Consolidated Financial Statements

Alaris Royalty Corp.

Audited statements for the years ended

December 31, 2010 and 2009

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AUDITOR'S REPORT TO THE SHAREHOLDERS

To the Shareholders

We have audited the accompanying consolidated financial statements of Alaris Royalty Corp. ("the Company"), which comprise the balance sheets as at December 31, 2010 and 2009, and the consolidated statements of earnings, shareholders' equity, comprehensive income and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, 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.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Alaris Royalty Corp. as at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG Chartered Accountants

Calgary, Canada

March 25, 2011

ALARIS ROYALTY CORP.

Consolidated Balance Sheets

	December 31, 2010	2009
Assets		
Current assets:		
Cash	$ 1,816,868	$ 3,826,000
Accounts receivable	688,514	2,470
Prepaid expenses	343,184	103,472
Future income taxes (note 10)	–	2,996,000
	2,848,566	6,927,942
Investment tax credit receivable (note 10)	10,922,393	11,030,007
Future income taxes (note 10)	25,527,962	22,248,900
Equipment (note 4)	69,671	74,477
Investments (note 3)		
Preferred LP units	157,363,963	111,124,642
Intangible assets	12,896,916	13,070,150
	170,260,879	124,194,792
	$209,629,471	$ 164,476,118
Liabilities and Shareholders' Equity/(Deficit)		
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,421,992	$ 939,085
Dividends payable	1,396,262	802,604
Future income taxes (note 10)	–	47,808
Bank indebtedness (note 5)	–	2,850,000
Subordinated debt (note 12)	–	6,500,000
	2,818,254	11,139,497
Bank indebtedness (note 5)	29,200,000	19,700,000
Future income taxes (note 10)	4,176,890	1,347,755
Deferred credit (note 10)	20,795,507	23,661,017
Shareholders' equity/(deficit):		
Shareholder's capital (note 6)	156,858,637	111,125,039
Warrants (note 6)	405,306	845,000
Contributed surplus	2,831,112	1,471,333
Deficit	(7,456,235)	(4,813,523)
	152,638,820	108,627,849
Commitments (note 14)		
Subsequent event (note 15)		
	$209,629,471	$ 164,476,118

See accompanying notes to consolidated financial statements.

On behalf of the Board:

_________________________ Director

_________________________ Director

ALARIS ROYALTY CORP.

Consolidated Statements of Operations and Deficit

	Year ended December 31, 2010	2009
Revenues:		
Royalties and distributions (note 3)	$ 16,657,034	$ 18,066,783
Interest and other	2,190	4,787
	16,659,224	18,071,570
Expenses:		
Interest	1,513,863	2,166,257
Non-cash stock based compensation (Note 8)	1,872,830	1,714,209
Stock based compensation (Note 8)	226,105	221,703
Salaries and benefits	1,060,915	984,933
Legal and accounting fees	443,262	471,848
Corporate and office	626,990	460,018
Financing	193,850	250,000
Depreciation and amortization	190,028	209,449
	6,127,843	6,478,417
Net Income before taxes	10,531,381	11,593,153
Future income tax expense/(recovery) (note 10)	545,609	(5,903,511)
Net Income and other comprehensive income for the year	9,985,772	17,496,664
Deficit, beginning of year	(4,813,523)	(13,239,854)
Dividends to shareholders (note 7)	(12,628,484)	(9,070,333)
Deficit, end of year	$ (7,456,235)	$ (4,813,523)
Earnings per share, basic	$ 0.76	$ 1.83
Earnings per share, fully diluted	$ 0.73	$ 1.83
Weighted average shares outstanding, basic	13,104,165	9,574,916
Weighted average shares outstanding, fully diluted (note 13)	13,651,879	9,574,916

See accompanying notes to consolidated financial statements.

ALARIS ROYALTY CORP.

