Consolidated Financial Statements of

DIVERSIFIED ROYALTY CORP.

Years ended December 31, 2018 and 2017

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Diversified Royalty Corp.

Opinion

We have audited the consolidated financial statements of Diversified Royalty Corp. (the Entity), which comprise:

- the consolidated statements of financial position as at December 31, 2018 and December 31, 2017
- the consolidated statements of net income and comprehensive income for the years then ended
- the consolidated statements of changes in equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at December 31, 2018 and December 31, 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "***Auditors' Responsibilities for the Audit of the Financial Statements***" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors’ report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors’ report. However, future events or conditions may cause the Entity to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this auditors' report is Michael J. Kennedy, CPA, CA.

KPMG LLP

Chartered Professional Accountants
Vancouver, Canada
March 11, 2019

DIVERSIFIED ROYALTY CORP.

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

As at December 31, 2018 and 2017

	Note		2018		2017
Assets					
Current assets:					
Cash and cash equivalents	5	$	78,342	$	85,816
Royalties and management fees receivable	7		3,965		4,008
Amounts receivable			153		150
Prepaid expenses and other			89		96
			82,549		90,070
Interest rate swap assets	12		-		160
Intangible assets	8		235,674		225,475
		$	318,223	$	315,705
Liabilities and Shareholders' Equity					
Current liabilities:					
Accounts payable and accrued liabilities		$	832	$	1,354
Restricted share unit obligation	15		-		218
			832		1,572
Long-term bank loans, net of deferred financing charges	10		64,856		57,772
Convertible debentures	11		51,940		50,771
Deferred income tax liability	13		7,738		3,463
Interest rate swap liabilities	12		137		-
Shareholders' equity:					
Share capital	14		184,528		180,906
Contributed surplus			25,974		25,265
Equity component of convertible debentures	11		2,938		2,938
Accumulated deficit			(20,720)		(6,982)
			192,720		202,127
		$	318,223	$	315,705

Nature of operations (note 1)
Contingencies (note 9)

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

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

Years ended December 31, 2018 and 2017

	Note		2018		2017
Royalty income	6	$	26,399	$	20,613
Management fees			310		306
			26,709		20,919
Expenses					
Salaries and benefits			1,627		1,616
Share-based compensation	15		1,406		975
General and administration			516		568
Professional fees			258		209
Litigation	9		3,120		331
			6,927		3,699
Income from operations			19,782		17,220
Interest expense on credit facilities			(5,395)		(2,080)
Other finance income, net	17		305		516
Fair value adjustment on interest rate swaps	12		(297)		257
Income before income taxes			14,395		15,913
Income tax expense	13		4,275		4,353
Net income and comprehensive income		$	10,120	$	11,560
Basic weighted average number of shares outstanding			107,195,740		105,916,177
Diluted weighted average number of shares outstanding			108,009,992		106,392,883
Basic income per share	16	$	0.09	$	0.11
Diluted income per share	16	$	0.09	$	0.11

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

DIVERSIFIED ROYALTY CORP.

Consolidated Statements of Changes in Equity
(Expressed in thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2018 and 2017

	Note	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	3(n)	-	-	218	-	-	218
		106,481,937	180,906	25,483	2,938	(6,982)	202,345
Common shares issued on DRIP		880,618	2,663	-	-	-	2,663
Restricted share units settled		275,845	669	(815)	-	-	(146)
Share options exercised		129,900	290	(58)	-	-	232
Share-based compensation		-	-	1,364	-	-	1,364
Dividends declared		-	-	-	-	(23,858)	(23,858)
Comprehensive income		-	-	-	-	10,120	10,120
Balance, December 31, 2018		107,768,300	$ 184,528	$ 25,974	$ 2,938	$ (20,720)	$ 192,720

	Note	Common shares	Share capital	Contributed surplus	Equity component of convertible debentures	Retained earnings (deficit)	Total equity
Balance, January 1, 2017		105,481,136	$ 178,256	$ 25,161	$ -	$ 5,024	$ 208,441
Common shares issued on DRIP		801,556	2,213	-	-	-	2,213
Restricted share units settled		147,745	338	(293)	-	-	45
Share options exercised		51,500	99	(22)	-	-	77
Share-based compensation		-	-	419	-	-	419
Issuance of Debentures, net of expenses and taxes	11	-	-	-	2,938	-	2,938
Dividends declared		-	-	-	-	(23,566)	(23,566)
Comprehensive income		-	-	-	-	11,560	11,560
Balance, December 31, 2017		106,481,937	$ 180,906	$ 25,265	$ 2,938	$ (6,982)	$ 202,127

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

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

Years ended December 31, 2018 and 2017

	2018	2017
Cash flows from (used in) operating activities:		
Net income	$ 10,120	$ 11,560
Adjustments for:		
Deferred income taxes	4,275	4,353
Share-based compensation	1,406	975
Fair value adjustments on interest rate swaps	297	(257)
Interest expense on credit facilities	5,395	2,080
Other finance income, net	(305)	(516)
Foreign exchange gain (loss)	12	(14)
Interest paid	(5,848)	(1,627)
Interest received	1,575	828
Changes in non-cash operating items:		
Royalties and management fees receivable	43	(2,490)
Amounts receivable	(3)	(57)
Prepaid expenses and other	7	(9)
Accounts payable and accrued liabilities	(257)	(418)
Net cash from operating activities	16,717	14,408
Cash flows from (used in) financing activities:		
Proceeds from issuance of debt	7,000	74,900
Proceeds from exercise of share options	232	77
Debt financing costs	(29)	(3,213)
Payment of dividends	(21,195)	(21,353)
Net cash from (used in) financing activities	(13,992)	50,411
Cash flows used in investing activities:		
Addition to intangible assets	(10,199)	(53,977)
Net cash used in financing activities	(10,199)	(53,977)
Net increase (decrease) in cash and cash equivalents	(7,474)	10,842
Cash and cash equivalents, beginning of year	85,816	74,974
Cash and cash equivalents, end of year	$ 78,342	$ 85,816

The accompanying notes are an integral part of these consolidated 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 consolidated financial statements of DIV as at and for the year ended December 31, 2018 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, 2018, the Sutton Royalty Rate was increased to $59.693 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"). 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.

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 consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The consolidated financial statements were authorized and approved for issue by the Company's Board of Directors on March 11, 2019.

(b) Basis of measurement:

These financial statements have been prepared on the historical cost basis except for the interest rate swaps and, prior to January 1, 2018, restricted share unit obligation, which are measured at fair value.

