Condensed Consolidated Interim Financial Statements of

DIVERSIFIED ROYALTY CORP.

Three and nine months ended September 30, 2023 and 2022

(Unaudited)

DIVERSIFIED ROYALTY CORP.
Condensed Consolidated Interim Statements of Financial Position
(Expressed in thousands of Canadian dollars)

	Note	September 30, 2023	December 31, 2022
Assets			
Current assets:			
Cash		$ 9,003	$ 7,409
Royalty and other receivables	5	4,933	5,591
Prepaid expenses and other		600	409
Interest rate swap assets	10	3,004	2,104
		17,540	15,513
Interest rate swap assets	10	1,006	1,205
Right-of-use asset and other		731	801
Investment in NND LP	6	42,589	42,339
Intangible assets	7	404,728	398,592
		$ 466,594	$ 458,450
Liabilities and Shareholders' Equity			
Current liabilities:			
Accounts payable and accrued liabilities		$ 1,522	$ 5,376
Income tax payable	12	266	1,486
Bank loans, net of deferred financing charges	8	10,856	-
		12,644	6,862
Bank loans, net of deferred financing charges	8	143,330	147,905
Convertible debentures	9	48,342	47,637
Promissory note		3,752	3,467
Exchangeable units and other	11	2,122	3,716
Lease obligation		723	770
Deferred income tax liability	12	17,954	14,205
Shareholders' equity:			
Share capital		258,974	253,139
Contributed surplus		40,661	39,776
Equity component of convertible debentures		5,127	5,127
Accumulated other comprehensive income		1,308	1,165
Accumulated deficit		(68,343)	(65,319)
		237,727	233,888
		$ 466,594	$ 458,450

The accompanying notes are an integral part of these 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 September 30, 2023	Three months ended September 30, 2022	Nine months ended September 30, 2023	Nine months ended September 30, 2022
Royalty income	4	$ 13,484	$ 11,493	$ 39,721	$ 32,064
Management fees		128	148	381	399
		13,612	11,641	40,102	32,463
Expenses:					
Salaries and benefits		473	471	1,568	1,569
Share-based compensation	13	324	267	1,004	823
General and administration		264	198	788	592
Professional fees		166	133	515	337
		1,227	1,069	3,875	3,321
Income from operations		12,385	10,572	36,227	29,142
Interest expense on credit facilities		(2,915)	(2,288)	(8,683)	(6,474)
Other finance costs, net	15	(437)	(660)	(1,240)	(1,489)
Fair value adjustment on financial instruments	6, 10, 11	417	1,966	4,900	6,585
Income before income taxes		9,450	9,590	31,204	27,764
Income tax expense	12	2,603	2,862	8,573	7,697
Income for the period		**$ 6,847**	**$ 6,728**	**$ 22,631**	**$ 20,067**
Other comprehensive income					
Item that may be reclassified subsequently to profit or loss:					
Foreign currency translation adjustment		1,535	-	143	-
Other comprehensive income for the period		**$ 1,535**	**$ -**	**$ 143**	**$ -**
Total comprehensive income for the period		**$ 8,382**	**$ 6,728**	**$ 22,774**	**$ 20,067**
Weighted average number of shares outstanding					
Basic		143,133,488	124,427,909	142,377,879	123,603,610
Diluted		144,425,877	125,523,340	143,780,998	144,110,093
Income per share					
Basic	14	$ 0.05	$ 0.05	$ 0.16	$ 0.16
Diluted	14	$ 0.05	$ 0.05	$ 0.16	$ 0.16

The accompanying notes are an integral part of these 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)

	Note	Common shares	Share capital	Contributed surplus	Equity component of convertible debentures	Accumulated other comprehensive income	Accumulated deficit	Total equity
Balance, December 31, 2022		141,422,794	$ 253,139	$ 39,776	$ 5,127	$ 1,165	$ (65,319)	$ 233,888
Common shares issued on DRIP		1,090,387	3,132	-	-	-	-	3,132
Common shares issued on RSU's settled		57,075	72	(90)	-	-	-	(18)
Share-based compensation - net of RSU's settled		-	-	975	-	-	-	975
Dividends declared		-	-	-	-	-	(25,655)	(25,655)
Settlement of consideration payable	7	832,848	2,631	-	-	-	-	2,631
Comprehensive income		-	-	-	-	143	22,631	22,774
Balance, September 30, 2023		143,403,104	$ 258,974	$ 40,661	$ 5,127	$ 1,308	$ (68,343)	$ 237,727