Consolidated Statements of Cash Flows

	Year ended December 31, 2010	2009
Cash provided by (used in):		
Operations:		
Net Income for the year	$ 9,985,772	$17,496,664
Add non-cash items:		
Depreciation and amortization	190,028	209,449
Stock based compensation (note 8)	1,872,830	1,714,209
Income tax expense/(recovery) (note 10)	545,609	(5,903,511)
	12,594,239	13,516,811
Change in non-cash working capital	(442,850)	436,314
	12,151,389	13,953,125
Investing:		
Purchase of Preferred LP Units	(46,239,320)	(13,000,000)
Purchase of capital assets	(11,989)	(20,234)
	(46,251,309)	(13,020,234)
Financing:		
Dividends to shareholders	(12,034,829)	(9,362,348)
New share capital	39,487,617	12,961,521
Proceeds from exercise of warrants	4,488,000	–
Repayment of senior debt	(2,850,000)	(2,450,000)
Repayment of subordinated debt	(6,500,000)	–
New borrowing of senior debt	9,500,000	–
	32,090,788	1,149,173
Increase (decrease) in cash	(2,009,132)	2,082,064
Cash, beginning of year	3,826,000	1,743,936
Cash, end of year	$ 1,816,868	$ 3,826,000

See accompanying notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010 and 2009

1. Basis of presentation:

Alaris Royalty Corp ("Alaris" or the "Corporation") operations consist primarily of investments in operating entities, typically in the form of long-term license and royalty arrangements or preferred limited partnership interests.

The consolidated financial statements of the Corporation have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are expressed in Canadian dollars.

2. Significant accounting policies:

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles.

(a) Investments:

Investments result from: (1) the direct or indirect purchase of intellectual property from various organizations/vendors and the subsequent license-back of the right for exclusive use to the vendor; or (2) the direct or indirect subscription for a preferred interest in a limited partnership; which interests provide a monthly distribution that is adjusted annually on the basis of a formula linked to revenues, gross margin, same-store sales, or other "top-line" measures as outlined in each of the respective agreements. Investments are initially recognized and measured at cost, including acquisition costs incurred after a letter of intent is signed, such as financial and legal due diligence fees relating directly to the purchase.

Investments that are a royalty structure are being amortized on a straight-line basis over an 80-year period and individually reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Investments that are a preferred interest in a limited partnership are not amortized but are assessed for objective evidence of impairment at each balance sheet date. When there is objective evidence that the investment has been impaired, and there is a decline in the recoverable amount below cost that is other than temporary, the amount of the impairment loss is the difference between the carrying amount of the investment and its fair value. Fair value is estimated using discounted cash flows.

(b) Equipment:

Equipment is recorded at cost. Depreciation is provided for over the estimated useful lives of assets on a declining balance basis.

(c) Intangible assets:

Effective January 1, 2009, the Corporation adopted CICA section 3064 Goodwill and Intangible Assets. The implementation of this standard did not have a material effect on the Company's financial statements.

2. Significant accounting policies (continued):

(d) Revenue recognition:

Revenue consists of amounts generated by licensing intellectual property or distributions from preferred interests in a limited partnership and is recognized when the monthly payments become due and are considered collectible.

(e) Financial instruments:

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument to another entity. Upon initial recognition all financial instruments, including derivatives, are recognized on the balance sheet at fair value. Subsequent measurement is then based on the financial instruments being classified into one of five categories: held for trading, held to maturity, loans and receivables, available for sale and other liabilities. The Corporation has designated its financial instruments into the following categories applying the indicated measurement methods:

Financial Instrument	Category	Measurement Method
Cash and cash equivalents	Held for trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Preferred LP units	Available for sale	Cost
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Bank indebtedness	Other liabilities	Amortized cost
Subordinated debt	Other liabilities	Amortized cost

The Corporation will assess at each reporting period whether there is a financial asset, other than those classified as held for trading, that is impaired. An impairment loss, other than temporary, is included in net earnings.

The Corporation has no embedded derivatives.

The Corporation records all transaction costs incurred in relation to the acquisition of investments classified as “available for sale” as an additional cost of the investment.

The Corporation applies trade-date accounting for the recognition of a purchase or sale of cash equivalents and derivative contracts.

