

Condensed Consolidated Interim Financial Statements of

**DIVERSIFIED ROYALTY CORP.**

Three and six months ended June 30, 2019 and 2018

**DIVERSIFIED ROYALTY CORP.**

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

	Note	June 30, 2019	December 31, 2018
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	4	\$ 46,641	\$ 78,342
Royalties and management fees receivable	6	4,467	3,965
Amounts receivable		2,254	153
Prepaid expenses and other		161	89
		53,523	82,549
Intangible assets	7	281,787	235,674
		\$ 335,310	\$ 318,223
<b>Liabilities and Shareholders' Equity</b>			
Current liabilities:			
Accounts payable and accrued liabilities		\$ 1,159	\$ 832
Income tax payable		232	-
Promissory note	7	4,734	-
		6,125	832
Long-term bank loans, net of deferred financing charges	8	75,085	64,856
Convertible debentures	9	52,557	51,940
Exchangeable MRM Units	10	1,093	-
Interest rate swap liabilities		843	137
Deferred income tax liability	11	9,978	7,738
Shareholders' equity:			
Share capital		160,483	184,528
Contributed surplus		39,824	25,974
Equity component of convertible debentures		2,938	2,938
Accumulated deficit		(13,616)	(20,720)
		189,629	192,720
		\$ 335,310	\$ 318,223

Nature of operations (note 1)  
Subsequent event (note 18)

The accompanying notes are an integral part of these 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)

	Note	Three months ended June 30,		Six months ended June 30,	
		2019	2018	2019	2018
Royalty income	5	\$ 7,466	\$ 6,704	\$ 13,791	\$ 12,643
Management fees		83	77	161	154
		7,549	6,781	13,952	12,797
Expenses					
Salaries and benefits		466	416	875	821
Share-based compensation	13	375	372	766	668
General and administration		184	158	309	275
Professional fees		78	54	131	110
Litigation		-	187	-	472
		1,103	1,187	2,081	2,346
Income from operations		6,446	5,594	11,871	10,451
Interest expense on credit facilities		(1,454)	(1,292)	(2,900)	(2,537)
Other finance income (costs), net	15	(34)	56	71	110
Fair value adjustment on financial instruments		(115)	(56)	(651)	72
Income before income taxes		4,843	4,302	8,391	8,096
Income tax expense	11	1,408	1,262	2,472	2,426
Net income and comprehensive income		\$ 3,435	\$ 3,040	\$ 5,919	\$ 5,670
Weighted average number of shares outstanding					
Basic		108,245,518	107,045,438	108,043,896	106,885,697
Diluted		109,331,265	107,833,324	109,053,981	107,689,584
Income per share					
Basic	14	\$ 0.03	\$ 0.03	\$ 0.05	\$ 0.05
Diluted	14	0.03	0.03	0.05	0.05

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**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	Equity component of convertible debentures	Accumulated deficit	Total equity
Balance, January 1, 2019	107,768,300	\$ 184,528	\$ 25,974	\$ 2,938	\$ (20,720)	\$192,720
Common shares issued on DRIP	748,329	2,265	-	-	-	2,265
Restricted share units settled	37,760	90	(110)	-	-	(20)
Share-based compensation	-	-	760	-	-	760
Stated capital adjustment (note 12)	-	(26,400)	13,200	-	13,200	-
Dividends declared	-	-	-	-	(12,015)	(12,015)
Comprehensive income	-	-	-	-	5,919	5,919
<b>Balance, June 30, 2019</b>	<b>108,554,389</b>	<b>\$ 160,483</b>	<b>\$ 39,824</b>	<b>\$ 2,938</b>	<b>\$ (13,616)</b>	<b>\$189,629</b>