	Note	Common shares	Share capital	Contributed surplus	Equity component of convertible debentures	Accumulated other comprehensive income	Accumulated deficit	Total equity
Balance, December 31, 2021		122,559,192	$ 201,972	$ 39,450	$ 2,938	$ -	$ (52,835)	$ 191,525
Common shares issued on DRIP		928,252	2,551	-	-	-	-	2,551
Common shares issued on RSU's settled		81,582	196	(300)	-	-	-	(104)
Share-based compensation - net of RSU's settled		-	-	783	-	-	-	783
Dividends declared		-	-	-	-	-	(20,392)	(20,392)
Redemption of convertible debentures	9	-	-	-	(774)	-	-	(774)
Issuance of convertible debentures	9	-	-	-	2,091	-	-	2,091
Addition to intangible assets	7	1,083,063	3,422	-	-	-	-	3,422
Comprehensive income		-	-	-	-	-	20,067	20,067
Balance, September 30, 2022		124,652,089	$ 208,141	$ 39,933	$ 4,255	$ -	$ (53,160)	$ 199,169

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

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

	Note	Three months ended September 30, 2023	Three months ended September 30, 2022	Nine months ended September 30, 2023	Nine months ended September 30, 2022
Operating activities:					
Net income		$ 6,847	$ 6,728	$ 22,631	$ 20,067
Adjustments for:					
Tax expense	12	2,603	2,862	8,573	7,697
Depreciation expense		25	25	75	74
Share-based compensation		324	267	1,004	823
Fair value adjustments on financial instruments		(417)	(1,966)	(4,900)	(6,585)
Interest expense on credit facilities		2,915	2,288	8,683	6,474
Other finance costs, net		437	660	1,240	1,489
Interest paid		(2,444)	(1,435)	(7,583)	(5,621)
Interest received		45	18	156	87
Taxes paid		(1,637)	(1,119)	(6,043)	(5,028)
Distributions received from NND LP		1,277	1,250	3,811	3,736
Distributions paid on Exchangeable MRM Units	11a	(53)	(278)	(126)	(278)
Changes in non-cash operating items:					
Royalties and management fees receivable		423	353	634	(210)
Amounts receivable		62	(8)	9	(5)
Prepaid expenses and other		(100)	(528)	(283)	(433)
Accounts payable and accrued liabilities		117	144	(4,465)	(2,062)
Cash flows generated from operating activities		10,424	9,261	23,416	20,225
Financing activities:					
Proceeds from issuance of debt, net of fees	7,8	11,976	-	19,472	-
Payment of lease obligations		(26)	(27)	(79)	(79)
RSUs settled in cash		-	-	(47)	-
Repayment of debt	8	(11,367)	-	(13,863)	-
Payment of dividends		(7,518)	(5,954)	(22,523)	(17,841)
Proceeds from issuance of convertible debentures, net of fees	9	-	-	-	50,400
Redemption of convertible debentures	9	-	-	-	(52,500)
Cash flows used in financing activities		(6,935)	(5,981)	(17,040)	(20,020)
Investing activities:					
Additions to intangible assets	7	-	-	(4,754)	-
Purchase of fixed assets		(4)	-	(5)	-
Cash flows used in investing activities		(4)	-	(4,759)	-
Net increase in cash		3,485	3,280	1,617	205
Cash, beginning of the period		5,525	5,865	7,409	8,939
Effect of foreign exchange rate changes on cash		(7)	5	(23)	6
Cash, end of the period		$ 9,003	$ 9,150	$ 9,003	$ 9,150

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

Diversified Royalty Corp. (“DIV”) is a company domiciled in Canada and governed by the Business Corporations Act (British Columbia). The condensed consolidated interim financial statements of DIV as at and for the three and nine months ended September 30, 2023 are composed of DIV and its subsidiaries (together referred to as the “Company”). The head office of the Company is located at 330-609 Granville Street, Vancouver, BC, V7Y 1A1. The registered office of the Company is located at the 25th Floor, 700 West Georgia Street, Vancouver, BC, V7Y 1B3. The Company’s common shares are listed on the Toronto Stock Exchange (“TSX”) and traded under the symbol “DIV”.

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”). The Company’s Royalty Partners and the respective licence and royalty arrangements are summarized below.

Sutton Group Realty Services Ltd. (“Sutton”): SGRS Royalties Limited Partnership (“SGRS LP”) (an entity controlled by the Company), owns the trademarks and certain other intellectual property rights utilized by Sutton in its residential real estate franchise business (the “SGRS Rights”). The Company granted Sutton the licence to use the SGRS Rights in exchange for a royalty payment currently equal to $65.906 per agent per month (the “Sutton Royalty Rate”) for the number of agents included in the royalty pool (the “Sutton Royalty Pool”).