(f) Income taxes:

The Corporation follows the asset and liability method of accounting for income taxes. The Corporation is a taxable entity under the Income Tax Act (Canada).

(g) Stock-based compensation:

Stock-based payments to non-employees and direct awards of stock to employees and non-employees are accounted for using a fair-value method of accounting.

2. Significant accounting policies (continued):

(h) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Significant management estimates include stock-based compensation expenses, future income tax amounts, valuation of intangible assets and preferred LP units, collectability of future royalties and distributions, and valuation of outstanding warrants.

3. Investments:

December 31, 2010	Acquisition Cost	Capitalized Costs	Accumulated Amortization	Net Cost
Lifemark Health	$ 67,500,000	$ 291,362	$ –	$ 67,791,362
Lower Mainland Steel	51,000,000	333,280	–	51,333,280
Solowave	32,500,000	494,787	–	32,994,787
KMH	5,000,000	244,534	–	5,244,534
Total Preferred LP Units	156,000,000	1,363,963	–	157,363,963
End of the Roll	7,200,000	74,920	(522,845)	6,752,075
MEDIchair	6,500,000	83,758	(438,917)	6,144,841
Total Intangible Assets	13,700,000	158,678	(961,762)	12,896,916
	$ 169,700,000	$ 1,522,641	$ (961,762)	$ 170,260,879

December 31, 2009	Acquisition Cost	Capitalized Costs	Accumulated Amortization	Net Cost
Lifemark Health	$ 59,500,000	$ 291,362	$ –	$ 59,791,362
Lower Mainland Steel	51,000,000	333,280	–	51,333,280
Total Preferred LP Units	110,500,000	624,642	–	111,124,642
End of the Roll	7,200,000	74,920	(431,910)	6,843,010
MEDIchair	6,500,000	83,758	(356,618)	6,227,140
Total Intangible Assets	13,700,000	158,678	(788,528)	13,070,150
	$ 124,200,000	$ 783,320	$ (788,528)	$ 124,194,792

3. Investments (continued):

Royalties and distributions:

	Year ended December 31, 2010	2009
Lifemark Health	$ 11,330,637	$ 8,379,439
Lower Mainland Steel	1,998,842	7,110,007
End of the Roll	1,354,892	1,395,568
MEDIchair	1,200,440	1,181,768
KMH	563,890	–
Solowave	208,333	–
	$ 16,657,034	$ 18,066,783

I – Preferred LP Units

(a) Investment in LifeMark Health Limited Partnership (“LifeMark Health”):

The Corporation holds 900,000 class A preferred partnership units ("LifeMark A Units") and 5,850,000 class B preferred partnership units ("LifeMark B Units") in LifeMark Health (the "LifeMark Investment") and were acquired as follows:

	A Units	B Units	Cost
December 31, 2008	900,000	3,750,000	$ 46,500,000
June 30, 2009	–	100,000	1,000,000
October 22, 2009	–	1,200,000	12,000,000
December 31, 2009	900,000	5,050,000	$ 59,500,000
May 18, 2010	–	800,000	8,000,000
December 31, 2010	900,000	5,850,000	$ 67,500,000

Pursuant to the LifeMark Health partnership agreement (the "LifeMark Partnership Agreement") dated December 30, 2004, the LifeMark A Units entitle the Corporation to receive an annual preferred distribution (the "A Unit Preferred Distribution") in priority to distributions on LifeMark Health's other partnership units in a minimum amount of $1.46 million. The minimum amount is adjusted in each subsequent fiscal year to the greater of (i) $1.46 million; and (ii) the A Unit Preferred Distribution for the prior fiscal year multiplied by the percentage increase in LifeMark Health's Same Clinic Sales (as defined in the LifeMark Partnership Agreement), being generally LifeMark Health's annual revenue from clinics that have been open for at least two years, for the previous year. Distributions on the LifeMark A Units are receivable monthly.