	Common shares	Share capital	Contributed surplus	Equity component of convertible debentures	Accumulated deficit	Total equity
Balance, January 1, 2018	106,481,937	\$ 180,906	\$ 25,265	\$ 2,938	\$ (6,982)	\$202,127
IFRS 2 amendments	-	-	218	-	-	218
	106,481,937	180,906	25,483	2,938	(6,982)	202,345
Common shares issued on DRIP	446,269	1,416	-	-	-	1,416
Restricted share units settled	228,159	557	(602)	-	-	(45)
Stock options exercised	129,900	290	(58)	-	-	232
Share-based compensation	-	-	660	-	-	660
Dividends declared	-	-	-	-	(11,892)	(11,892)
Comprehensive income	-	-	-	-	5,670	5,670
<b>Balance, June 30, 2018</b>	<b>107,286,265</b>	<b>\$ 183,169</b>	<b>\$ 25,483</b>	<b>\$ 2,938</b>	<b>\$ (13,204)</b>	<b>\$198,386</b>

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**DIVERSIFIED ROYALTY CORP.**

Condensed Consolidated Interim Statements of Cash Flows  
(Unaudited)  
(Expressed in thousands of Canadian dollars)

	Six months ended June 30,	
	2019	2018
Cash flows from (used in) operating activities:		
Net income	\$ 5,919	\$ 5,670
Adjustments for:		
Deferred income taxes	2,240	2,426
Share-based compensation	766	668
Fair value adjustments on financial instruments	651	(72)
Interest expense on credit facilities	2,900	2,537
Other finance income, net	(71)	(110)
Foreign exchange gain (loss)	(8)	12
Interest paid	(2,900)	(2,988)
Interest received	779	725
Changes in non-cash operating items:		
Royalties and management fees receivable	(502)	112
Amounts receivable	(2,101)	30
Prepaid expenses and other	(72)	(50)
Accounts payable and accrued liabilities	301	(176)
Income tax payable	232	-
Net cash from operating activities	8,134	8,784
Cash flows from (used in) financing activities:		
Proceeds from long-term debt	10,300	7,000
Debt financing costs	(130)	(29)
Proceeds from exercise of share options	-	232
Payment of dividends	(9,750)	(10,476)
Net cash from (used in) financing activities	420	(3,273)
Cash flows used in investing activities:		
Additions to intangible assets	(40,255)	(10,199)
Net cash used in investing activities	(40,255)	(10,199)
Net decrease in cash and cash equivalents	(31,701)	(4,688)
Cash and cash equivalents, beginning of period	78,342	85,816
Cash and cash equivalents, end of period	\$ 46,641	\$ 81,128

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

## DIVERSIFIED ROYALTY CORP.

Notes to Condensed Consolidated Interim Financial Statements  
(Unaudited)  
(Tabular amounts expressed in thousands of Canadian dollars)

For the three and six months ended June 30, 2019 and 2018

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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 three and six months ended June 30, 2019 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, 2019, the monthly Sutton Royalty Rate was increased to \$60.887 per agent.

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”). Effective September 18, 2017, ML LP amended its licence and royalty agreement with Mr. Lube (the “ML LRA Amendment”) in connection with Mr. Lube’s new retail tire program. Pursuant to the ML LRA Amendment, ML LP has agreed to charge an effective royalty rate payable on system sales derived from the sale of tires and rims of 2.5% (compared to 6.95% on all other system sales) for the locations in the Mr. Lube Royalty Pool. On May 1, 2018, the Mr. Lube royalty rate on non-tire sales was increased by 0.5% from 6.95% to 7.45%.

On August 25, 2017, the Company indirectly acquired through AM Royalties Limited Partnership (“AM LP”) (a wholly owned subsidiary of the Company), the Canadian AIR MILES trademarks and certain Canadian intellectual property rights (collectively, the “AIR MILES Rights”) from a subsidiary of Aimia Inc. (“Aimia”). In accordance with the terms of two license agreements with LoyaltyOne Co. (collectively the “AIR MILES Licenses”) acquired by AM LP as part of acquisition of the AIR MILES Rights, LoyaltyOne Co. has an exclusive right to use the AIR MILES Rights for the purposes of operating the AIR MILES reward program in Canada (the “AIR MILES Program”) for an indefinite term in exchange for a royalty payment equal to 1% of gross billings from the AIR MILES Program.