Mr. Lube Canada Limited Partnership (“Mr. Lube + Tires”): ML Royalties Limited Partnership (“ML LP”) (an entity controlled by the Company) owns the trademarks and certain other intellectual property rights utilized by Mr. Lube + Tires in its business (the “ML Rights”). The Company granted Mr. Lube + Tires the licence to use the ML Rights in exchange for a royalty payment currently equal to 7.95% of non-tire system sales and 2.50% of tire system sales of Mr. Lube + Tires locations in the royalty pool (the “Mr. Lube + Tires Royalty Pool”).

AIR MILES Loyalty Inc. (“Loyalty Inc.”): AM Royalties Limited Partnership (“AM LP”) (a wholly owned subsidiary of the Company) owns the Canadian AIR MILES trademarks and certain related Canadian intellectual property rights (collectively, the “AIR MILES® Rights”) used by Loyalty Inc. (an affiliate of the Bank of Montreal) in operating the AIR MILES® reward program in Canada (the “AIR MILES® Program”). In accordance with the terms of two licence agreements with Loyalty Inc. (collectively, the “AIR MILES® Licences”), Loyalty Inc. has an exclusive right to use the AIR MILES® Rights in Canada in exchange for a royalty payment equal to 1% of gross billings from the AIR MILES® Reward Program.

Mr. Mikes Restaurants Corporation (“Mr. Mikes”): MRM Royalties Limited Partnership (“MRM LP”) (an entity controlled by the Company) owns the trademarks and certain other intellectual property rights utilized by Mr. Mikes in its restaurant business (the “MRM Rights”). The Company granted Mr. Mikes the licence to use the MRM Rights in exchange for a royalty based on the actual system sales of the Mr. Mikes locations in the royalty pool, which was comprised of 44 Mr. Mikes Restaurants (the “Mr. Mikes Royalty Pool”).

Nurse Next Door Professional Homecare Services Inc. (“Nurse Next Door”): NND Royalties Limited Partnership (“NND LP”) (an entity that is majority-owned by the Company) has legal ownership of the trademarks and certain other intellectual property rights utilized by Nurse Next Door Professional Homecare Services Inc. (“Nurse Next Door”) in its premium home care business (the “NND Rights”) (note 6). NND LP granted Nurse Next Door the licence to use the NND Rights. The Company, through its ownership of NND LP Class A units, is currently entitled to receive a cash distribution of $5.1 million per year, which grows at a fixed rate of 2.0% per annum (the “DIV Distribution Entitlement”).

Oxford Learning Centres, Inc. (“Oxford”): OX Royalties Limited Partnership (“OX LP”) (an entity controlled by the Company) owns the trademarks and certain other intellectual property rights utilized by Oxford Learning Centres, Inc. (“Oxford”) in its supplemental education business (the “Oxford Rights”). The Company granted Oxford the licence to use the Oxford Rights in exchange for a royalty payment currently equal to 7.67% of the gross sales of Oxford locations in the royalty pool (the “Oxford Royalty Pool”).

1. Nature of operations (continued):

Stratus Building Solutions Franchising, LLC ("Stratus") (a US based company): Strat-B Royalties Limited Partnership ("Strat-B LP") (an entity controlled by the Company) owns the trademarks and certain other intellectual property rights utilized by Stratus in its business (the "Stratus Rights"). The Company granted Stratus the licence to use the Stratus Rights in exchange for a royalty payment currently equal to US$6.0 million per annum which grows at a rate of 5% in 2023, 2024, 2025 and 2026 and 4% thereafter.

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 in accordance with IFRS Accounting Standards 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, 2022.

These condensed consolidated interim financial statements were authorized and approved for issue by the Company's Board of Directors on November 8, 2023.

(b) Basis of measurement:

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 consolidated financial statements for the year ended December 31, 2022.

(c) Functional and presentation currency:

These consolidated financial statements are presented in Canadian dollars ("CAD").

The functional currency of Strat-B LP is the United States dollar ("USD"). All other entities in the Company have a Canadian dollar functional currency. References to "$" or "CAD" are related to Canadian dollars, while references to "US$" or "USD" are related to United States ("US") dollars.

3. Significant accounting policies:

These condensed consolidated interim financial statements have been prepared using the same accounting policies as the annual consolidated financial statements for the year ended December 31, 2022.