3. Investments (continued):

(a) Investment in LifeMark Health Limited Partnership (“LifeMark Health”) (continued):

Pursuant to the LifeMark Partnership Agreement, the LifeMark B Units entitle the Corporation to receive an annual preferred distribution (the "B Unit Preferred Distribution") in priority to distributions on LifeMark Health's other partnership units, other than the LifeMark A Units, in an amount equal to the B Unit Preferred Distribution for the prior fiscal year multiplied by the percentage increase or decrease in LifeMark Health's Same Clinic Sales for the previous fiscal year. Distributions on the LifeMark B Units are receivable monthly.

LifeMark Health has the option at any time after December 30, 2009 (i) to repurchase all (but not less than all) of the LifeMark A and B Preferred Units at a pre-negotiated premium to the original purchase price.

(b) Investment in Lower Mainland Steel Limited Partnership (“LMS”):

The Corporation holds 510,000 Preferred partnership units ("LMS Units") in Lower Mainland Steel (the "LMS Investment"). 150,000 of the LMS Units were acquired on February 2, 2007 for an aggregate acquisition cost of $15 million. Alaris acquired another 360,000 LMS Units on December 21, 2007 for an aggregate acquisition cost of $36 million.

Pursuant to the LMS partnership agreement (the "LMS Partnership Agreement") dated April 2, 2007 and as amended December 21, 2007, the LMS Units entitle the Corporation to receive an annual preferred distribution (the “Preferred Distribution") in priority to distributions on LMS’ other partnership units. For the year ending December 31, 2010, the Corporation was entitled to a base preferred distribution of $2.0 million. The base is in two distinct portions and is adjusted at two points (January 1st and April 1st) in each subsequent twelve month period to the Preferred Distribution for the prior twelve month period multiplied by the percentage increase or decrease in LMS’ Gross Profit (as defined in the LMS Partnership Agreement) for the most recently completed fiscal year. Distributions on the LMS Units are paid monthly.

LMS has the option at any time after April 1, 2010 to repurchase all (but not less than all) of the LMS Units at a pre-negotiated premium to the original purchase price.

(c) Investment in KMH Limited Partnership (“KMH”):

The Corporation holds 50,000 Preferred partnership units ("KMH Units") in KMH Limited Partnership (the "KMH Investment"). 30,000 of the KMH Units were acquired on April 27, 2010 for an aggregate acquisition cost of $3 million. Alaris acquired another 20,000 KMH Units on May 18, 2010 for an aggregate acquisition cost of $2 million.

3. Investments (continued):

Pursuant to the KMH partnership agreement (the "KMH Partnership Agreement") dated April 27, 2010, the KMH Units entitle the Corporation to receive an annual preferred distribution (the “Preferred Distribution") in priority to distributions on KMH’s other partnership units in an amount equal to the Preferred Distribution for the prior fiscal year multiplied by the percentage increase or decrease in KMH’s Same Clinic Sales for the previous fiscal year. Distributions on the KMH Units are receivable monthly.

KMH has the option at any time after April 27, 2013 to repurchase all (but not less than all) of the KMH Units at a pre-negotiated premium to the original purchase price.

(d) Investment in Solowave Design, LP (“Solowave”):

The Corporation holds 3,250,000 Preferred partnership units ("Solowave Units") in Solowave Design Limited Partnership (the "Solowave Investment") acquired on December 16, 2010 for an aggregate acquisition cost of $32.5 million.

Pursuant to the Solowave partnership agreement (the "Solowave Partnership Agreement") dated December 16, 2010, the Solowave Units entitle the Corporation to receive an annual preferred distribution (the “Preferred Distribution") in priority to distributions on Solowave’s other partnership units in an amount equal to the Preferred Distribution for the prior fiscal year multiplied by the percentage increase or decrease in Solowave’s Same Customer Net Sales for the previous fiscal year. Distributions on the Solowave Units are receivable monthly.

Solowave has the option at any time after December 16, 2013 to repurchase all (but not less than all) of the Solowave Units at a pre-negotiated premium to the original purchase price.