(c) Functional and presentation currency:

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

2. Basis of preparation:

(d) Use of estimates and judgments:

The preparation of the consolidated 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.

(i) Critical judgments:

- Consolidation:

  In applying the criteria outlined in IFRS 10, *Consolidated Financial Statements,* judgment is required in determining whether DIV controls SGRS LP and ML LP. Making this judgment involves taking into consideration the concepts of power over these entities, exposure and rights to variable returns, and the ability to use power to direct the relevant activities of these entities to generate economic returns. Using these criteria, management has determined that DIV ultimately controls these entities through its majority ownership of the respective general partners.

- Capitalization of acquisition costs:

  At the time of acquisition, the Company considers whether or not it represents a business combination or an asset acquisition. This requires the Company to make certain judgments as to whether or not the assets acquired include the inputs, processes and outputs necessary to constitute a business. Under a business combination, acquisition-related costs are recognized as an expense. When the acquisition does not represent a business combination, it is accounted as an asset acquisition, where the costs are capitalized to the respective asset.

(ii) Key estimates and assumptions:

- Intangible assets:

  The Company carries the intangible assets at cost and are not amortized as they have an indefinite life.

  The Company tests intangible assets for impairment annually or when there is any indication that an asset may be impaired. This requires the Company to use a valuation technique to determine if impairment exists. This valuation technique that is dependent on a number of different variables that requires management to exercise judgment. As a result, the estimated cash flows the intangible assets are expected to generate could differ materially from actual results.

- Fair value of exchangeable partnership units in SGRS LP and ML LP (“Exchangeable Partnership Units”):

  The Company does not assign any value to the Exchangeable Partnership Units as they do not currently meet the relevant criteria for exchange into common shares of DIV (note 8).

- Deferred taxes:

  Deferred tax assets and liabilities are due to temporary differences between the carrying amount for accounting purposes and the tax basis of certain assets and liabilities, as well as undeducted tax losses. In recognizing a deferred tax asset, management makes estimates related to expectations of future taxable income, and the expected timing of reversals of existing temporary differences.

- Convertible debentures:

  The Company exercises judgment in determining the allocation of the equity and liability component of the convertible debenture. The liability allocation is based on the estimated fair value of a similar liability that does not have an equity conversion option and the residual amount is allocated to the equity component.

3. Significant accounting policies:

These annual consolidated financial statements have been prepared using the accounting policies described below.

(a) Basis of consolidation:

These consolidated financial statements include the accounts of DIV, SGRS LP, ML LP, AM LP and the respective general partners. All significant intercompany transactions and balances have been eliminated on consolidation.

(b) Cash and cash equivalents:

Cash and cash equivalents consist of cash on hand, balances on deposit with Canadian chartered banks, and short-term investments with terms of three months or less on the date of acquisition.

(c) Revenue recognition:

The Company has two revenue streams, royalty income and management fee revenue.

- Royalty income: The Company licenses its intellectual property rights to third parties in exchange for royalty payments. The royalty income is recognized based on the usage or sales that have occurred during the period.
- Management fee revenue: The Company provides strategic and other services to certain royalty partners in exchange for a fixed monthly fee. Management fee is recognized as earned over the term of the agreement.

Royalty income and management fees for Mr. Lube and Sutton are usually receivable within 21 days after the calendar month. Royalty income from the AIR MILES Program is usually receivable within 14 days after the calendar quarter.

(d) Intangible assets:

The intangible assets are recorded at cost, which includes directly attributable acquisition costs, and are adjusted to record the additions to the respective royalty pools. The intangible assets are not amortized as they have an indefinite life, and are assessed for impairment as described in note 3(e).

(e) Impairment of intangible assets:

Intangible assets that are not amortized are subject to an annual impairment test or when events or changes in circumstances indicate that the carrying value may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or "CGUs"). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the CGU). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the asset. An impairment loss is recognized for the amount by which the intangible asset's carrying amount exceeds its recoverable amount.

A previously recognized impairment loss is assessed at each reporting date for any indicators that the loss has decreased or no longer exists. An impairment loss is reversed only to the extent that the intangible asset's carrying value does not exceed the carrying amount that would have existed had the original impairment loss had been recognized.

(f) Dividends to DIV shareholders:

Dividends to the Company's shareholders are made monthly based upon available cash at the discretion of the Board of Directors. Dividends are recorded when declared and are subject to the Company retaining such reasonable working capital reserves as may be considered appropriate by the Company.

3. Significant accounting policies (continued):

(g) Earnings per share:

The Company presents basic and diluted earnings per share ("EPS") data for its common shares. Basic EPS is calculated by dividing the net income attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is determined by adjusting the net income attributable to common shareholders and the weighted average number of common shares outstanding, adjusted for dilutive potential common shares, which comprise share options and restricted share units.

(h) Employee benefits:

(i) Share options:

The Company measures the compensation cost of share-based option awards to employees at the grant date using the Black-Scholes option pricing model to determine the fair value of the options. The compensation cost of the options is recognized as share-based compensation expense over the relevant vesting period of the share options. Forfeitures are estimated and are adjusted if actual forfeitures differ from the original estimate unless forfeitures are due to market-based vesting conditions. When the equity-settled share options are exercised, share capital is increased by the sum of the consideration paid and the carrying value of the share options recorded to contributed surplus.

(ii) Restricted share units:

Restricted share units ("RSUs") are settled, in accordance with the respective RSU agreements, in common shares or cash based on the number of vested restricted share units multiplied by the fair market value of the common shares on the vesting date.

The Company measures the cost of equity-settled RSUs based on the fair value of the underlying shares at the grant date, and is recorded as share-based compensation expense with a corresponding increase in equity over the vesting period. The cost of cash-settled RSUs is based on the fair value of the underlying shares at the grant date, and is re-measured at the end of each reporting period until the liability is settled. The fair value of the cash-settled RSUs is recognized as compensation expense and a liability over the vesting period.

RSUs that have a net settlement feature for withholding tax obligations are classified in its entirety as equity-settled (note 3(n)).

(i) Provisions:

A provision is recognized if, as a result of a past event, the Company has a legal or constructive present obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are reviewed at the end of each reporting period and adjusted or reversed to reflect management's best estimate of the expenditure required to settle the present obligation at the end of the reporting period. Provisions are reduced by actual expenditures for which the provision was originally recognized. Where discounting has been used, the carrying amount of the provision is accreted during the period to reflect the passage of time.