(Tabular amounts expressed in thousands of Canadian dollars)

4. Royalty income:

	Three months ended September 30, 2023	Three months ended September 30, 2022	Nine months ended September 30, 2023	Nine months ended September 30, 2022
Mr. Lube + Tires	$ 7,254	$ 6,156	$ 20,446	$ 17,018
Stratus[1]	2,018	-	6,072	-
Oxford	905	904	3,329	3,049
AIR MILES®	1,071	1,723	3,308	5,044
Mr. Mikes[2]	1,168	1,663	3,405	3,854
Sutton	1,068	1,047	3,161	3,099
	$ 13,484	$ 11,493	$ 39,721	$ 32,064

1) Stratus royalty income three and nine months ended September 30, 2023 was US$1.5 million and US$4.5 million respectively (three and nine months ended September 30, 2022 - $nil), translated at an average foreign exchange rate of $1.3413 and $1.3454 to US$1, respectively.
2) For the three and nine months ended September 30, 2023, Mr. Mikes royalty income includes payments of $0.05 million and $0.14 million, respectively (three and nine months ended September 30, 2022 – $0.58 million and $1.11 million, respectively), representing payment of deferred contractual royalty fees, which have been recognized as revenue upon collection.

Effective July 1, 2023, the monthly Sutton Royalty Rate increased from $64.614 per agent to $65.906 per agent.

5. Royalty and other receivables:

	September 30, 2023	December 31, 2022
Mr. Lube + Tires	$ 2,465	$ 2,102
AIR MILES®	699	1,641
Stratus[1]	613	612
Oxford	440	445
Sutton	383	376
Mr. Mikes	319	392
Other	7	16
Nurse Next Door	7	7
	$ 4,933	$ 5,591

1) Stratus royalty receivable was US$0.45 million at September 30, 2023, translated at a foreign exchange rate of $1.3577 to US$1.

6. Investment in NND LP:

The Company's investment in NND LP is a financial instrument measured at fair value. The valuation of the financial instrument includes an estimate of the discounted cash flow receivable from Nurse Next Door and takes into consideration the likelihood of Nurse Next Door exercising the NND Buy-Out Option and the NND Exchange Mechanism. The NND Buy-Out Option and NND Exchange Mechanism are embedded derivatives with a negligible value at September 30, 2023 and December 31, 2022. The contractual cash flows receivable from Nurse Next Door were discounted at a rate of 15.0% (December 31, 2022 – 14.4%).

The total fair value of NND LP at September 30, 2023 was $42.6 million (December 31, 2022 - $42.3 million) and a fair value gain of $4.1 million was recorded during the nine months ended September 30, 2023 (2022 – $3.0 million). A one percentage point increase in the discount rate would decrease the fair value by $2.9 million. A one percentage point decrease in the discount rate would increase the fair value by $3.4 million.

For the nine months ended September 30, 2023 the DIV Distribution Entitlement was $3.8 million gross and net of expenses incurred by NND LP (September 30, 2022 - $3.7 million gross and net of expenses incurred by NND LP).

(Tabular amounts expressed in thousands of Canadian dollars)

7. Intangible Assets:

		ML Rights (a)		AIR MILES (b)		SGRS Rights (c)		MRM Rights (d)		Oxford Rights (e)		Stratus Rights (f) (1)		Total
Balance, December 31, 2022	$	175,235	$	34,453	$	28,274	$	38,006	$	41,351	$	81,273	$	398,592
Additions		5,938		-		-		-		-		-		5,938
Foreign Exchange		-		-		-		-		-		198		198
Balance, September 30, 2023	$	181,173	$	34,453	$	28,274	$	38,006	$	41,351	$	81,471	$	404,728

1) At September 30, 2023, the Stratus Rights were translated at the period end rate of $1.3577 to US$1, giving rise to a $0.2 million foreign exchange gain recorded to other comprehensive income.

On April 21, 2023, DIV and Mr. Lube + Tires entered into an amendment (the "LP Amendment") to the amended and restated limited partnership agreement (the "LP Agreement") of DIV's direct subsidiary ML LP to confirm the terms on which five new locations would be added to the Mr. Lube + Tires Royalty Pool on May 1, 2023.

The initial consideration paid to Mr. Lube + Tires for the estimated net additional royalty revenue from the five new locations was $4.7 million, representing 80% of the total estimated consideration of $5.9 million. The initial consideration of $4.7 million was elected by DIV to be paid in cash (the "2023 Amendment Consideration"). The initial consideration is based on the forecast system sales of such locations for year ending December 31, 2023. As a result of the LP Amendment, the remaining consideration payable for the additional royalty revenue of the five new Mr. Lube + Tires locations added to the Mr. Lube + Tires Royalty Pool on May 1, 2023 will be paid to Mr. Lube + Tires on May 1, 2025 (as opposed to May 1, 2024), and will be adjusted to reflect the actual system sales of these five new locations for the year ending December 31, 2024 (as opposed to the actual system sales for the year ending December 31, 2023).