On May 20, 2019, the Company indirectly acquired through MRM Royalties Limited Partnership (“MRM LP”) (an entity controlled by the Company), the trademarks and certain other intellectual property rights utilized by Mr. Mikes Restaurants Corporation (“Mr. Mikes”) in its restaurant business (the “MRM Rights”). The Company granted Mr. Mikes the licence to use the MRM Rights for a term ending on May 19, 2118 in exchange for a royalty payment initially equal to 4.35% of notional system sales of Mr. Mikes locations in the royalty pool (the “Mr. Mikes 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, 2018.

## DIVERSIFIED ROYALTY CORP.

Notes to Condensed Consolidated Interim Financial Statements  
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### 2. Basis of preparation (continued):

(a) Statement of compliance (continued):

These condensed consolidated interim financial statements were authorized and approved for issue by the Company's Board of Directors on August 8, 2019.

(b) Basis of measurement:

These financial statements have been prepared on the historical cost basis except for the interest rate swaps and Exchangeable MRM Units, 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, 2018, except as described below.

*Exchangeable MRM Units*

In connection with the acquisition of MRM Rights, MRM LP issued Class B and Class C units of MRM LP (the "Exchangeable MRM Units") to Mr. Mikes (note 7). These units are exchangeable into common shares of DIV upon satisfaction of certain performance criteria. On May 20, 2019, the maximum number of DIV shares that may be issued in exchange for the Class B and Class C units of MRM LP is 355,032. The Exchangeable MRM Units are recorded as a liability and measured at fair value in the Company's financial statements.

(c) Functional and presentation currency:

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

### 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, 2018, except as described below.

On January 1, 2019, the Company adopted IFRS 16, *Leases* ("IFRS 16"). 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 Company does not have any leases within the scope of IFRS 16, therefore the adoption of IFRS 16 did not have an impact on the Company's accumulated deficit as at January 1, 2019.

### 4. Cash and cash equivalents:

	June 30, 2019	December 31, 2018
Cash	\$ 1,121	\$ 1,024
Cash equivalents	45,520	77,318
	<u>\$ 46,641</u>	<u>\$ 78,342</u>

**DIVERSIFIED ROYALTY CORP.**

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**5. Royalty pools:**

## (a) Mr. Lube:

Royalty income from Mr. Lube was as follows:

Expressed in thousands of Canadian dollars, except for number of locations	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Locations in the Mr. Lube Royalty Pool at period end	122	118	122	118
Mr. Lube Royalty Pool system sales	\$ 55,968	\$ 52,683	\$ 105,720	\$ 99,745
Royalty income	4,074	3,784	7,737	7,044

Effective May 1, 2019, the Mr. Lube Royalty Pool was adjusted to include the royalties from four new Mr. Lube locations. With the adjustment for these four new locations, the Mr. Lube Royalty Pool had 122 locations effective May 1, 2019 (note 7).

During the six months ended June 30, 2019, royalty income from Mr. Lube did not have any make-whole payments. During the six months ended June 30, 2018, royalty income from Mr. Lube included make-whole payments totaling \$0.02 million on lost system sales of \$0.3 million.

## (b) Sutton:

Royalty income from Sutton was as follows:

Expressed in thousands of Canadian dollars, except for number of agents	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Number of agents at period end	5,400	5,400	5,400	5,400
Royalty income	\$ 967	\$ 948	\$ 1,934	\$ 1,896

Effective July 1, 2019, the monthly Sutton Royalty Rate was increased from \$59.693 per agent to \$60.887 per agent, representing the 2.0% annual contractual increase in the Sutton Royalty Rate for 2019.

