Condensed Consolidated Interim Financial Statements of

DIVERSIFIED ROYALTY CORP.

Three and six months ended June 30, 2017 and 2016
(Unaudited)

NOTICE OF NO AUDITOR REVIEW OF CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102 “Continuous Disclosure Obligations”, if an auditor has not performed a review of the interim financial statements, the financial statements must be accompanied by a notice indicating that they have not been reviewed by an auditor.

The accompanying unaudited interim condensed consolidated financial statements of the Company have been prepared by and are the responsibility of the Company’s management.

The Company’s independent auditor has not performed a review of these financial statements in accordance with standards established by CPA (Chartered Professional Accountants) Canada for a review of interim financial statements by an entity’s auditor.

DIVERSIFIED ROYALTY CORP.

Condensed Consolidated Interim Statements of Financial Position
(Unaudited)
(Expressed in thousands of Canadian dollars)

	Note		June 30, 2017		December 31, 2016
Assets					
Current assets:					
Cash and cash equivalents	4	$	70,946	$	74,974
Royalties and management fees receivable	6		1,579		1,518
Amounts receivable			84		93
Prepaid expenses and other			124		87
			72,733		76,672
Deferred income tax asset	7		203		2,053
Interest rate swap assets	10		27		-
Intangible assets			171,498		171,498
		$	244,461	$	250,223
Liabilities and Shareholders' Equity					
Current liabilities:					
Accounts payable and accrued liabilities		$	475	$	592
Restricted share unit obligation	11		429		434
			904		1,026
Long-term bank loans, net of deferred financing charges	9		40,697		40,659
Interest rate swap liabilities			-		97
Shareholders' equity:					
Share capital			179,408		178,256
Contributed surplus			25,182		25,161
Retained earnings			(1,730)		5,024
			202,860		208,441
		$	244,461	$	250,223

Nature of operations (note 1)
Contingencies (note 8)
Subsequent event (note 15)

See accompanying notes to condensed consolidated interim financial statements.

DIVERSIFIED ROYALTY CORP.
Condensed Consolidated Interim Statements of Net Income and Comprehensive Income
(Unaudited)
(Expressed in thousands of Canadian dollars, except per share amounts)

			Three months ended				Six months ended		
	Note		June 30, 2017		June 30, 2016		June 30, 2017		June 30, 2016
Royalty income	5	$	4,459	$	7,418	$	8,531	$	14,332
Management fees			76		75		152		150
			4,535		7,493		8,683		14,482
Expenses:									
Salaries and benefits			326		288		676		594
Share-based compensation	11		169		201		331		320
General and administration			186		136		335		254
Professional fees			54		74		107		138
Litigation	8		47		1,123		94		4,454
			782		1,822		1,543		5,760
Income from operations			3,753		5,671		7,140		8,722
Interest expense on credit facilities			(367)		(557)		(730)		(1,111)
Other finance income (costs), net	13		155		(59)		319		247
Fair value adjustment on interest rate swaps	10		128		34		124		30
Income before income taxes			3,669		5,089		6,853		7,888
Income tax expense	7		979		1,397		1,850		2,151
Net income and comprehensive income		$	2,690	$	3,692	$	5,003	$	5,737
Weighted average number of shares outstanding									
Basic			105,810,224		113,251,882		105,673,619		113,183,484
Diluted			106,247,555		113,354,212		106,357,066		113,277,477
Income per share									
Basic	12	$	0.03	$	0.03	$	0.05	$	0.05
Diluted	12		0.03		0.03		0.05		0.05

See accompanying notes to condensed consolidated interim financial statements.

DIVERSIFIED ROYALTY CORP.
Condensed Consolidated Interim Statements of Changes in Equity
(Unaudited)
(Expressed in thousands of Canadian dollars, except for share amounts)

	Common shares	Share capital	Contributed surplus	Retained earnings	Total equity
Balance, January 1, 2017	105,481,136	$ 178,256	$ 25,161	$ 5,024	$ 208,441
Common shares issued on DRIP	363,444	916	-	-	916
Restricted share units vested	102,975	236	(179)	-	57
Share-based compensation	-	-	200	-	200
Dividends declared	-	-	-	(11,757)	(11,757)
Comprehensive income	-	-	-	5,003	5,003
Balance, June 30, 2017	105,947,555	$ 179,408	$ 25,182	$ (1,730)	$ 202,860

	Note	Common shares	Share capital	Contributed surplus	Retained earnings (accumulated deficit)	Total equity
Balance, January 1, 2016		113,065,496	$ 230,357	$ 8,542	$ 2,618	$ 241,517
Common shares issued on DRIP		269,198	579	-	-	579
Share-based compensation		-	-	320	-	320
Dividends declared		-	-	-	(12,591)	(12,591)
Dividends payable to OJFG		-	-	-	(98)	(98)
Comprehensive income		-	-	-	5,737	5,737
Balance, June 30, 2016		113,334,694	$ 230,936	$ 8,862	$ (4,334)	$ 235,464

See accompanying notes to condensed consolidated interim financial statements.