On May 1, 2021, the Mr. Lube + Tires Royalty Pool was adjusted to include royalties from 13 new flagship Mr. Lube + Tires locations. The initial consideration previously paid by DIV on May 1, 2021 was $7.7 million, which represented 80% of the total estimated consideration for those 13 locations, which estimate was based on the forecast system sales of these 13 locations for the 2021 fiscal year. The remaining consideration payable for the net additional royalty revenue related to 7 of the 13 locations of $1.6 million was paid by DIV to Mr. Lube + Tires in cash on May 1, 2022 based the actual system sales of these locations for the year ending December 31, 2021. The remaining consideration for the net additional royalty revenue related to 6 of the 13 locations of $2.8 million was paid by DIV to Mr. Lube + Tires in cash on May 1, 2023 (the "2021 True-up Consideration") based on the actual system sales of these locations for the year ending December 31, 2022.

On May 1, 2022, the Mr. Lube + Tires Royalty Pool was adjusted to include royalties from six new flagship Mr. Lube + Tires locations (the "2022 True-Up Locations") and to remove two locations that had been permanently closed. The initial consideration previously paid by DIV on May 1, 2022 was $3.4 million, which was paid in the form of 1,083,063 common shares of DIV on the basis of the 20-day volume weighted average closing price of the common shares for the period ended April 25, 2022 of $3.1592 per common share (the "2022 Share Price"). The initial consideration represented 80% of the total estimated consideration for those 2022 True-Up Locations, which estimate was based on the forecast system sales of these 2022 True-Up Locations for the 2022 fiscal year. The remaining consideration payable for the net additional royalty revenue related to the 2022 True-Up Locations of $2.6 million was paid by DIV to Mr. Lube + Tires in the form of 832,848 common shares valued on the 2022 Share Price and was determined based on the actual system sales of these locations for the year ended December 31, 2022. In accordance with the terms of the LP Agreement, ML LP also made a cash payment to Mr. Lube + Tires of approximately $192,000 representing the amount of the dividends of DIV that would have been received by Mr. Lube + Tires had the 832,848 common shares been issued to Mr. Lube + Tires on May 1, 2022.

To fund the 2023 Amendment Consideration and the 2021 True-up Consideration, DIV drew an additional $7.5 million on its Acquisition Facility (defined below, note 8a).

(Tabular amounts expressed in thousands of Canadian dollars)

8. Bank loans, net of deferred financing charges:

(a) Acquisition facility:

DIV has a $50.0 million senior secured credit facility (the "Acquisition Facility") with a Canadian chartered bank, that matures on April 20, 2026. On August 15, 2023, DIV used the incremental cash from the ML LP amended credit facility (refer to note 8b) to pay down $10.9 million of the outstanding balance on the Acquisition Facility. As at September 30, 2023, the Company had $nil outstanding under the Acquisition Facility.

(b) Term loan facilities and operating lines of credit:

As at September 30, 2023, the Company had the following short and long-term loan facilities and operating lines of credit:

Short-term loan facilities[1]	Interest rate	Maturity date	Face value	Carrying value
MRM LP term loan	BA + 1.95%	Jun 24, 2024	$ 10,300	$ 10,279
AM LP term loan[3]	BA + 1.95%	Sep 30, 2026	577	577
			$ 10,877	$ 10,856

Long-term loan facilities[1]	Interest rate	Maturity date	Face value	Carrying value
ML LP term loan[2]	BA + 2.00%	May 1, 2025	$ 79,870	$ 79,670
AM LP term loan[3]	BA + 1.95%	Sep 30, 2026	13,955	13,852
SGRS LP term loan	BA + 1.95%	Jun 30, 2026	6,300	6,269
NNDH LP term loan	BA + 1.90%	Nov 15, 2024	14,500	14,456
OX LP term loan	BA + 1.95%	Apr 27, 2025	9,000	8,965
Strat-B LP term loan	SOFR + 2.11%	Nov 15, 2027	20,366	20,255
			$ 143,990	$ 143,467

1) Current and Long term bank loans on the statement of financial position include $154.3 million term loan facilities less $137,000 in deferred financing fees on the Acquisition Facility.
2) On August 15, 2023. ML LP amended its credit facility agreement with an increase to the term loan facility from $67.9 million to $79.9 million, of which $10.9 million was used to pay down the outstanding balance on the Acquisition Facility.
3) On March 2, 2023, AM LP made a $2.4 million partial principal paydown on its $17.4 million credit facility, reducing the outstanding principal balance to $15.0 million. During the nine months ended September 30, 2023, AM LP made further partial principal paydowns of $0.5 million, in aggregate, on its credit facility. In addition, AM LP is subsequently expected to make a further $0.6 million partial principal paydown during the fourth quarter of 2023.