## (c) AIR MILES:

Royalty income related to the AIR MILES Program was as follows:

Expressed in thousands of Canadian dollars	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Gross billings	\$ 196,996	\$ 197,240	\$ 366,502	\$ 370,367
Royalty income	1,970	1,972	3,665	3,703



## DIVERSIFIED ROYALTY CORP.

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### 5. Royalty pools (continued):

(d) Mr. Mikes:

Pursuant to the term of the licence and royalty agreement between Mr. Mikes and MRM LP dated May 20, 2019 (the "Mr. Mikes Licence and Royalty Agreement"), the royalty paid by Mr. Mikes to MRM LP is calculated by multiplying the notional system sales of restaurants in the Mr. Mikes Royalty Pool by an agreed royalty rate, which is initially set at 4.35%.

Royalty income from Mr. Mikes from May 20, 2019, the date of the MRM Rights acquisition, to June 30, 2019 was as follows:

Expressed in thousands of Canadian dollars	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Restaurants in the Mr. Mikes Royalty Pool at period end	38	n / a	38	n / a
Mr. Mikes Royalty Pool notional system sales	\$ 10,458	n / a	\$ 10,458	n / a
Royalty income	455	-	455	-

### 6. Royalties and management fees receivable:

	June 30,		December 31,	
	2019		2018	
Mr. Lube	\$	1,421	\$	1,242
Sutton		347		347
AIR MILES		2,226		2,376
Mr. Mikes		473		-
	\$	4,467	\$	3,965

### 7. Intangible assets:

	SGRS Rights	ML Rights	AIR MILES Program	MRM Rights	Total
Balance, January 1, 2019	\$ 32,273	\$ 149,424	\$ 53,977	-	\$ 235,674
Additions	-	2,903	-	43,210	46,113
Balance, June 30, 2019	\$ 32,273	\$ 152,327	\$ 53,977	\$ 43,210	281,787

(a) ML Rights:

On May 1, 2019, the Mr. Lube Royalty Pool has been adjusted to include the royalties from four new Mr. Lube locations. The initial consideration paid to Mr. Lube for the estimated additional royalty revenue is \$2.7 million, representing 80% of the total estimated consideration of \$3.4 million. In exchange for the addition to the Mr. Lube Royalty Pool, Mr. Lube received the right to exchange Class B LP units of ML LP for common shares of DIV. DIV elected to pay the initial consideration to Mr. Lube in cash. The remaining consideration payable for the additional royalty revenue will be paid to Mr. Lube on May 1, 2020, the next adjustment date, and will be adjusted to reflect the actual system sales of the four new locations added to the Mr. Lube Royalty Pool for the year ending December 31, 2019.

The actual system sales of the two new Mr. Lube locations added to the Mr. Lube Royalty Pool on May 1, 2018 have now been determined for the year ended December 31, 2018. The total consideration payable to Mr. Lube for the net additional royalty revenue of these two locations based on their actual system sales for the year ended December 31, 2018 is \$1.1 million. After taking into account the \$0.9 million previously paid on May 1, 2018, DIV paid Mr. Lube the remaining \$0.2 million of cash consideration on May 1, 2019.

## DIVERSIFIED ROYALTY CORP.

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### 7. Intangible assets (continued):

#### (b) MRM Rights:

On May 20, 2019, the Company acquired, through MRM LP, the MRM Rights for \$43.2 million. The purchase price was satisfied by a cash payment of \$37.1 million, the issuance of 1,000,000,000 Class B and Class C units of MRM LP having an agreed value of \$1.15 million to Mr. Mikes, and a promissory note of \$4.95 million, payable subject to certain conditions being met. The cash payment was financed by cash on hand of \$37.1 million, which was subsequently partially refinanced by the issuance of \$10.3 million of debt (note 8). In addition, \$0.2 million in costs incurred for the acquisition of the MRM Rights were capitalized as part of the purchase.

The promissory note is payable on the later of May 20, 2020 and the date Mr. Mikes has opened the five locations earmarked to be opened in 2019, subject to Mr. Mikes meeting the required royalty coverage test. Once these five locations are open and Mr. Mikes has met the required royalty coverage test, these locations will be added to the Mr. Mikes Royalty Pool. The promissory note is initially recorded at a fair value of \$4.7 million and is subsequently measured at amortized cost using the effective interest method.

