

	Cara Actual	KRL Actual	Pro Forma Adjustments		Pro Forma Consolidated
Fiscal Year-End	*53 weeks ended Dec. 31, 2017*	*52 weeks ended Oct. 1, 2017*			*Combined*
Sales at corporate restaurants	$ 406,726	$ 293,978	$ -		$ 700,704
Food processing and distribution sales	248,153	-	-		248,153
Retail sales	-	12,483	-		12,483
Call centre service charge revenues	12,345	-	-		12,345
Franchise revenues	108,017	16,293	-		124,310
Total gross revenue from continuing operations	$ 775,241	$ 322,754	$ -		$ 1,097,995
Cost of inventories sold	(300,105)	(99,705)	-		(399,810)
Selling, general and administrative expenses	(335,210)	(182,333) [(1)]	(34,949)	**a**	(552,492)
Impairment of assets	(6,856)	-	-		(6,856)
Restructuring and other	(4,376)	-	-		(4,376)
Retail operating costs	-	(11,939)	11,939	**a**	-
Royalty expense	-	(23,999)	23,999	**a**	-
Operating income	128,694	4,778	989		134,461
Net interest expense and other financing charges	(12,453)	(5,063)	7,453	**b**	(10,063)
Share of gain from investments in joint ventures	322	-	-		322
Interest income on Exchangeable Partnership units	-	5,584	(5,584)	**b**	-
Change in fair value of Exchangeable Partnership units	-	(4,163)	-		(4,163)
Interest income on Class C Partnership units	-	4,275	(4,275)	**b**	-
Amortization of deferred gain	-	1,518	(1,518)	**a**	-
Loss on disposal of property, plant and equipment	-	(529)	529	**a**	-
Earnings before income taxes	116,563	6,400	(2,406)		120,557
Income taxes					
Current	(11,153)	(12)	-		(11,165)
Deferred	4,398	(432)	641	**c**	4,607
Net earnings	**$ 109,808**	**$ 5,956**	**$ (1,765)**		**$ 113,999**
Net earnings attributable to					
Shareholders of the Company	$ 109,726	$ 5,956	$ (1,765)		$ 113,917
Non-controlling interest	82	-	-		82
	$ **109,808**	$ **5,956**	$ **(1,765)**		$ **113,999**
Pro Forma net earnings per share attributable to the Common Shareholders of the Company (in dollars)					
Basic earnings per share	$ 1.84				$ 1.80
Diluted earnings per share	$ 1.77				$ 1.73

Notes
[(1)] Breakdown of selling, general and administrative expenses for KRL:

Restaurant operating costs (excluding product costs)	
Restaurant labour costs	$ (89,513)
Operating supplies	(7,919)
Local marketing and promotion expenses	(9,063)
Other trade costs	(20,915)
Facility costs	(23,718)
Total restaurant operating costs (excluding product costs)	$ (151,128)
Restaurant pre-opening costs	(1,266)
Amortization of restaurant assets	(11,160)
Amortization of corporate and intangible assets	(569)
General and administrative expenses	(17,960)
Executive bonus	(250)
Total selling, general and administrative expenses	$ (182,333)

See accompanying notes to the pro forma consolidated financial statements.

Notes to Pro Forma Consolidated Financial Statements (Unaudited)
(Amounts in thousands of Canadian dollars)
(Narrative and tabular amounts are unaudited)

1. Corporate Information

Cara Operations Limited (the “Company” or “Cara”) is a publicly listed company formed in Ontario, Canada and its shares are listed on the Toronto Stock Exchange. The pro forma consolidated financial statements are of the Company and its subsidiaries, together referred to as Cara.

2. Basis of Presentation

The audited consolidated balance sheet as at December 31, 2017 and the audited consolidated statement of earnings for the 53 weeks ended December 31, 2017 of Cara were prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board. The audited consolidated statement of financial position as at October 1, 2017 and the audited consolidated statement of comprehensive income for the 52 weeks ended October 1, 2017 of Keg Restaurants Ltd. (“KRL”) were also prepared in accordance with IFRS.

The unaudited pro forma consolidated statement of financial position as at December 31, 2017 combine the historical consolidated statements of Cara and KRL to give effect as if the merger (the “Transaction”) occurred on December 26, 2016, the beginning of Cara’s most recent financial year. The unaudited pro forma consolidated statement of financial position has been derived from the following:

- the audited consolidated balance sheet of Cara as at December 31, 2017; and
- the audited consolidated statement of financial position of KRL as at October 1, 2017

The unaudited pro forma consolidated statements of earnings for the 53 weeks ended December 31, 2017 combine the historical consolidated statements of Cara and KRL to give effect as if the Transaction occurred on December 26, 2016, the beginning of Cara’s most recent financial year. The unaudited pro forma consolidated statements of earnings of Cara have been derived from the following:

- the audited consolidated statement of earnings of Cara for the 53 weeks ended December 31, 2017; and
- the audited consolidated statement of comprehensive income of KRL for the 52 weeks ended October 1, 2017

The adjustments and assumptions outlined below that give effect to pro forma events are directly attributable to the KRL merger. The accounting policies used in the preparation of the unaudited pro forma consolidated financial statements are consistent with those described in the audited consolidated financial statements of Cara for the year ended December 31, 2017 which can be found on sedar.com (filed March 9, 2018). Cara elected to not account for the merger as a business combination under Business Combinations (“IFRS 3”), as the Transaction represented a combination of entities under common control of Fairfax Financial Holdings Limited ("Fairfax"). Accordingly, the combination was recorded on a book value basis.