3. Significant accounting policies (continued):

(j) Income tax:

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of the previous year.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities on the consolidated statements of financial position and the amounts attributed to the assets and liabilities for tax purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(k) Financial instruments:

Financial assets are classified and measured based on the business model in which they are held and the characteristics of their cash flows. At initial recognition, all financial assets classified as amortized cost and fair value through other comprehensive income ("FVOCI") are measured at fair value plus transaction costs that are directly attributable to its acquisition. The Company classifies its financial assets in the following categories:

- Financial assets at amortized cost: A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as FVTPL: it is held in a business model whose objective is to hold the asset to collect contractual cash flows and the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Financial assets within this category are subsequently measured at amortized cost using the effective interest method. Interest income, foreign exchange gains and losses, impairment losses and gain or loss on de-recognition are recognized in profit or loss.
- Debt investments at FVOCI: A debt instrument is classified as FVOCI if it meets both of the following conditions and is not designated as FVTPL: it is held in a business model whose objective is achieved by collecting contractual cash flows and the sale of the financial asset and the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Financial assets within this category are subsequently measured at fair value. Interest income, dividend income, foreign exchange gains and losses are recognized in profit or loss. Other gains and losses are recognized in other comprehensive income ("OCI") and are reclassified to profit or loss on de-recognition.
- Equity investments at FVOCI: On initial recognition of an equity instrument that is not held for trading, the Company may irrevocably elect to present subsequent changes in the investment's fair value in OCI. This election is made on an investment-by-investment basis. Financial assets within this category are subsequently measured at fair value. Dividend income and foreign exchange gains and losses are recognized in profit or loss. Other gains and losses are recognized in OCI and are never reclassified to profit or loss.

3. Significant accounting policies (continued):

(k) Financial instruments (continued):

- Financial assets at fair value through profit and loss ("FVTPL"): Financial assets not classified as amortized cost or FVOCI are measured at FVTPL. This includes all derivative financial instruments. On initial recognition, the Company may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise. These assets are subsequently measured at fair value, with net gains or losses, including any interest or dividend income, recognized through profit or loss.

Financial liabilities are classified as measured at amortized cost or FVTPL. Once the classification of a financial liability has been determined, reclassification is not permitted.

- Financial liabilities at amortized cost: A financial liability is measured at amortized cost using the effective interest method if it is not designated as FVTPL. Interest expense and foreign exchange gains and losses are recognized in profit or loss.

- Financial liabilities at FVTPL: A financial liability is classified as FVTPL if it is classified as held-for-trading, it is a derivative or it is designated as such on initial recognition. Financial liabilities at FVTPL are measured at fair value and net gains and losses, including any interest expense are recognized in profit or loss. For financial liabilities classified as FVTPL, changes in credit risk will be recognized in other comprehensive income, with the remainder of 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.

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

The Company has elected as an accounting policy choice for non-substantial modifications of variable or fixed rate debt, if certain criteria are met, to adjust the carrying amount of the financial liability on modification for directly attributable transaction costs and any consideration paid to or received from the counterparty. The effective interest rate is then adjusted to amortize the difference between the revised carrying amount and the expected cash flows over the life of the modified instrument. No gain or loss is recognized in profit or loss. This accounting policy applies to variable or fixed rate debt that had an insignificant original issue discount that can be prepaid at par, or prepaid with insignificant prepayment fees, to the extent that modification has the effect of repricing the debt to a market rate of interest.

(l) Impairment of financial assets:

The Company uses an expected credit loss ("ECL") impairment model. The ECL impairment model applies to financial assets measured at cost, contract assets and debt investments at FVOCI, but not to investments in equity instruments. The Company has elected to use the lifetime ECL approach. Under this approach, the impairment allowance is recorded as a result of all possible default events over the expected life of the financial asset. ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the Company in accordance with the contract and the cash flows that the Company expects to receive) and are discounted at the effective interest rate of the financial asset. The Company considers reasonable and supportable information when assessing the credit risk of a financial asset and in estimating the ECLs, which includes:

- Significant financial difficulty of the Company's counterparty;
- Delinquencies in interest or principal payments over 30 days; and
- It becomes probable that the borrower will enter into bankruptcy or other financial reorganization.

ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Company expects to receive). ECLs are discounted at the effective interest rate of the asset.

(Tabular amounts expressed in thousands of Canadian dollars)

3. Significant accounting policies (continued):

(m) Convertible debentures:

The Company accounts for convertible debentures by allocating the proceeds of the debentures, net of financing costs, between liability and equity based on estimated fair values of the debt and conversion option. The liability component is valued first and the difference between the proceeds of the convertible debentures and the fair value of the liability component is assigned to the equity component. Interest expense is recorded as a charge to earnings and is calculated at an effective rate with the difference between the coupon rate and the effective rate being credited to the debt component of the convertible debentures (accretion expense) such that, at maturity the debt component is equal to the face value of the outstanding convertible debentures.

(n) Changes in accounting policies and disclosures:

IFRS 15, Revenue from Contracts with Customers:

On January 1, 2018, the Company adopted IFRS 15, *Revenue from Contracts with Customers* ("IFRS 15"). The standard contains a single model that applies to contracts with customers. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. IFRS 15 supersedes IAS 18, *Revenue,* and related interpretations.

The Company adopted IFRS 15 using the cumulative effect method with the effect of initially applying this standard recognized at the date of initial application, January 1, 2018. The adoption of IFRS 15 did not have an impact on the Company's accumulated deficit as at January 1, 2018.

IFRS 9, Financial Instruments:

On January 1, 2018, the Company adopted IFRS 9, *Financial Instruments* ("IFRS 9") on a retrospective basis. IFRS 9 sets out the requirements for recognizing and measuring financial assets and liabilities. IFRS 9 replaced IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39").

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. IFRS 9 retains the existing requirements in IAS 39 for the classification of financial liabilities as amortized cost or FVTPL.

The following table and the accompanying notes explain the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Company's financial assets and liabilities.

	Original classification under IAS 39	New classification under IFRS 9
Cash and cash equivalents	Loans and receivables	Amortized cost
Royalties and management fees receivable	Loans and receivables	Amortized cost
Amounts receivable	Loans and receivables	Amortized cost
Interest rate swap assets and liabilities	FVTPL	FVTPL
Accounts payable and accrued liabilities	Financial liabilities at amortized cost	Amortized cost
Long-term bank loans	Financial liabilities at amortized cost	Amortized cost
Convertible debentures	Financial liabilities at amortized cost	Amortized cost

IFRS 9 replaces the "incurred loss" model in IAS 39 and has an expected credit loss ("ECL") impairment model. The new impairment model applies to financial assets measured at cost, contract assets and debt investments at FVOCI, but not to investments in equity instruments.