DIVERSIFIED ROYALTY CORP.
Condensed Consolidated Interim Statements of Cash Flows
(Unaudited)
(Expressed in thousands of Canadian dollars)

	Six months ended June 30, 2017	2016
Cash flows from (used in) operating activities:		
Net income for the period	$ 5,003	$ 5,737
Adjustments for:		
Deferred income taxes	1,850	2,151
Share-based compensation	331	320
Fair value adjustments on interest rate swaps	(124)	(30)
Interest expense on credit facilities	730	1,111
Other finance income, net	(319)	(247)
Foreign exchange gain/loss	(4)	341
Interest paid	(730)	(1,111)
Interest received	397	12
Changes in non-cash operating items:		
Royalties and management fees receivable	(61)	(311)
Amounts receivable	9	(2,195)
Prepaid expenses and other	(37)	(45)
Accounts payable and accrued liabilities	(196)	183
Provisions	-	2,586
Net cash provided by operating activities	6,849	8,502
Cash flows used in financing activities:		
Debt re-financing costs	(36)	-
Payment of dividends	(10,841)	(12,012)
Net cash used in financing activities	(10,877)	(12,012)
Net decrease in cash and cash equivalents	(4,028)	(3,510)
Cash and cash equivalents, beginning of period	74,974	8,889
Cash and cash equivalents, end of period	$ 70,946	$ 5,379

See accompanying notes to condensed consolidated interim financial statements.

Diversified Royalty Corp., (“DIV”), formerly BENEV Capital Inc. and prior to that Bennett Environmental Inc., is a company domiciled in Canada and incorporated on July 29, 1992 under the Canada Business Corporation Act. The condensed consolidated interim financial statements of DIV as at and for the six months ended June 30, 2017 are composed of DIV and its subsidiaries (together referred to as the “Company”). The Company’s common shares are listed on the Toronto Stock Exchange (“TSX”) and traded under the symbol “DIV”. The registered office of the Company is located at 902-510 Burrard Street, Vancouver, BC, V6C 3A8.

1. Nature of operations:

The current business of DIV is to acquire royalties from well-managed multi-location businesses and franchisors in North America (“Royalty Partners”).

On June 19, 2015, the Company indirectly acquired, through SGRS Royalties Limited Partnership (“SGRS LP”) (an entity controlled by the Company), all of the Canadian and U.S. trademarks and certain other intellectual property rights utilized by Sutton Group Realty Services Ltd. (“Sutton”) in its residential real estate franchise business (the “SGRS Rights”). The Company granted Sutton the licence to use the SGRS Rights for a term ending on December 31, 2114 in exchange for a royalty payment initially equal to $56.25 per agent per month (the “Sutton Royalty Rate”) for the number of agents included in the royalty pool (the “Sutton Royalty Pool”). Effective July 1, 2016, the Sutton Royalty Rate was increased to $57.375 per agent per month.

On August 19, 2015, the Company indirectly acquired through ML Royalties Limited Partnership (“ML LP”) (an entity controlled by the Company), the trademarks and certain other intellectual property rights (the “ML Rights”) from Mr. Lube Canada Limited Partnership (“Mr. Lube”). The Company granted Mr. Lube the licence to use the ML Rights for a term ending on August 19, 2114 in exchange for a royalty payment initially equal to 6.95% of system sales of Mr. Lube locations in the royalty pool (the “Mr. Lube Royalty Pool”).

Substantially all of the Company’s operating revenues are earned from the receipt of royalties and management fees from its Royalty Partners. Accordingly, the revenues of the Company and its ability to pay dividends to shareholders are dependent on the ongoing ability of its Royalty Partners to generate cash and pay royalties and management fees to the Company.

2. Basis of preparation:

(a) Statement of compliance:

These condensed consolidated interim financial statements have been prepared in accordance with IAS 34, *Interim Financial Reporting*. Certain information and note disclosures normally included in the annual consolidated financial statements prepared in accordance with International Financial Reporting Standards (“IFRS”) have been omitted or condensed. Accordingly, these condensed consolidated interim financial statements should be read in conjunction with the Company’s annual consolidated financial statements for the year ended December 31, 2016.