II – Intangible Assets

(e) Investment in End of the Roll Carpet and Vinyl (“End of the Roll”):

On May 1, 2005, the Corporation purchased certain intellectual property (the "ER IP") from End of the Roll for an aggregate purchase price of $7.2 million pursuant to an acquisition agreement (the "ER Acquisition Agreement") dated May 1, 2005 (the "End of the Roll Investment"). The ER IP includes End of the Roll's trademarks, trade names, website, and proprietary system for operating franchises. The ER IP was subsequently licensed to End of the Roll for a term (the "Term") of 80 years pursuant to a license agreement (the "ER License Agreement") dated May 1, 2005 in consideration of an annual royalty (the "Royalty"). The Royalty for the first 12-month period from May 1, 2005 to April 30, 2006 was $1.2 million (the "Initial Royalty"). The Royalty for each subsequent 12-month period during the Term is calculated by increasing or decreasing the Royalty for End of the Roll's fiscal year just ended by the percentage change in Same Store Sales (as defined in the ER License Agreement), being generally the total sales of all franchisee retail stores that have been open for at least two years, over the fiscal year immediately preceding the fiscal year just ended. Royalty payments are receivable monthly.

3. Investments (continued):

End of the Roll has the option at any time after May 1, 2010 to repurchase the ER IP (and terminate the Royalty) at a pre-negotiated premium to the original purchase price.

(f) Investment in MEDIchair Ltd. (“MEDIchair”):

On September 12, 2005, the Corporation purchased certain intellectual property (the "MEDIchair IP") from MEDIchair for an aggregate purchase price of $6.5 million (the "MEDIchair Investment") pursuant to an acquisition agreement (the "MEDIchair Acquisition Agreement") dated September 12, 2005. The MEDIchair IP includes MEDIchair's trademarks, trade names, website, and proprietary system for operating franchises. The MEDIchair IP was subsequently licensed to MEDIchair for a term (the "Term") of 80 years pursuant to a license agreement (the "MEDIchair License Agreement") dated September 12, 2005 in consideration of an annual royalty (the "Royalty"). The Royalty for the 12-month period from October 1, 2006 to September 30, 2007 was $1.053 million. The Royalty for each subsequent 12-month period during the Term is calculated by increasing or decreasing the Royalty in MEDIchair's fiscal year just ending by the percentage change in Same Store Royalties (as defined in the MEDIchair License Agreement), being generally the total annual royalties received by MEDIchair from all franchisees whose retail stores have been opened for at least two years over the fiscal year immediately preceding the fiscal year just ending, subject to a maximum percentage change in any year of 10%.

MEDIchair has the option at any time after October 1, 2010 to repurchase the MEDIchair IP (and terminate the Royalty) at a pre-negotiated premium to the original purchase price.

4. Equipment:

Equipment consists of leasehold improvements, furniture and fixtures, and computer equipment. The amounts are net of accumulated depreciation of $116,604 (December 31, 2009 - $104,532).

5. Debt

The Corporation has a $30,100,000 secured revolving credit facility with a syndicate of Canadian chartered banks. Interest is payable at the lenders’ prime rate plus 3.5% (6.5% at December 31, 2010). The term out date under the credit facility is December 31, 2011. If an extension is not received by December 31, 2011, the facility will be repaid in thirty-six equal monthly installments commencing January 31, 2012. There are financial covenants under this facility and at December 31, 2010, the Corporation is in compliance with each of the covenants based on a letter received by the Corporation from the lending syndicate clarifying the exclusion of certain non-cash and extraordinary amounts in the calculation of the covenants for the remainder of the term of the agreement. Bank fees of $193,850 were paid in the year ended December 31, 2010 (2009 - $250,000) as a result of the renewal of the facility in December 2010.

6. Shareholders equity:

The Corporation has authorized, issued and outstanding, 15,759,939 voting, 666,665 non-voting common shares.