The adoption of IFRS 9 did not have an impact on the Company's accumulated deficit as at January 1, 2018.

(Tabular amounts expressed in thousands of Canadian dollars)

3. Significant accounting policies (continued):

(n) Changes in accounting policies and disclosures (continued):

Amendments to IFRS 2, Share-Based Payments:

On January 1, 2018, the Company adopted the amendments to IFRS 2, *Share-Based Payments* (“IFRS 2”). The amendments to IFRS 2 address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction, the classification of a share-based payment transaction with net settlement features for withholding tax obligations, and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash-settled to equity-settled.

On January 1, 2018, as a result of adopting the amendments to IFRS 2, the Company reclassified $0.2 million related to its restricted share unit obligation from liabilities to contributed surplus. The Company ceased to apply mark-to-market accounting on share-based payment transactions with a net settlement feature for withholding tax obligations.

4. New standards applicable in future periods:

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 does not have any leases within the scope of IFRS 16, therefore the adoption of IFRS 16 will not have an impact on its financial statements.

5. Cash and cash equivalents:

		2018		2017
Cash	$	1,024	$	1,263
Cash equivalents		77,318		84,553
	$	78,342	$	85,816

6. Royalty pools:

(a) Mr. Lube:

Pursuant to the terms of the licence and royalty agreement dated August 19, 2015 (the “Mr. Lube Licence and Royalty Agreement”), the royalty paid by Mr. Lube to ML LP is calculated by multiplying the system sales of locations within the Mr. Lube Royalty Pool by an agreed royalty fee (the “Mr. Lube Royalty Rate”, initially set at 6.95%). In addition, ML LP is entitled to receive a make-whole payment in the event that a Mr. Lube location in the ML Royalty Pool is permanently closed during the royalty payment period. The make-whole payment is based on the lost system sales multiplied by the Mr. Lube Royalty Rate. Mr. Lube will also, subject to meeting certain performance criteria, be provided opportunities to increase the Mr. Lube Royalty Rate in four, 0.5% increments (note 8(b)).

In September 2017, Mr. Lube launched a new tire program. In connection with this incremental line of business, on October 20, 2017, ML LP amended its licence and royalty agreement (the “ML LRA Amendment”) with Mr. Lube in respect of this new retail tire program. Mr. Lube is charging a lower royalty fee and waived certain other fees payable by Mr. Lube franchisees on the sale of tires and rims to account for the lower margins on these hard goods. 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 currently in the Mr. Lube Royalty Pool. The ML LRA Amendment is effective from September 18, 2017.

6. Royalty pools (continued):

(a) Mr. Lube (continued):

Effective May 1, 2018, the royalty rate paid by Mr. Lube on non-tire sales at flagship locations has been increased by 0.5% from 6.95% to 7.45% (note 8(b)). In addition, the Mr. Lube Royalty Pool was adjusted to include the royalties from two new Mr. Lube locations and to remove one Mr. Lube location that has been permanently closed. With the adjustment for these two new locations and one closure, the Mr. Lube Royalty Pool had 118 locations effective May 1, 2018 (note 8(b)).

Royalty income from Mr. Lube for the years ended December 31, 2018 and 2017 was as follows:

Expressed in thousands of Canadian dollars, except for number of locations		2018		2017
Locations in the Mr. Lube Royalty Pool at period end		118		117
Mr. Lube Royalty Pool system sales	$	206,482	$	198,549
Royalty income		14,845		13,816

During the year ended December 31, 2018, royalty income from Mr. Lube includes make-whole payments totaling $0.02 million (2017 - $0.06 million) on lost system sales of $0.3 million (2017 - $0.8 million).

(b) Sutton:

Pursuant to the terms of the licence and royalty agreement dated June 19, 2015 (the “Sutton Licence and Royalty Agreement”), the royalty paid by Sutton to SGRS LP is calculated by multiplying a determined number of agents in the Sutton Royalty Pool by the Sutton Royalty Rate. Sutton has the ability, subject to meeting certain performance criteria, to increase the amount of the annual royalty payable to the Company by increasing the number of agents in the Sutton Royalty Pool. The number of agents in the Sutton Royalty Pool may be increased annually, and will never be decreased. The Sutton Royalty Rate will automatically increase by 2% each July 1st beginning in 2016. Sutton will also have the ability, subject to meeting certain performance criteria, to increase the Sutton Royalty Rate in 10.0% increments four times during the life of the royalty (note 8(a)).

Royalty income from Sutton for years ended December 31, 2018 and 2017 were calculated as follows:

Expressed in thousands of Canadian dollars, except for number of agents and the Sutton Royalty Rate		2018		2017
Agents in the Sutton Royalty Pool at period end		5,400		5,400
Royalty income	$	3,830	$	3,754

Effective July 1, 2018, the monthly Sutton Royalty Rate increased from $58.523 per agent to $59.693 per agent, representing the 2.0% annual contractual increase in the Sutton Royalty Rate for 2018. Effective July 1, 2017, the monthly 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) AIR MILES:

The royalty paid by LoyaltyOne Co. to AM LP is equal to 1% of the gross billings from the AIR MILES Program in accordance with the terms of the AIR MILES Licenses. Royalty income related to the AIR MILES Program for the year ended December 31, 2018 and the period from August 25, 2017 (the date of the AIR MILES Rights acquisition) to December 31, 2017 was as follows:

Expressed in thousands of Canadian dollars		2018		2017
Gross billings	$	772,396	$	304,306
Royalty income		7,724		3,043

(Tabular amounts expressed in thousands of Canadian dollars)

7. Royalties and management fees receivable:

		2018		2017
Mr. Lube	$	1,242	$	1,175
Sutton		347		340
AIR MILES		2,376		2,493
	$	3,965	$	4,008

8. Intangible assets:

		SGRS Rights		ML Rights		AIR MILES Program		Total
		(a)		(b)		(c)		
Balance, January 1, 2017	$	32,273	$	139,225	$	-	$	171,498
Acquisition of AIR MILES Rights		-		-		53,977		53,977
Balance, December 31, 2017	$	32,273	$	139,225	$	53,977		225,475
Mr. Lube Royalty Rate increase and store roll-in		-		10,199		-		10,199
Balance, December 31, 2018	$	32,273	$	149,424	$	53,977	$	235,674

(a) SGRS Rights:

SGRS LP licensed the SGRS Rights back to Sutton for 99 years in exchange for a royalty payment equal to the Sutton Royalty Pool multiplied by the Sutton Royalty Rate (note 6(b)).