The pro forma adjustments are determined based on available financial information and certain estimates and assumptions. The actual adjustments to the consolidated financial statements of Cara will depend on a number of factors. For example, the actual pretax and income tax adjustments will differ, possibly materially, from the pro forma adjustments. Management of Cara believe, however, that the pro forma assumptions provide a reasonable basis for presenting all of the significant effects of the transactions contemplated and that the pro forma adjustments give appropriate effect to those assumptions and are properly applied in the unaudited pro forma consolidated financial statements.

The pro forma consolidated financial statements have been presented for information purposes only. They may not be indicative of the financial position and results of operations that would have occurred if the transaction had been in effect on the dates indicated or of the financial position or operating results which may be experienced in the future. They also do not purport to project the future financial position or operating results of the combined company.

The pro forma consolidated financial statements do not include all the information and disclosures required by IFRS for annual financial statements and should be read in conjunction with the financial statements of Cara and the financial statements of KRL that are incorporated by reference or included herein. These pro forma statements and notes have been prepared in thousands of Canadian dollars unless otherwise noted.

These financial statements do not reflect any costs savings, operating synergies or revenue enhancements that the combined company may achieve, nor do these statements reflect any costs necessary to achieve these cost savings, operating synergies and revenue enhancements.

3. Description of the Transaction

Cara acquired all of the outstanding shares of KRL. Cara paid to KRL's shareholders, Fairfax and Mr. Aisenstat, an aggregate purchase price of approximately $200 million, comprised of $105 million in cash and 3,801,123 Cara subordinate voting shares. Cara funded the cash portion of the purchase price by drawing on its existing credit facility. Of the subordinate voting shares issued, 3,400,000 were issued to Fairfax, a related party, as partial consideration that resulted in Fairfax beneficially owning 7,224,180 subordinate voting shares immediately following closing plus 19,903,378 multiple voting shares, representing 43.5% of Cara’s total issued and outstanding shares and 56.9% voting control.

In addition to $200 million in up front consideration, Cara may be required to pay up to an additional $30 million of cash consideration, of which $17 million has been recorded as a contingent liability on Cara’s balance sheet in *merger reserve* within Shareholders’ Equity / (Deficiency) with a corresponding increase in other long-term liabilities.

4. Pro Forma Statement of Financial Position (Balance Sheet)

The unaudited pro forma consolidated statements of financial position (balance sheet) of Cara as at December 31, 2017 are based on historical financial statements of Cara and KRL, adjusted for the effects of the following:

a) *cash and cash equivalents* increased because the *current portion of other receivables* was settled from the Transaction proceeds as part of the closing of the Transaction. This increase to *cash and cash equivalents* was partially offset by $1.765 million, driven by interest paid on the $105 million increase in long-term debt per note (g) below;

b) reclassification of KRL's *distributions receivable from the Partnership* to *accounts receivable* to align with Cara's financial statement presentation;

c) reclassification of KRL's *other receivables* to *long-term receivables* to align with Cara's financial statement presentation;

d) reclassification of KRL's *exchangeable unit investment in the Partnership* and *Class C unit investment in the Partnership* to *investment in the Keg Limited Partnership*;

e) reclassification of KRL's *current portion of note payable* to *accounts payable and accrued liabilities;*

f) reclassification of KRL's *current portion of unearned revenue* to *gift card liability* to align with Cara's financial statement presentation;

g) the impact from $105 million of increased *long-term debt* as a result of total cash consideration paid by Cara to acquire KRL combined with the reclassification of KRL's *note payable* to *long-term debt*;

h) the increase in *other long-term liabilities* due to:

    i. contingent liability of $17 million which Cara may have to incur upon the achievement of certain financial milestones within the first 3 fiscal years following closing; and

    ii. reclassification of KRL's *unearned revenue* to align with Cara's financial statement presentation

i) the reversal of KRL's $1.00 in *share capital* and the addition of $94.7 million in share capital to reflect the share capital consideration paid by Cara to acquire KRL; and

j) the *merger reserve* which reflects:

    i. $94.7 million net change to *share capital* mentioned in (i) immediately above;

    ii. $17 million contingent liability mentioned in (h)(i) immediately above; and

    iii. $105 million in cash consideration paid by Cara to acquire KRL

5. Pro Forma Statements of Earnings

The unaudited pro forma consolidated statements of earnings of Cara for the 53 weeks ended December 31, 2017 are based on historical financial statements of Cara and KRL, adjusted for the effects of the following:

a) reclassification of KRL's *retail operating costs, royalty expense, amortization of deferred gain* and *loss on disposal of property, plant and equipment* to *selling general and administration* to align with Cara's financial statement presentation;

b) the impact on interest expense due to:

    i. $105 million of increased long-term debt as a result of total cash consideration paid by Cara to acquire KRL; and

    ii. reclassification of KRL's *interest income on Exchangeable Partnership units* and *interest income on Class C Partnership units* to *net interest expense and other financing charges* to align with Cara's financial statement presentation; and

c) the tax impact of the pro forma increase to interest expense; a 26.7% tax rate for Cara was assumed.

6. Pro Forma Earnings Per Share

The calculation of basic and diluted earnings per share for the 53 weeks ended December 31, 2017 on the pro forma consolidated statement of earnings assume 63,370,395 shares were outstanding on a basic basis and 65,900,201 shares were outstanding on a diluted basis. These totals assume that 3,801,284 new shares were issued on December 26, 2016 in connection with the Transaction.