These condensed consolidated financial statements were authorized and approved for issue by the Company’s Board of Directors on August 14, 2017.

(b) Basis of measurement:

These financial statements have been prepared on the historical cost basis except for the interest rate swaps and restricted share unit obligation, which are measured at fair value.

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. The critical judgments and key estimates and assumptions are the same as described in the Company’s annual financial statements for the year ended December 31, 2016.

(c) Functional and presentation currency:

These condensed consolidated interim financial statements are presented in Canadian dollars, which is the Company’s functional currency.

(Expressed in thousands of Canadian dollars)

3. Significant accounting policies:

These condensed consolidated interim financial statements have been prepared using the same accounting policies as the annual financial statements for the year ended December 31, 2016, except as described below.

(a) Changes in accounting policies and disclosures:

Effective January 1, 2017, the Company adopted the amendments to IAS 7, *Statement of Cash Flows,* and IAS 12, *Income Taxes.* The adoption of these amendments did not have a material impact on the Company's consolidated financial statements.

(b) New standards applicable in future periods:

In May 2014, the International Accounting Standards Board ("IASB") issued IFRS 15, *Revenue from Contracts with Customers*, which 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 judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The mandatory effective date of IFRS 15 is for annual periods beginning on or after January 1, 2018. The Company is currently evaluating the impact of IFRS 15 on its consolidated financial statements.

IFRS 9, *Financial Instruments*, replaces the guidance in IAS 39, *Financial Instruments: Recognition and Measurement* on the classification and measurement of financial assets and liabilities. Under IFRS 9, financial assets are classified and measured based on the business model in which they are held and the characteristics of their cash flows. In addition, under IFRS 9 for financial liabilities measured at fair value, changes in fair value attributable to changes in credit risk will be recognized in other comprehensive income, with the remainder of the changes recognized in profit or loss. However, if this requirement creates or enlarges an accounting mismatch in profit or loss, the entire change in fair value will be recognized in profit or loss. The mandatory effective date of IFRS 9 is for annual periods beginning on or after January 1, 2018. The Company is currently evaluating the impact of IFRS 9 on its consolidated financial statements.

In January 2016, the IASB issued IFRS 16, *Leases*. This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of a low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. The mandatory effective date of IFRS 16 is for annual periods beginning on or after January 1, 2019. The Company is currently evaluating the impact of IFRS 16 on its consolidated financial statements.

4. Cash and cash equivalents:

	June 30, 2017	December 31, 2016
Cash	$ 698	$ 812
Cash equivalents	70,248	74,162
	$ 70,946	$ 74,974

5. Royalty pools:

(a) Mr. Lube:

Royalty income from Mr. Lube for the six months ended June 30, 2017 and 2016 were calculated as follows:

Expressed in thousands of Canadian dollars, except for number of locations	Six months ended June 30, 2017	2016
Locations in the Mr. Lube Royalty Pool at period end	117	117
Mr. Lube Royalty Pool system sales	$ 95,621	$ 92,007
Royalty income	6,673	6,409

During the six months ended June 30, 2017, royalty income from Mr. Lube includes make-whole payments totaling $0.03 million (2016 - $0.01 million) on lost system sales of $0.4 million (2016 - $0.2 million).

(b) Sutton:

Royalty income from Sutton for the six months ended June 30, 2017 and 2016 were calculated as follows:

Expressed in thousands of Canadian dollars, except for number of agents and the Sutton Royalty Rate	Six months ended June 30, 2017	2016
Agents in the Sutton Royalty Pool at period end	5,400	5,185
Sutton Royalty Rate (per agent per month)	$ 57.375	$ 56.250
Royalty income	1,858	1,750

Effective July 1, 2017, the Sutton Royalty Rate increased from $57.375 per agent to $58.523 per agent, representing the 2.0% annual contractual increase in the Sutton Royalty Rate for 2017.

(c) Franworks:

Royalty income from Franworks Franchise Corp. (“Franworks”) for the six months ended June 30, 2017 and 2016 were calculated as follows:

Expressed in thousands of Canadian dollars, except for number of restaurants	Six months ended June 30, 2017	2016
Restaurants in the Franworks Royalty Pool at period end	-	82
Franworks Royalty Pool system sales	$ -	$ 101,279
Royalty income	-	6,173

On November 27, 2016, the Company completed the sale of the Canadian and U.S. trademarks and other intellectual property rights related to the Original Joe’s, Elephant & Castle and State & Main restaurant business (the “FW Rights”) to Original Joe’s Franchise Group Inc. (“OJFG”), a wholly-owned subsidiary of Franworks. Upon closing the sale of the FW Rights, the previously existing royalty and other commercial arrangements between the Company and Franworks were terminated.