The Class B and Class C units are exchangeable into common shares of the Company through certain agreements among Mr. Mikes, MRM Royalties GP Inc. and the Company, in each case, upon satisfaction of certain performance criteria and the approval of the TSX. The Class B units become exchangeable into common shares of the Company upon adding eligible Mr. Mikes locations to the MRM Royalty Pool (other than the five locations subject to the promissory note). The Class C units become exchangeable into common shares of the Company upon increases in the MRM Royalty Rate, which may be done in increments of 0.25% six times during the life of the royalty, in accordance with the partnership agreement dated May 20, 2019 among Mr. Mikes, the Company and MRM Royalties GP Inc. On May 20, 2019, the total Exchangeable MRM Units was 355,032, and represents a retained interest in MRM LP (the "Initial Retained Interest") of approximately 4.1%. The Initial Retained Interest must be held in perpetuity and cannot be exchanged by Mr. Mikes for common shares of DIV without DIV's prior written approval and the approval of the TSX.

Annually on April 1, the Mr. Mikes Royalty Pool may be adjusted, subject to meeting certain criteria, to include gross sales from new Mr. Mikes restaurants less gross sales from Mr. Mikes restaurants that were permanently closed during the preceding calendar year. In return for adding these net sales to the Mr. Mikes Royalty Pool, Mr. Mikes receives the right to indirectly acquire common shares of the Company through the exchange of Class B LP units of MRM LP (the "MRM Additional Entitlement"). The MRM Additional Entitlement is determined based on the estimated net-tax-adjusted royalty revenue added to the MRM Royalty Pool (adjusted by a 10% discount for restaurants that were open for business prior to December 31, 2024, or a 7.5% discount for all other locations), divided by the yield of the Company's shares, divided by the weighted average share price of the Company's shares of the 20 trading days ending on the fifth trading day preceding April 1. Mr. Mikes receives 80% of the estimated MRM Additional Entitlement initially, with the balance received on April 1 of the subsequent year when the actual full year performance of the new locations is known with certainty. The MRM Additional Entitlement is exchanged by Mr. Mikes into common shares of DIV, or settled in cash at DIV's option, pursuant to the Mr. Mikes Exchange Agreement.

In addition to the royalty, Mr. Mikes will pay the Company a management fee of approximately \$0.04 million per year for strategic and other services. The management fee will be increased at a rate of 2.5% per annum over the term of the Mr. Mikes Licence and Royalty Agreement.

## DIVERSIFIED ROYALTY CORP.

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(Unaudited)  
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### 8. Borrowings:

As at June 30, 2019, the Company had the following term loan facilities and operating lines of credit:

Term loan facilities	Interest rate	Maturity date	Face value	Carrying value
SGRS LP term loan	BA + 2.00%	Jun 30, 2022	\$ 6,300	\$ 6,252
ML LP term loan	BA + 1.95%	Jul 31, 2022	41,600	41,393
AM LP term loan	BA + 2.25%	Sep 6, 2022	17,400	17,269
MRM LP term loan	BA + 1.95%	Jun 24, 2024	10,300	10,171
			\$ 75,600	\$ 75,085

Operating lines of credit	Interest rate	Maturity date	Maximum available	Available for use
SGRS LP line of credit	BA + 2.00%	Jun 30, 2022	\$ 500	\$ 500
ML LP line of credit	Prime + 0.25%	Jul 31, 2022	1,000	1,000
AM LP line of credit	BA + 2.25%	Sep 6, 2022	3,000	3,000
MRM line of credit	Prime + 0.25%	Jun 24, 2024	500	500
			\$ 5,000	\$ 5,000

On June 24, 2019, in connection with the acquisition of the MRM Rights (note 7), MRM LP entered into a credit agreement with a Canadian chartered bank for a senior credit facility that consists of a non-amortizing \$10.3 million term loan facility and \$0.5 million line of credit. The MRM LP term loan and line of credit are secured by the MRM Rights and the royalties payable by Mr. Mikes. The MRM LP term loan and line of credit are subject to certain financial covenants, including a covenant for MRM LP to maintain a funded debt to EBITDA ratio of not more than 3.0:1.0.