Operating lines of credit	Interest rate	Maturity date	Maximum available	Available for use
ML LP term loan	Prime + 0.25%	May 1, 2025	$ 1,000	$ 1,000
AM LP term loan	BA + 1.95%	Sep 30, 2026	3,000	3,000
SGRS LP term loan	BA + 1.95%	Jun 30, 2026	500	500
MRM LP term loan	Prime + 0.25%	Jun 24, 2024	500	500
OX LP term loan	Prime + 0.25%	Apr 27, 2025	500	500
Strat-B LP term loan	SOFR + 2.11%	Nov 15, 2027	679	679
			$ 6,179	$ 6,179

As at September 30, 2023, the Company was in compliance with all financial covenants associated with its Acquisition Facility, term loan facilities and operating lines of credit.

(Tabular amounts expressed in thousands of Canadian dollars)

9. Convertible debentures:

On March 30, 2022, the Company issued convertible unsecured subordinated debentures ("2027 Debentures") for an aggregate principal amount of $52.5 million at a price of $1,000 per debenture ("the Offering"). The 2027 Debentures mature on June 30, 2027 and bear interest at an annual rate of 6.00% payable semi-annually in arrears on the last day of December and June in each year, commencing June 30, 2022. At the holder's option, the 2027 Debentures may be converted into common shares of the Company at any time prior to the earlier of the last business day immediately preceding June 30, 2027 and the date specified by the Company for redemption. The conversion price will be $4.05 per common share (the "Conversion Price"), subject to adjustment in certain circumstances.

The 2027 Debentures are not redeemable prior to June 30, 2025, except upon the satisfaction of certain conditions after a change of control has occurred. On and after June 30, 2025 and prior to June 30, 2026, the 2027 Debentures may be redeemed in whole or in part from time to time at DIV's option, provided that the volume weighted average trading price of the common shares on the TSX during the 20 consecutive trading days ending on the fifth trading day preceding the date on which the notice of the redemption is given is not less than 125% of the Conversion Price. On or after June 30, 2026 and prior to the maturity date, DIV may, at its option, redeem the 2027 Debentures, in whole or in part, from time to time at par plus accrued and unpaid interest. On redemption or at maturity, the Company will repay the indebtedness of the 2027 Debentures by paying an amount equal to the principal amount of the outstanding debentures, together with accrued and unpaid interest thereon.

The Company may, at its option, elect to satisfy its obligation to repay the principal amount of the 2027 Debentures, which are to be redeemed or which have matured, by issuing shares to the holders of the convertible debentures. The number of shares to be issued will be determined by dividing $1,000 of principal amount of the debentures by 95% of the current market price on the maturity date.

On initial recognition, the Company valued the liability component of the 2027 Debentures at $49.4 million and the equity component at $3.1 million. In addition, the Company incurred transaction costs of $2.6 million, of which $2.4 million was allocated to the liability component and $0.2 million was allocated to the equity component. The net amount recognized as the equity component of the 2027 Debentures, after deferred taxes of $0.8 million, was $2.1 million.

The following table reconciles the principal amount of the 2027 Debentures to the carrying value of the liability component:

	September 30, 2023	December 31, 2022
Principal amount - 2027 Debentures	$ 52,500	$ 52,500
Equity component	(3,074)	(3,074)
Unamortized deferred financing fees	(1,847)	(2,161)
Accretion on liability component	763	372
	$ 48,342	$ 47,637

10. Interest rate swaps:

The following table summarizes the interest rate swap agreements the Company has entered into as of September 30, 2023:

Term loan facilities	Effective date	Maturity date	Fixed interest rate	Notional amount
ML LP	Jul 29, 2022	May 1, 2025	3.75%	$ 39,750
ML LP	Dec 15, 2022	May 1, 2025	6.09%	11,250
ML LP[1]	Sept 15, 2023	May 1, 2025	7.58%	9,000
AM LP	Aug 19, 2022	Sep 30, 2026	5.39%	8,700
MRM LP	Jul 25, 2019	Jun 24, 2024	4.05%	10,300
NNDH LP	Feb 12, 2020	Nov 15, 2024	3.98%	7,500
OX LP	Aug 26, 2020	Apr 27, 2025	2.96%	4,500
Strat-B LP	Jan 1, 2023	Nov 15, 2027	5.72%	15,274

1) Effective September 15, 2023 (refer to note 17c), ML LP entered into a swap agreement with a Canadian chartered bank to swap 75% of the incremental $12 million loan (refer to note 8b). The fixed interest rate includes an interest rate of 5.58% plus credit spread of 2.00%.

(Tabular amounts expressed in thousands of Canadian dollars)

11. Exchangeable Units and Other:

(a) 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 (the "MRM Units") held by DIV. The 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 in the statements of net income. During the nine months ended September 30, 2023 MRM LP issued distributions of $0.1 million (2022 - $0.3 million) to Mr. Mikes.