Upon closing the Sutton Acquisition, SGRS LP issued 100,000,000 Class A, Class B, Class C, Class D, and Class E LP units to Sutton. These units will become exchangeable into common shares of the Company through the exchange agreement dated June 19, 2015 among Sutton, SGRS Royalties GP Inc. and the Company upon the satisfaction of certain performance criteria. The Class A LP Units become exchangeable into common shares of the Company on the contribution of additional agents into the Sutton Royalty Pool. The Class B, Class C, Class D, and Class E LP units become exchangeable into common shares of the Company on increases in the Sutton Royalty Rate of 10.0% increments four times during the life of the royalty, in accordance with the partnership agreement dated June 19, 2015 among Sutton, the Company, and SGRS Royalties GP Inc. (the “Sutton Exchange Agreement”).

In addition to the royalty, Sutton will pay the Company a management fee of approximately $0.1 million per year for strategic and other services. The management fee will be increased by 10.0% every five years.

Annually on July 1, the Sutton Royalty Pool may be adjusted, subject to meeting certain performance criteria, to increase the number of agents. In return for increasing the number of agents in the Sutton Royalty Pool, Sutton receives the right to indirectly acquire common shares of the Company through the exchange of Class A LP Units of SGRS LP (the “SGRS Additional Entitlement”). The SGRS Additional Entitlement is determined based on 92.5% of the estimated net tax-adjusted royalty revenue added to the Sutton Royalty Pool, divided by the yield of the Company’s shares, divided by the weighted average share price of the Company’s shares over the 20 days preceding May 31. The SGRS Additional Entitlement is automatically exchanged by Sutton into common shares of DIV, or settled in cash at DIV’s option, pursuant to the Sutton Exchange Agreement.

8. Intangible assets (continued):

(b) ML Rights:

ML LP licensed the ML Rights back to Mr. Lube for 99 years in exchange for a royalty payment equal to the system sales of the Mr. Lube locations in the Mr. Lube Royalty Pool multiplied by the Mr. Lube Royalty Rate (note 6(a)).

Upon closing the Mr. Lube Acquisition, ML LP issued 100,000,000 Class B, Class C, Class D, Class E, and Class F units to Mr. Lube. These units will become exchangeable into common shares of the Company through the exchange agreement dated August 19, 2015 among Mr. Lube, ML Royalties GP Inc. and the Company (the “Mr. Lube Exchange Agreement”) upon the satisfaction of certain performance criteria. The Class B LP units of ML LP become exchangeable into common shares of the Company upon adding Mr. Lube locations to the ML Royalty Pool. The Class C, Class D, Class E, and Class F LP units become exchangeable into common shares of the Company on increases in the ML Royalty Rate of 0.5% increments four times during the life of the royalty, in accordance with the partnership agreement dated August 19, 2015 among Mr. Lube, the Company, and ML Royalties GP Inc.

In addition to the royalty, Mr. Lube will pay the Company a management fee of approximately $0.2 million per year for strategic and other services. The management fee will be increased at a rate of 2.0% per annum over the term of the Mr. Lube Licence and Royalty Agreement.

Annually on May 1, the Mr. Lube Royalty Pool may be adjusted, subject to meeting certain criteria, to include gross sales from new Mr. Lube locations less gross sales from Mr. Lube locations that were permanently closed during the preceding calendar year. In return for adding these net sales to the Mr. Lube Royalty Pool, Mr. Lube receives the right to indirectly acquire common shares of the Company through the exchange of Class B LP Units of ML LP (the “ML Additional Entitlement”). The ML Additional Entitlement is determined based on the estimated net tax-adjusted royalty revenue added to the Mr. Lube Royalty Pool (adjusted by a 20% discount for locations that were open for business prior to June 30, 2019, or a 7.5% discount for all other additions), divided by the yield of the Company’s shares, divided by the weighted average share price of the Company’s shares over the 20 days preceding March 31. Mr. Lube receives 80% of the estimated ML Additional Entitlement initially, with the balance received on May 1 of the subsequent year when the actual full year performance of the new locations is known with certainty. The ML Additional Entitlement is automatically exchanged by Mr. Lube into common shares of DIV, or settled in cash at DIV’s option, pursuant to the Mr. Lube Exchange Agreement.

On May 1, 2018, the Mr. Lube royalty rate increased by 0.5% from 6.95% to 7.45%. In exchange for increasing the Mr. Lube royalty rate, Mr. Lube received the right to exchange Class C LP units of ML LP for common shares of DIV. DIV elected to pay for the Mr. Lube royalty rate increase in cash, in lieu of common shares of DIV, which was partially financed by an increase in the term loan facility of ML LP (note 10). The total consideration paid to Mr. Lube for the royalty rate increase was $9.2 million.

On May 1, 2018, the Mr. Lube Royalty Pool was adjusted to include two new Mr. Lube locations and to remove one Mr. Lube location that was permanently closed. The initial consideration payable to Mr. Lube for the estimated net additional royalty revenue is $0.9 million, representing 80% of the total estimated consideration of $1.2 million. In exchange for the net 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 for the initial consideration to Mr. Lube in cash, which was partially financed by an increase in the term loan facility of ML LP (note 10). The remaining consideration payable for the net additional royalty revenue will be paid to Mr. Lube on May 1, 2019, the next adjustment date, and will be adjusted to reflect the actual system sales of the two new locations added to the Mr. Lube Royalty Pool for the year ended December 31, 2018.

During the year ended December 31, 2017, there were no additions to the Mr. Lube Royalty Pool.

8. Intangible assets (continued):

(c) AIR MILES Rights:

On August 25, 2017, the Company acquired, through AM LP, the AIR MILES Rights from a subsidiary of Aimia for $53.8 million plus additional contingent consideration of up to $13.8 million. The Company funded the payment through cash on hand of $36.4 million and the issuance of $17.4 million in debt. Additionally, $0.2 million in costs incurred for the acquisition of the AIR MILES Program in Canada were capitalized as part of the purchase. The contingent consideration is subject to certain milestones being met. The milestones relate to the renewal of The Bank of Montreal's AIR MILES sponsorship contract, or the replacement of the AIR MILES sponsorship contract with another one of the four other major Canadian chartered banks on or prior to July 31, 2019, as well as the royalty revenue post contract renewal or replacement. If payable, the contingent consideration would be recorded as an expense.

In accordance with the terms of the AIR MILES Licenses, AM LP will receive an aggregate royalty, payable quarterly, equal to 1% of gross billings from the AIR MILES Program in Canada in perpetuity.