As at June 30, 2019, SGRS LP, ML LP, AM LP and MRM LP were in compliance with all financial covenants.

### 9. Convertible debentures:

The following table reconciles the principal amount of the convertible debentures to the carrying value of the liability component.

	June 30, 2019	December 31, 2018
Principal amount	\$ 57,500	\$ 57,500
Equity component of debentures	(4,312)	(4,312)
Unamortized deferred financing fees	(1,848)	(2,080)
Accretion on liability component of debentures	1,217	832
	\$ 52,557	\$ 51,940

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### 10. Exchangeable MRM Units:

Mr. Mikes is entitled to receive distributions from MRM LP on the Initial Retained Interest on a pro rata basis with the limited partnership units of MRM LP held by DIV. The Exchangeable MRM Units are recorded as a liability and measured at fair value. The distributions issued by MRM LP to Mr. Mikes are recorded as an expense on the Company's income statement. During the three and six months ended June 30, 2019, MRM LP issued distributions of \$nil.

The fair value of the Exchangeable MRM Units is determined at the end of each period by multiplying the number of Exchangeable MRM Units held by Mr. Mikes at the end of the period by the closing price of DIV shares on the last business day of the period. As at June 30, 2019, the Exchangeable MRM Units were valued at \$1.1 million based on the DIV closing share price of \$3.08 at period end, multiplied by the total number of Exchangeable MRM Units of 355,032.

### 11. Income taxes:

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Current tax expense	\$ 232	\$ -	\$ 232	\$ -
Deferred tax expense	1,176	1,262	2,240	2,426
	\$ 1,408	\$ 1,262	\$ 2,472	\$ 2,426

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

	June 30, 2019	December 31, 2018
Non-capital losses	\$ -	\$ 1,016
Intangible assets	273	282
Investment tax credits	199	199
Other	175	37
Financing and share issuance costs	(15)	185
Convertible debentures	(836)	(939)
Intangible assets	(9,774)	(8,518)
Net deferred tax liability	\$ (9,978)	\$ (7,738)

As at December 31, 2018, the Company had non-capital loss carryforwards of \$3.8 million. As at June 30, 2019, the Company's non-capital loss carryforwards were fully utilized.

The deferred tax liability as at June 30, 2019 is largely associated with the temporary differences on the Company's intangible assets, which have an undepreciated capital cost allowance of approximately \$187.7 million (December 31, 2018 - \$150.3 million).

### 12. Share Capital:

On June 11, 2019, the Company held an Annual and Special Meeting where shareholders approved a special resolution to reduce the stated capital to \$160.0 million. This approval resulted in a reduction of share capital of \$26.4 million, and a combined increase of contributed surplus and retained earnings of \$26.4 million.

**DIVERSIFIED ROYALTY CORP.**

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**13. Share-based compensation:**

## (a) Restricted share units:

The number of RSUs outstanding is as follows:

	Number of RSUs	Weighted average grant- date fair value
Balance, January 1, 2019	921,521	\$ 3.30
Granted	67,825	3.15
Dividends earned	33,225	3.11
Settled	(46,387)	(2.64)
Balance, June 30, 2019	976,184	\$ 3.32
Unvested	950,771	\$ 3.33
Vested	25,413	\$ 2.92

## (b) Share options:

The following table summarizes the changes in the Company's share options during the six months ended June 30, 2019:

	Number of options	Weighted average exercise price
Balance, January 1, 2019 and June 30, 2019	2,300,000	\$ 3.26

The following table summarizes information relating to outstanding and exercisable options as at June 30, 2019:

Exercise prices	Options outstanding			Options exercisable	
	Number of options	Weighted average remaining life (years)	Weighted average exercise price per share	Number exercisable	Weighted average exercise price per share
\$ 3.22 - \$ 3.53	2,300,000	3.30	\$ 3.26	-	\$ -