The fair value of the MRM Units is determined at the end of each period by multiplying the number of 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 September 30, 2023 the MRM Units were valued at $0.9 million (December 31, 2022 - $1.1 million) based on the DIV closing share price of $2.56 as at September 30, 2023 (December 31, 2022 - $2.98), multiplied by the total number of MRM Units of 355,032.

(b) ML Units:

The balance as at September 30, 2023 of $1.2 million (December 31, 2022 - $2.6 million) in exchangeable units and other relates to 20% consideration payable to Mr. Lube + Tires for the 2023 addition of 5 locations to be paid to Mr. Lube + Tires on May 1, 2025.

12. Income taxes:

The income taxes recognized in the statements of net income are as follows:

	Three months ended September 30, 2023	Three months ended September 30, 2022	Nine months ended September 30, 2023	Nine months ended September 30, 2022
Deferred income tax expense	$ 899	$ 1,040	$ 3,749	$ 3,321
Current income tax expense	1,704	1,822	4,824	4,376
	$ 2,603	$ 2,862	$ 8,573	$ 7,697

The tax effect of temporary differences that gives rise to the net deferred tax liabilities as at September 30, 2023 and December 31, 2022 are as follows:

	September 30, 2023	December 31, 2022
Intangible assets	$ 200	$ 211
Financing and share issuance costs	553	775
Convertible debentures	(624)	(730)
Other	(1,388)	(1,281)
Intangible assets	(16,695)	(13,180)
Net deferred income tax liability	$ (17,954)	$ (14,205)

The deferred tax liability as at September 30, 2023 is largely associated with the temporary differences on the Company's intangible assets, which have an undepreciated capital cost allowance of approximately $255.4 million (December 31, 2022 - $265.8 million). In addition, pursuant to NND LP's limited partnership agreement dated November 15, 2019, its undepreciated capital cost allowance of approximately $42.5 million at September 30, 2023 (December 31, 2022 - $44.1 million) is allocated to the Company for tax purposes.

Tax attributes are subject to review, and potential adjustment, by competent authority.

(Tabular amounts expressed in thousands of Canadian dollars)

13. Share-based compensation:

(a) Restricted share units (RSU's):

The number of RSUs outstanding as at September 30, 2023 is as follows:

	September 30, 2023	
	Number of RSUs	Weighted average grant-date fair value
Balance, beginning of period	550,112	$ 2.08
Granted	322,420	3.01
Dividends earned	49,699	2.93
Settled	(72,703)	3.01
Balance, end of period	849,528	$ 2.40
Vested, but not settled	(5,059)	3.18
Unvested	844,469	$ 2.40

(b) Share options:

The following table summarizes the changes in the Company's share options during the nine months ended September 30, 2023:

	September 30, 2023	
	Number of options	Weighted average exercise price
Balance, beginning of period	1,583,334	$ 2.66
Granted	791,667	3.00
Balance, end of period	2,375,001	$ 2.78

The following tables summarizes information relating to outstanding and exercisable options as at September 30, 2023:

Expiry Date	Exercise Price	Weighted average remaining life (years)	Options outstanding	Options exercisable
May 6, 2026	$ 2.52	2.60	791,667	527,778
January 1, 2027	2.80	3.26	791,667	263,889
January 1, 2028	3.00	4.26	791,667	-
Balance, September 30, 2023		3.37	2,375,001	791,667

The weighted average assumptions used in calculating the fair values of options granted in 2023 are as follows:

Risk free rate	3.34%
Expected life	5.0 years
Expected volatility	34.59%
Forfeiture rate	Nil
Expected dividends	8.05%

(Tabular amounts expressed in thousands of Canadian dollars)

14. Income per share:

	Three months ended September 30, 2023	Three months ended September 30, 2022	Nine months ended September 30, 2023	Nine months ended September 30, 2022
Income for the period - basic	$ 6,847	$ 6,728	$ 22,631	$ 20,067
Interest expense on convertible debentures, net of tax[1]	-	-	-	2,626
Income for the period - diluted	$ 6,847	$ 6,728	$ 22,631	$ 22,693
Weighted average number of shares outstanding - basic	143,133,488	124,427,909	142,377,879	123,603,610
Effective impact of dilutive securities:				
Share options	92,888	54,518	166,890	115,038
RSUs	844,469	685,881	881,197	733,636
Convertible debentures[1]	-	-	-	19,302,777
Exchangeable MRM units	355,032	355,032	355,032	355,032
Weighted average number of shares outstanding - diluted	144,425,877	125,523,340	143,780,998	144,110,093
Income per share				
Basic	$ 0.05	$ 0.05	$ 0.16	$ 0.16
Diluted	$ 0.05	$ 0.05	$ 0.16	$ 0.16

1) For the three and nine months ended September 30, 2023, the interest expense on convertible debentures and the effective impact from convertible debentures on securities is excluded from the income per share calculation as the impact is anti-dilutive.