(d) Impairment assessment:

Annually, on December 31, the Company tests the carrying value of its intangible assets for impairment. Impairment exists if the present value of the net cash flows is greater than the carrying value of the CGU. The estimates of future cash flows require a number of key assumptions about future business performance. These assumptions and estimates are based on the relevant business' historical experience, economic trends, as well as past and ongoing communications with relevant stakeholders of the Company.

The expected future cash flows are based on the most recent annual forecasts prepared by management and extrapolated over five years, with a terminal capitalization rate applied on the expected cash flows thereafter to reflect the indefinite life of the intangible assets. Subsequent to the most recent annual forecast, revenue is projected to grow at a rate ranging from 1.5% to 2.75% (2017 – 2.0%). These projected cash flows are discounted at pre-tax rates, based on the risks associated with the assets, which range from 11.2% to 14.8% (2017 - 12.4% to 18.1%).

The Company also considers other reasonably possible scenarios where forecasted revenue is less than budget, along with other reasonably possible higher discount rates to determine whether the intangible assets would be impaired under those scenarios. As the carrying values of the SGRS Rights at December 31, 2018 approximate the estimated recoverable amounts, a subsequent change in any key assumption utilized in the estimate of future cash flows may result in an impairment loss. As at December 31, 2018, the Company has determined that no additional impairment exists.

9. 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.

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.

On November 28, 2018, in an effort to avoid the expense and uncertainty of further litigation, and with no admission of fault by any party, the Company and Sevenson entered into a settlement agreement (the "Settlement Agreement"). Under the Settlement Agreement, Sevenson surrendered and released all claims it has against the Company. The Company surrendered and released all claims it has against Sevenson. As consideration for the Settlement Agreement, the Company made a payment totaling US$1.86 million on November 29, 2018.

(Tabular amounts expressed in thousands of Canadian dollars)

10. Borrowings:

As at December 31, 2018, 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	$ 6,245
ML LP term loan	BA + 1.95%	Jul 31, 2022	41,600	41,361
AM LP term loan	BA + 2.25%	Sep 6, 2022	17,400	17,250
			$ 65,300	$ 64,856

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
			$ 4,500	$ 4,500

As at December 31, 2017, 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	$ 6,230
ML LP term loan	BA + 1.95%	Jul 31, 2022	34,600	34,329
AM LP term loan	BA + 2.25%	Sep 6, 2022	17,400	17,213
			$ 58,300	$ 57,772

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
			$ 4,500	$ 4,500

(a) SGRS LP term loan and line of credit:

SGRS LP has a credit agreement that consists of a non-amortizing $6.3 million term loan and a $0.5 million demand operating facility from a Canadian chartered bank. The SGRS LP term loan and line of credit are secured by the SGRS Rights and the royalties payable by Sutton under the Sutton Licence and Royalty Agreement.

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.

The SGRS LP term loan and line of credit are subject to certain financial covenants, including a covenant for SGRS LP to maintain EBITDA for the trailing twelve-month period of at least $2.9 million. As at December 31, 2018 and 2017, SGRS LP was in compliance with all financial covenants associated with this facility.

10. Borrowings (continued):

(b) ML LP term loan and line of credit:

ML LP has a credit agreement that originally consisted of a non-amortizing $34.6 million term loan and a $1.0 million demand operating facility from a Canadian chartered bank. On May 1, 2018, ML LP amended its credit agreement to increase its term loan facility from $34.6 million to $41.6 million. The increase in the term loan facility was used to partially finance the consideration paid to Mr. Lube for the increase in the Mr. Lube Royalty Rate and the net addition to the Mr. Lube royalty pool (note 8). The ML LP term loan and line of credit are secured by the ML Rights and the royalties payable by Mr. Lube under the Mr. Lube Licence and Royalty Agreement.

On July 31, 2017, ML LP amended the terms of its term loan and line of credit agreement to extend the maturity date from August 19, 2018 to July 31, 2022.

The ML LP term loan and line of credit are subject to certain financial covenants, including a covenant for ML LP to maintain a funded debt to EBITDA ratio of not more than 3.0:1.0. As at December 31, 2018 and 2017, ML LP was in compliance with all financial covenants associated with this facility.

(c) AM LP term loan and line of credit:

AM LP has a credit agreement that consists of a non-amortizing $17.4 million term loan facility and $3.0 million demand operating facility from a Canadian chartered bank. The AM LP term loan and line of credit are secured by the AIR MILES Rights and the royalties payable by LoyaltyOne Co. under the AIR MILES Licenses.

The AM LP term loan and line of credit are subject to certain financial covenants, including a covenant for AM LP to maintain a funded debt to EBITDA ratio of not more than 2.5:1.0. As at December 31, 2018 and 2017, AM LP was in compliance with all financial covenants.

11. Convertible debentures:

On November 7, 2017, the Company issued convertible unsecured subordinated debentures ("Debentures") for an aggregate principal amount of $57.5 million at a price of $1,000 per Debenture. The Debentures mature on December 31, 2022 and bear interest at an annual rate of 5.25% payable semi-annually in arrears on the last day of December and June in each year, commencing June 30, 2018. At the holder's option, the Debentures may be converted into common shares of the Company at any time prior to the earlier of: (i) the last business day immediately preceding December 31, 2022; or (ii) the date specified by the Company for redemption of the Debentures. The conversion price will be $4.55 per common share (the "Conversion Price), subject to adjustment in certain circumstances.

The Debentures are not redeemable prior to January 1, 2021, except upon the satisfaction of certain conditions after a change of control has occurred. On or after January 1, 2021 and prior to December 31, 2021, the 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 December 31, 2021 and prior to the maturity date, DIV may, at its option, redeem the 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 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 convertible 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 convertible debentures by 95% of the then current market price on the day preceding the date fixed for redemption or the maturity date.

On initial recognition, the Company valued the liability component at $53.2 million and the equity component at $4.3 million. In addition, the Company incurred transaction costs of $2.8 million, of which $2.6 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 Debentures was $2.9 million, after deferred taxes of $1.2 million and transaction costs of $0.2 million.

(Tabular amounts expressed in thousands of Canadian dollars)

11. Convertible debentures (continued):

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

	2018	2017
Principal amount	$ 57,500	$ 57,500
Equity component of debentures	(4,312)	(4,312)
Unamortized deferred financing fees	(2,080)	(2,522)
Accretion on liability component of debentures	832	105
	$ 51,940	$ 50,771

12. 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 100% of the SGRS LP term loan facility, 83% of the ML LP term loan facility, and 50% of the AM LP term loan facility.