## DIVERSIFIED ROYALTY CORP.

Notes to Condensed Consolidated Interim Financial Statements  
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For the three and six months ended June 30, 2019 and 2018

### 14. Income per share:

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Income for the period	\$ 3,435	\$ 3,040	\$ 5,919	\$ 5,670
Weighted average number of shares outstanding – basic	108,245,518	107,045,438	108,043,896	106,885,697
Dilutive adjustment for share options	-	69,580	-	79,332
Dilutive adjustment for restricted share units	925,788	718,306	929,663	724,555
Dilutive adjustment for Exchangeable MRM Units	159,959	-	80,422	-
Weighted average number of shares outstanding – diluted	109,331,265	107,833,324	109,053,981	107,689,584
Net income per common share:				
Basic	\$ 0.03	\$ 0.03	\$ 0.05	\$ 0.05
Diluted	\$ 0.03	\$ 0.03	\$ 0.05	\$ 0.05

### 15. Other finance income (costs), net:

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Foreign exchange gain (loss)	\$ (4)	\$ 7	\$ (8)	\$ 12
Finance income	336	363	779	725
Amortization of deferred financing charges	(148)	(135)	(292)	(271)
Accretion expense	(218)	(179)	(408)	(356)
	\$ (34)	\$ 56	\$ 71	\$ 110

### 16. Financial instruments:

The Company must classify fair value measurements according to a hierarchy that reflects the significance of the inputs used in performing such measurements. The Company'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 carrying value of current financial assets and liabilities approximate their fair value due to their short-term nature. The carrying value of the long-term bank loans approximates their fair value as these facilities bear interest at floating market interest rates. The fair value of the convertible debentures of \$57.6 million and the Exchangeable MRM Units of \$1.1 million are measured using Level 1 inputs. The fair value of the interest rate swap liabilities are measured using Level 2 inputs.

**DIVERSIFIED ROYALTY CORP.**

Notes to Condensed Consolidated Interim Financial Statements  
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**16. Financial instruments (continued):**

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

	June 30, 2019	December 31, 2018
Assets carried at amortized cost:		
Cash and cash equivalents	\$ 46,641	\$ 78,342
Royalties and management fees receivable	4,467	3,965
Amounts receivable	2,254	153
	<b>\$ 53,362</b>	<b>\$ 82,460</b>
Liabilities carried at amortized cost:		
Accounts payable and accrued liabilities	\$ 1,159	\$ 832
Promissory note	4,734	-
Long-term bank loans	75,085	64,856
Convertible debentures	52,557	51,940
	<b>\$ 133,535</b>	<b>\$ 117,628</b>
Liabilities carried at fair value:		
Interest rate swap liabilities	\$ 843	\$ 137
Exchangeable MRM Units	1,093	-
	<b>\$ 1,936</b>	<b>\$ 137</b>

**17. Supplemental cash flow information:**

The following table reconciles the movements in liabilities to cash flows arising from financing activities:

	Long-term debt (note 8)	Debentures (note 9)	Promissory note (note 7)	Total
Balance, December 31, 2018	\$ 64,856	\$ 51,940	\$ -	\$ 116,796
Changes from financing cash flows:				
Proceeds from issuance of debt	10,300	-	-	10,300
Debt financing costs	(130)	-	-	(130)
Liability-related other changes:				
Debt issued on purchase of intangible asset, net of discount	-	-	4,710	4,710
Amortization of deferred financing charges	59	233	-	292
Accretion expense	-	384	24	408
Balance, June 30, 2019	<b>\$ 75,085</b>	<b>\$ 52,557</b>	<b>\$ 4,734</b>	<b>\$ 132,376</b>

**18. Subsequent event:**

In July 2019, MRM LP entered into an interest rate swap arrangement with an effective date of July 25, 2019 and a maturity date of June 24, 2024 that results in a fixed interest rate of 4.05% for \$10.3 million of the MRM LP term loan facility.