15. Other finance costs, net:

	Three months ended September 30, 2023	Three months ended September 30, 2022	Nine months ended September 30, 2023	Nine months ended September 30, 2022
Finance income	$ 45	$ 18	$ 156	$ 87
Foreign exchange (loss) gain	(4)	5	(21)	6
Distributions on Exchangeable Units	(53)	(278)	(126)	(278)
Fair value adjustment on promissory note	(99)	-	(286)	-
Accretion expense and other	(143)	(193)	(423)	(663)
Amortization of deferred financing charges	(183)	(212)	(540)	(641)
	$ (437)	$ (660)	$ (1,240)	$ (1,489)

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 term loan facilities approximate their fair value as these facilities bear interest at floating market interest rates. The fair value of the term loan facilities is measured using Level 2 inputs. The fair value of the convertible debentures is measured using Level 1 inputs. The fair value of the MRM Units, ML Units and the interest rate swap liabilities are measured using Level 2 inputs. The fair value of the investment in NND LP (note 6) is measured using Level 3 inputs.

(Tabular amounts expressed in thousands of Canadian dollars)

16. Financial instruments (continued):

The following table presents the carrying amounts of each category of financial assets and liabilities as at September 30, 2023:

As at September 30, 2023	Carrying value		Fair value hierarchy		
	FVTPL	Amortized cost	Level 1	Level 2	Level 3
Financial assets:					
Cash	$ -	$ 9,003	$ -	$ -	$ -
Royalty and other receivables	-	4,933	-	-	-
Interest rate swap assets	4,010	-	-	4,010	-
Investment in NND LP	42,589	-	-	-	42,589
	$ 46,599	$ 13,936	$ -	$ 4,010	$ 42,589
Financial liabilities:					
Accounts payable and accrued liabilities	$ -	$ 1,522	$ -	$ -	$ -
Bank loans, net of deferred financing charges	-	154,186	-	-	-
Promissory note	-	3,752	-	-	-
Lease obligation	-	723	-	-	-
Convertible debentures	-	48,342	48,342	-	-
Exchangeable units and other	2,122	-	-	2,122	-
	$ 2,122	$ 208,525	$ 48,342	$ 2,122	$ -

17. Subsequent events:

(a) On October 4, 2023, DIV and its wholly-owned subsidiary BARB Royalties Limited Partnership ("BARB LP") entered into an acquisition agreement with BarBurrito Restaurants Inc. ("BarBurrito") and an affiliate of BarBurrito pursuant to which BARB LP acquired (the "Acquisition") the trademarks and certain other intellectual property rights utilized by BarBurrito in its quick service Mexican restaurants in Canada (the "BarBurrito Rights") for a purchase price (the "Purchase Price"), excluding GST, of $72.0 million cash, a retained interest provided to BarBurrito through the issuance of limited partnership units of BARB LP and a $36.0 million promissory note that is repayable by BARB LP to BarBurrito in one or more payments as consideration for eligible new BarBurrito locations added to the BarBurrito royalty pool, for a total of $108.0 million. The cash portion of the Purchase Price was funded with (i) $50.0 million drawn from DIV's Acquisition Facility, (ii) DIV's cash on hand of $2.0 million, (iii) $10.0 million drawn from a new senior credit facility issued to BARB LP, and (iv) $10.0 million drawn from a new senior term credit facility issued to DIV (the "Additional Term Facility"). The Additional Term Facility has a term of 18 months, is non-amortizing, and has a floating interest rate based on bankers' acceptance rate plus a credit spread.

Immediately following the closing of the Acquisition, DIV licenced the BarBurrito Rights back to BarBurrito for 99 years, in exchange for an initial royalty payment of $8.3 million per annum. The royalty grows at a fixed rate of 4% per annum for the first seven years and, commencing on January 1, 2031, will fluctuate based on the gross sales of the BarBurrito locations in the Royalty Pool (initially set at 225 locations).

(b) On October 4, 2023, DIV's board of directors approved an increase in DIV's annual dividend from 24.0 cents per share to 24.5 cents per share effective November 1, 2023, an increase of 2.1%.

(c) On October 10, 2023, ML LP entered into a swap agreement with a Canadian chartered bank for 75% of its incremental $12.0 million credit facility or $9.0 million. The swap agreement, effective as of September 15, 2023, has a fixed rate of 5.58% plus credit spread of 2.00% and matures on May 1, 2025.

(d) On October 27, 2023, DIV amended the terms of the Acquisition Facility, increasing the interest-only period before amortization begins after each draw from six months to twelve months. In addition, the applicable bank credit spread on interest increased by 0.25% and the applicable bank credit spread on standby fees increased by 0.09%.