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 the Company has entered into as of December 31, 2018:

	Effective date	Maturity date	Fixed interest rate	Notional amount
SGRS LP	Jun 19, 2018	Jun 21, 2021	4.64%	$ 6,300
ML LP	Aug 13, 2018	Jul 31, 2022	4.17%	34,600
AM LP	Sep 6, 2017	Aug 19, 2022	4.42%	8,700

13. Deferred income taxes:

	2018	2017
Deferred income tax expense	$ 4,275	$ 4,353
	$ 4,275	$ 4,353

(Tabular amounts expressed in thousands of Canadian dollars)

13. Deferred income taxes (continued):

Income tax expense as reported differs from the amount that would be computed by applying the combined Federal and Provincial statutory income tax rates to the income before income taxes. The reason for the difference is as follows:

	2018	2017
Income before income taxes	$ 14,395	$ 15,913
Combined Canadian federal and provincial rates	27%	26%
Expected tax expense	3,887	4,137
Increased (decreased) by:		
Permanent and other non-deductible differences	388	123
Impact of deferred tax rates applied versus current tax rates	-	92
Change in prior year estimates	-	1
	$ 4,275	$ 4,353

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

	2018	2017
Non-capital losses	$ 1,016	$ 2,225
Financing and share issuance costs	185	704
Intangible assets	282	304
Investment tax credits	199	199
Other	37	16
Convertible debentures	(939)	(1,136)
Intangible assets	(8,518)	(5,775)
Net deferred tax liability	$ (7,738)	$ (3,463)

As at December 31, 2018, the Company has non-capital loss carry forwards of $3.8 million (2017 - $8.2 million), which can be carried forward and applied against future taxable income. Non-capital loss carry forwards expires as summarized in the table below.

2033	$ 643
2034	3,120
	$ 3,763

The deferred tax liability as at December 31, 2018 is largely associated with the temporary differences on the Company's intangible assets, which have an undepreciated capital cost allowance of approximately $150.3 million (2017 - $160.4 million).

14. Share capital:

As at December 31, 2018, the authorized share capital of the Company consists of an unlimited number of common shares.

The Company has a dividend reinvestment plan ("DRIP") that allows eligible holders of the Company's common shares to reinvest some or all cash dividends paid in respect of their common shares in additional common shares of the Company. At the Company's election, these additional common shares may be issued from treasury or purchased on the open market. If the Company elects to issue common shares from treasury, the common shares will be purchased under the DRIP at a 3% discount to the volume weighted average of the closing price for the common shares on the TSX for the five trading days immediately preceding the relevant dividend payment date. The Company may, from time to time, change or eliminate the discount applicable to common shares issued from treasury.

(Tabular amounts expressed in thousands of Canadian dollars)

15. Share-based compensation:

(a) Restricted share units:

The Company has a long-term incentive plan (the "Plan") available to both employees and non-employees as a form of retention and incentive compensation. The maximum number of common shares issued under the Plan is 10% of the issued and outstanding common shares of the Company at the time of the grant.

Under the Plan, the Company can issue RSUs whereby each RSU is equal in value to one common share of the Company and is entitled to dividends that would arise thereon if it was an issued and outstanding common share. The notional dividends are recorded as additional issuance of RSUs during the life of the RSU. Currently, all the outstanding RSUs will be settled in common shares, unless the RSU holder elects to settle a portion of the RSUs in cash to pay the applicable withholding taxes.

The number of RSUs outstanding is as follows:

	2018		2017	
	Number of RSUs	Weighted average grant-date fair value	Number of RSUs	Weighted average grant-date fair value
Balance, beginning of year	892,674	$ 3.08	606,016	$ 2.42
Granted	307,042	3.21	609,913	3.36
Dividends earned	56,404	3.08	49,639	2.80
Settled	(334,599)	2.59	(372,894)	2.43
Balance, end of year	921,521	$ 3.30	892,674	$ 3.08
Unvested	898,615	$ 3.31	722,911	$ 3.29
Vested	22,906	$ 2.90	169,763	$ 2.19

As at December 31, 2018, approximately 14% of the unvested RSUs will vest in 2019, 75% will vest in 2020, and the remainder in 2021.

(b) Share options:

The following table summarizes the changes in the Company's share options during the years ended December 31, 2018 and 2017:

	2018		2017	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance, beginning of year	2,481,400	$ 3.15	232,900	$ 1.66
Granted	-	-	2,300,000	3.26
Exercised	(129,900)	1.79	(51,500)	1.50
Expired	(51,500)	1.50	-	-
Balance, end of year	2,300,000	$ 3.26	2,481,400	$ 3.15

(Tabular amounts expressed in thousands of Canadian dollars)

15. Share-based compensation (continued):

(b) Share options (continued):

The total fair value of the share options granted of $0.9 million during the year ended December 31, 2017 was calculated as of the grant date using the Black-Scholes option pricing model with the following assumptions and inputs:

	2017
Expected life	5 years
Expected volatility	29.3%
Expected dividend yield	6.8%
Risk-free interest rate	1.8%
Weighted average share price	$ 3.26

The following table summarizes information relating to outstanding and exercisable options as at December 31, 2018:

	Options outstanding			Options exercisable	
Exercise prices	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	3.80	$ 3.26	-	$ -
	2,300,000	3.80	$ 3.26	-	$ -

16. Income per share:

	2018	2017
Income for the year	$ 10,120	$ 11,560
Weighted average number of shares outstanding – basic	107,195,740	105,916,177
Dilutive adjustment for share options	36,865	93,245
Dilutive adjustment for RSUs	777,387	383,461
Weighted average number of shares outstanding – diluted	108,009,992	106,392,883
Net income per common share:		
Basic	$ 0.09	$ 0.11
Diluted	$ 0.09	$ 0.11

17. Other finance income (costs), net:

	2018	2017
Finance income	$ 1,575	$ 828
Foreign exchange gain (loss)	12	(14)
Amortization of deferred financing charges	(555)	(193)
Accretion expense	(727)	(105)
	$ 305	$ 516

(Tabular amounts expressed in thousands of Canadian dollars)

18. 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 restricted share unit obligation is measured using Level 1 inputs. The fair value of the convertible debentures of $56.6 million is measured using Level 1 inputs. The fair value of the interest rate swap assets (liabilities) are measured using Level 2 inputs.