(Expressed in thousands of Canadian dollars)

6. Royalties and management fees receivable:

	June 30, 2017	December 31, 2016
Mr. Lube	$ 1,245	$ 1,184
Sutton	334	334
	$ 1,579	$ 1,518

7. Deferred income taxes:

The tax effect of temporary differences that gives rise to the net deferred tax asset are as follows:

	June 30, 2017	December 31, 2016
Deferred tax asset:		
Non-capital losses	$ 2,939	$ 3,479
Financing and share issuance costs	1,045	1,266
Intangible assets	303	312
Investment tax credits	199	199
Other	104	138
Gross deferred tax asset	4,590	5,394
Deferred tax liability:		
Intangible assets	(4,387)	(3,341)
Net deferred tax asset	$ 203	$ 2,053

As at June 30, 2017, the Company has non-capital loss carry forwards of $11.3 million, which can be carried forward and applied against future taxable income.

The deferred tax liability as at June 30, 2017 is largely associated with the temporary differences on the Company's intangible assets, which have an undepreciated capital cost allowance of approximately $111.0 million.

8. Contingencies:

In 2008, Sevenson Environmental Services Inc. ("Sevenson"), a prime contractor on a U.S. Federal Government project filed a complaint against the Company and many other persons in a U.S. court.

In 2009, the Court stayed all proceedings in this matter pending the conclusion of the Antitrust Division of the United States Department of Justice investigation into the same matter. On November 18, 2014, the stay was lifted.

On February 11, 2015, Sevenson filed its third amended complaint against the Company. The complaint alleges that employees of the Company conspired with an employee of the prime contractor relating to, among other things, the awarding of contracts during the years 2002 through 2004. Of the 21 counts in the complaint, only six name the Company as a defendant. The complaint seeks not less than approximately $1.1 million U.S. plus the value of additional gratuities from the Company and punitive damages.

Counsel for the Company brought a motion to dismiss the third amended complaint for failure to plead enough facts to state a claim for relief that is plausible on its face. In October 2015, the Company filed a counterclaim against Sevenson. In December 2015, the Company and Sevenson agreed to non-binding mediation. This mediation was unsuccessful in resolving this issue.

Management intends to defend against this claim vigorously and has prepared a significant portion of its defense and counterclaim against Sevenson. Management considers that it is not probable that a liability will result and no amount has been recorded in the Company's financial statements in respect of the complaint.

(Expressed in thousands of Canadian dollars)

9. Borrowings:

As at June 30, 2017, the Company had the following term loan facilities and operating lines of credit:

Term loan facilities	Principal	Interest rate	Maturity date	Unamortized transaction costs	Carrying value
SGRS LP term loan	$ 6,300	BA + 2.00%	Jun 30, 2022	$ (78)	$ 6,222
ML LP term loan	34,600	BA + 2.50%	Aug 19, 2018	(125)	34,475
	$ 40,900			$ (203)	$ 40,697

Operating lines of credit	Maximum available	Interest rate	Maturity date	Amount drawn	Remainder Available for use
SGRS LP line of credit	$ 500	BA + 2.00%	Jun 30, 2022	$ -	$ 500
ML LP line of credit	1,000	Prime + 1.50%	Aug 19, 2018	-	1,000
	$ 1,500			$ -	$ 1,500

On June 20, 2017, SGRS LP amended the terms of its term loan and line of credit agreement to extend the maturity date from June 19, 2018 to June 30, 2022. In addition, the interest rate for the SGRS LP term loan and operating line of credit facilities were decreased to the BA rate plus 2.00%.

As at June 30, 2017, SGRS LP and ML LP were in compliance with all financial covenants.

10. Interest rate swaps

The Company has interest rate swap agreements that entitle the Company to receive interest at floating rates and effectively pay interest at fixed rates for the SGRS LP and ML LP term loan facilities.

The interest rate swaps are re-measured at fair value at the end of each reporting period with fair values calculated as the present value of contractual cash flows based on quoted forward curves and discount rates incorporating the applicable yield curve. The following table summarizes the interest rate swap agreements outstanding as of June 30, 2017:

	Notional amount	Fixed interest rate	Maturity date	Unrealized gain since inception
SGRS LP	$ 6,300	3.16%	Jun 19, 2018	$ 3
ML LP	34,600	3.62%	Aug 13, 2018	24
	$ 40,900			$ 27

(Expressed in thousands of Canadian dollars)

11. Share-based compensation:

(a) Restricted share units:

The number of RSUs outstanding is as follows:

	June 30, 2017	
	Number of RSUs	Weighted average grant-date fair value
Balance, beginning of period	606,016	$ 2.42
Granted	94,953	2.56
Dividends earned	25,507	2.60
Settled	(134,425)	2.33
Balance, end of period	592,051	$ 2.47

In January 2016, the Company announced that the Board of Directors of the Company elected to receive all compensation related to 2016 in the form of RSUs. In addition, the Company's President and CEO elected to receive at least 45% of his base salary related to 2016 in RSUs. The RSUs were issued quarterly pursuant to the Company's long-term incentive plan at the five-day weighted average trading price of DIV's common shares as at the end of each quarter. In connection with this election, and as compensation for the services provided during the three months ended December 31, 2016, the Company granted a total of 11,863 RSUs to three directors and 18,725 RSUs to the Company's President and CEO at a weighted average grant date fair value of $2.50 per RSU on March 29, 2017. These RSUs fully vested on March 31, 2017, and were settled on April 3, 2017. The Company issued 102,975 common shares in exchange for 102,975 of the vested RSUs. The remaining 31,450 of the vested RSUs were settled in cash to pay the applicable withholding taxes.

On March 29, 2017, a total of 58,059 RSUs were granted to five directors at a grant date fair value of $2.58 per RSU, which vest in their entirety on April 1, 2020.

On May 12, 2017, a total of 6,306 RSUs were issued at a grant date fair value of $2.57 per RSU to certain directors that elected to receive their compensation related to 2017 in the form of RSUs. These RSUs fully vest on April 2, 2018.

(b) Share options:

There were no changes to the Company's outstanding options during the six months ended June 30, 2017. The following table summarizes information relating to outstanding and exercisable options as at June 30, 2017:

Exercise price	Number of options outstanding and exercisable	Weighted average remaining contractual life (years)
$ 1.50	103,000	1.00
$ 1.79	129,900	1.13
	232,900	1.07

(Expressed in thousands of Canadian dollars)

12. Income per share:

	Three months ended June 30, 2017	Three months ended June 30, 2016	Six months ended June 30, 2017	Six months ended June 30, 2016
Income for the period	$ 2,690	$ 3,692	$ 5,003	$ 5,737
Weighted average number of shares outstanding – basic	105,810,224	113,251,882	105,673,619	113,183,484
Dilutive adjustment for share options	86,094	102,330	84,658	93,993
Dilutive adjustment for RSUs	351,237	-	598,789	-
Weighted average number of shares outstanding – diluted	106,247,555	113,354,212	106,357,066	113,277,477
Net income per common share:				
Basic	$ 0.03	$ 0.03	$ 0.05	$ 0.05
Diluted	$ 0.03	$ 0.03	$ 0.05	$ 0.05

13. Other finance income (costs), net:

	Three months ended June 30, 2017	Three months ended June 30, 2016	Six months ended June 30, 2017	Six months ended June 30, 2016
Foreign exchange gain (loss)	$ (3)	$ (11)	$ (4)	$ 341
Finance income	196	5	397	12
Amortization of deferred financing charges	(38)	(53)	(74)	(106)
Other finance income (costs), net	$ 155	$ (59)	$ 319	$ 247

14. Financial instruments:

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

	June 30, 2017	December 31, 2016
Assets carried at amortized cost:		
Cash and cash equivalents	$ 70,946	$ 74,974
Royalties and management fees receivable	1,579	1,518
Amounts receivable	84	93
	$ 72,609	$ 76,585
Assets carried at fair value:		
Interest rate swap assets	$ 27	$ -

(Expressed in thousands of Canadian dollars)

14. Financial instruments (continued):

	June 30, 2017	December 31, 2016
Liabilities carried at amortized cost:		
Accounts payable and accrued liabilities	$ 475	$ 592
Long-term bank loans	40,697	40,659
	$ 41,172	$ 41,251
Liabilities carried at fair value:		
Restricted share unit obligation	$ 429	$ 434
Interest rate swap liabilities	-	97
	$ 429	$ 531

15. Subsequent event:

On July 31, 2017, ML LP amended its credit agreement to extend the maturity date from August 19, 2018 to July 31, 2022. In addition, the interest rate for the ML LP term loan facility now bears interest at BA plus 1.95% and the ML LP line of credit bears interest at prime plus 0.25%. After taking into account ML LP's existing interest rate swap arrangement, the effective interest rate on the ML LP term loan facility is fixed at 3.07% per annum until August 13, 2018. In connection with amending its credit agreement, ML LP entered into a new interest rate swap arrangement that results in an effective interest rate of 4.17% from August 13, 2018 to July 31, 2022.