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

	2018	2017
Assets carried at amortized cost:		
Cash and cash equivalents	$ 78,342	$ 85,816
Royalties and management fees receivable	3,965	4,008
Amounts receivable	153	150
	$ 82,460	$ 89,974
Assets carried at fair value:		
Interest rate swap assets	$ -	$ 160
Liabilities carried at amortized cost:		
Accounts payable and accrued liabilities	$ 832	$ 1,354
Long-term bank loans	64,856	57,772
Convertible debentures	51,940	50,771
	$ 117,628	$ 109,987
Liabilities carried at fair value:		
Interest rate swap liabilities	$ 137	$ -
Restricted share unit obligation	-	218
	$ 137	$ 218

(Tabular amounts expressed in thousands of Canadian dollars)

19. Financial risk management:

The Company has exposure to the following risks from its use of financial instruments: credit risk, market risk, liquidity risk, currency risk and interest rate risk. This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities. The Company, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Board of Directors has responsibility for the oversight of the Company's risk management framework. The Board of Directors has mandated the Audit Committee to review how management monitors compliance of the Company's risk management policies and procedures and review the adequacy of the risk management policies and procedures.

(a) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk is associated with the Company's cash and cash equivalents, royalties and management fees receivable, and amounts receivable.

Credit risk on the Company's cash and cash equivalents are mitigated by holding these amounts with a Canadian chartered bank of high creditworthiness. Credit risk on the royalties and management fees receivable is monitored through regular review of the operating and financing activities of the Company's Royalty Partners. The carrying amount of financial assets represents the maximum credit exposure.

The maximum exposure to credit risk at December 31, 2018 and 2017 were as follows:

		2018		2017
Cash and cash equivalents	$	78,342	$	85,816
Royalties and management fees receivable		3,965		4,008
Amounts receivable		153		150
	$	82,460	$	89,974

The aging of royalties and management fees receivable, as well as amounts receivable at December 31, 2018 and 2017 were as follows:

		2018		2017
Current	$	4,118	$	4,118
Over 30 days		-		40
	$	4,118	$	4,158

19. Financial risk management (continued):

(b) Liquidity risk:

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Company's approach to managing liquidity risk is to monitor consolidated cash flow to ensure that there will always be sufficient liquidity to meet liabilities when due.

As at December 31, 2018, the Company had a cash and cash equivalents balance of $78.3 million (2017 - $85.8 million) and positive working capital of $81.7 million (2017 - $88.5 million). Management expects to refinance the non-amortizing loans as they become due, and has sufficient cash resources to settle other contractual liabilities as they become payable.

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements.

	Carrying amount	Contractual cash flow	2019	2020	2021	2022	Thereafter
Accounts payable and accrued liabilities	$ 832	$ 832	$ 832	$ -	$ -	$ -	$ -
Long-term bank loans[(1)]	64,856	75,397	2,805	2,805	2,805	66,982	
Convertible debentures	51,940	69,576	3,019	3,019	3,019	60,519	-
Total contractual obligations	$117,628	$ 145,805	$ 6,656	$ 5,824	$ 5,824	$127,501	$ -

(1) Includes the impact of interest rate swap agreements.

It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

(c) Currency risk:

Currency risk is the risk that the fair value or future cash flows will fluctuate due to changes in foreign exchange rates. The Company's exposure to foreign currency risk at the reporting date is described below:

Expressed in thousands of U.S. dollars	2018	2017
Cash and cash equivalents	$ 144	$ 293
Net exposure in thousands of U.S. dollars	$ 144	$ 293

A 10% strengthening (weakening) of the Canadian dollar against the U.S. dollar would have increased (decreased) equity and comprehensive income and loss by a nominal amount as at December 31, 2018 and 2017.

(d) Interest rate risk:

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's exposure to interest rate risk mainly arises from the long-term bank loans, which are subject to floating interest rates. As at December 31, 2018, interest rate risk was mitigated by interest rate swap arrangements on $49.6 million of $65.3 million of the Company's term loan facilities. As at December 31, 2017, interest rate risk is mitigated by interest rate swap arrangements that fix the interest rates on $49.6 million of $58.3 million of the Company's term loan facilities.

Based on the balance outstanding on December 31, 2018 and 2017, a one percentage point increase (decrease) in the interest rate would increase (decrease) interest expense by a nominal amount.

(Tabular amounts expressed in thousands of Canadian dollars)

19. Financial risk management (continued):

(e) Capital management:

The Company's objective is to maintain a strong capital base to maintain investor, creditor and market confidence and to develop the business.

Management defines capital as the Company's total shareholders' equity, long-term bank loans and convertible debentures. The Board of Directors does not establish quantitative return on capital criteria for management. The Board of Directors reviews the capital structure on a quarterly basis.

In order to maintain or adjust the capital structure, the Company may issue new shares, warrants, or debt, draw on its operating line of credit, purchase shares for cancellation pursuant to normal course issuer bids, or reduce debt.

20. Related party transactions:

In addition to information disclosed elsewhere in these consolidated financial statements, the Company had the following related party transactions during the years ended December 31, 2018 and 2017:

Key management personnel of the Company includes Members of the Board of Directors, the President and CEO, and CFO. The table below provides a breakdown of the compensation of key management personnel included in net income:

		2018		2017
Short-term benefits	$	1,490	$	1,473
Share-based compensation		1,406		975
	$	2,896	$	2,448

During the year ended December 31, 2018, the Company paid fees of $0.2 million (2017 - $0.6 million) to a legal firm where a former director of the Company is a partner.

The Company's President and CEO and one of the Company's directors are co-founders and managing partners of Maxam Capital Corp ("Maxam"). The Company entered into a services agreement with Maxam whereby Maxam provides rent and administrative services to the Company. During the year ended December 31, 2018, the Company paid Maxam approximately $0.1 million (2017 - $0.1 million).

The above transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

(Tabular amounts expressed in thousands of Canadian dollars)

21. Supplemental cash flow information:

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

	Long-term debt (note 10)	Debentures (note 11)	Total
Balance, December 31, 2016	$ 40,659	$ -	$ 40,659
Changes from financing cash flows:			
Proceeds from issuance of debt	17,400	57,500	74,900
Debt financing and prepayment fees	(415)	(2,798)	(3,213)
Liability-related other changes:			
Equity component of debentures	-	(4,101)	(4,101)
Amortization of deferred financing charges	128	65	193
Accretion expense	-	105	105
Balance, December 31, 2017	$ 57,772	$ 50,771	$ 108,543
Changes from financing cash flows:			
Proceeds from issuance of debt	7,000	-	7,000
Debt financing costs	(29)	-	(29)
Liability-related other changes:			
Amortization of deferred financing charges	113	442	555
Accretion expense	-	727	727
Balance, December 31, 2018	$ 64,856	$ 51,940	$ 116,796