Issued Common Shares	Number of Shares	Amount
Balance at December 31, 2008	8,455,169	$90,278,747
Issued in lieu of dividends on restricted share units	12,679	132,348
Issued by short form prospectus	2,300,000	12,955,000
Short form prospectus costs	-	(838,483)
Income tax benefit of share issue costs		222,427
Issued upon RSUs vesting to Directors	31,250	375,000
Balance at December 31, 2009 (Voting shares)	10,799,098	103,125,039
Issued in lieu of dividends on restricted share units	14,191	138,050
Issued upon RSUs vesting to Directors	31,250	375,000
Warrants exercised in the period	598,400	4,488,000
Fair value of warrants exercised in the period	-	439,694
Issued by short form prospectus in May 2010	1,840,000	16,560,000
Short form prospectus costs in May 2010	-	(1,239,548)
Income tax benefit of share issue costs	-	326,373
Issued by short form prospectus in Dec 2010	2,477,000	26,008,500
Short form prospectus costs in Dec 2010	-	(1,839,035)
Income tax benefit of share issue costs	-	476,562
Balance at December 31, 2010 (Voting shares)	15,759,939	$ 148,858,637
Non-voting shares	666,665	8,000,000
Balance at December 31, 2010 (Voting, non-voting)	16,426,604	$ 156,858,637

Issued Warrants	Number of Warrants	Amount
Balance at December 31, 2009	1,150,000	$ 845,000
Exercised during the year	(598,400)	(439,694)
Balance at December 31, 2010	551,600	$ 405,306

The warrants are exercisable at $7.50 at any time up to twenty-four (24) months from the date of their issue (October 22, 2009), subject to a mandatory exercise if, at the Corporation's option, any time after twelve (12) months from their issue, if the volume weighted average price of the voting common shares on the Toronto Stock Exchange is above $9.00 per common share for twenty (20) consecutive trading days.

7. Dividends and Distributions:

For January and February 2010, the Corporation had declared a dividend of $0.07 per voting and non-voting common share. For March through November 2010, the dividend was increased to $0.08 per voting and non-voting common share per month. For December 2010, the dividend was increased to $0.085 per voting and non-voting common share per month ($12,628,484 in aggregate). For the year ended December 31, 2009, dividends of $9,070,333 were declared.

8. Stock-based compensation:

The Corporation has a Restricted Share Unit Plan ("RSU Plan") and a Stock Option Plan as approved by shareholders at a special shareholders meeting on July 31, 2008 that authorizes the Board of Directors to grant awards of RSUs and Options subject to a maximum of ten percent of the issued and outstanding common shares of the Corporation.

The RSU Plan will settle in voting common shares which may be issued from treasury or purchased on the Toronto Stock Exchange. The Corporation has reserved 867,624 and issued 384,400 RSUs to management and Directors as of December 31, 2010. The RSUs issued to directors vest over a three-year period. The RSUs issued to management (290,650) do not vest until the end of the three-year period and are subject to certain performance conditions relating to operating cash flow per share. The stock-based compensation expense relating to the RSU Plan is based on the issue price at the time of grant and management's estimate of the future performance conditions and will be amortized over the thirty-six month vesting period. Payments in lieu of dividends on the unvested RSUs are made monthly in accordance with the Corporation's dividend policy. Payments to management are split evenly between cash and common shares.

For the year ended December 31, 2010, the Corporation incurred stock-based compensation expenses of $2,098,935 which includes: $1,634,059 (non-cash expense) for the 2010 portion of the RSU Plan expense that is to be amortized over the thirty-six month vesting period of the plan; $226,105 for payments to staff and directors in lieu of dividends under the RSU Plan; $138,050 (non-cash expense) for shares issued in lieu of dividends under the RSU Plan; and $100,721 (non-cash expense) for the 2010 amortization of the fair value of outstanding stock options. The Corporation has reserved 707,369 and issued 610,150 options (319,150 in 2009) that vest over a four-year period and expire in five years. The fair value of the warrants (note 6) and options were calculated using a Black-Scholes model with the following assumptions:

	Warrants 2009	Options 2009	Options 2010
Dividend yield	12%	12%	8.7%
Expected volatility	53%	56%	52%
Risk free rate of return	2.46%	2.74%	2.15%
Expected life	2 years	5 years	5 years
Weighted average value per option/warrant	$ 0.7560	$ 1.3430	$ 2.5921

8. Stock-based compensation (continued):

The number and weighted average exercise prices of share options is as follows:

	Weighted Avg Exercise Price 2010	Number of Options 2010	Weighted Avg Exercise Price 2009	Number of Options 2009
Outstanding at January 1	$ 10.52	319,150	$ 12.00	224,150
Forfeited during the year	–	–	12.00	(5,000)
Granted during the year	11.56	291,000	7.27	100,000
Outstanding at December 31	11.01	610,150	10.52	319,150
Exercisable at December 31	$ 11.12	134,575	$ 12.00	54,788

The options outstanding at December 31, 2010, have an exercise price in the range of $7.27 to $12.00 (same as 2009) and a weighted average contractual life of 3.6 years (2009 – 4.1 years). No share options were exercised in 2009 or 2010.

9. Financial risk management

The Corporation is exposed to financial risks as set out below.

(a) Credit risk and other price risk:

Other price risk is the risk that future cash flows associated with portfolio investments will fluctuate. Cash flow from investments are generally based on a percentage of the investments gross revenue, same store sales, gross margin or other similar revenue. Accordingly, to the extent that the financial performance of the investment declines in respect of the relevant performance metric, cash payments to the Corporation will decline. Portfolio investment agreements allow for the repayment of investments at the option of the portfolio entity, and such repayment could affect future cash flows.

Credit risk is the risk of financial loss to the Corporation if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Corporation's investments. Concentrations of credit risk exist when a significant proportion of the Corporation's assets are invested in a small number of individually significant investments, and investments with similar characteristics and/or subject to similar economic, political and other conditions that may prevail.

9. Financial risk management (continued):

The Corporation is exposed to credit related losses on current and future amounts receivable pursuant to investment agreements. In the event of non-performance by counterparties, future royalty and distributions revenue from the investments could be reduced, resulting in impairment of investment values. The investment agreements provide that payments are receivable monthly no later than the last day of the month. As at December 31, 2010, all amounts receivable for the year ended December 31, 2010 had been received.

Cash and cash equivalents consist of cash bank balances and short-term deposits maturing in less than 90 days. The Corporation manages the credit exposure related to short-term investments by selecting counter parties based on credit ratings and monitors all investments to ensure a stable return, avoiding complex investment vehicles with higher risk such as asset backed commercial paper.

The carrying amount of investments, accounts receivable and cash and cash equivalents represents the maximum credit exposure. The Corporation does not have an allowance for doubtful accounts as at December 31, 2010 and did not provide for any doubtful accounts nor was it required to write-off any receivables or investments during the year ended December 31, 2010.

(b) Liquidity risk:

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. The Corporation's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Corporation's reputation. The Corporation has the following financial instruments that mature as follows:

	Total	0-6 months	6 mo - 1 yr	1 - 2 years	3 - 4 years
Accounts payable and accrued liabilities	$ 1,421,992	$ 1,421,992	$ –	$ –	$ –
Dividends payable	1,396,262	1,396,262	–	–	–
Bank indebtedness	29,200,000	–	–	19,466,667	9,733,333
Total	$32,018,254	$ 2,818,254	$ –	$19,466,667	$ 9,733,333

(c) Market risk:

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Corporation's net earnings or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

9. Financial risk management (continued):

Foreign currency exchange rate risk and commodity price risk

The Corporation does not have any direct exposure to foreign currency exchange rate risk or commodity price risk. The Corporation had no forward exchange rate contracts or commodity price contracts in place as at or during the year ended December 31, 2010.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Corporation is exposed to interest rate fluctuations on its bank debt that bears a floating rate of interest. As at December 31, 2010, if interest rates had been 1% lower with all other variables held constant, net income for the period would have been $292,500 higher, due to lower interest expense. An equal and opposite impact would have occurred to net income had interest rates been 1% higher.

The Corporation had no interest rate swap or financial contracts in place as at or during the year ended December 31, 2010.

(d) Capital management:

The Corporation manages capital by monitoring certain debt covenants set out in its credit facility. The Corporation has a maximum senior debt to contracted EBITDA of 1.7:1 (1.49:1 at December 31, 2010). EBITDA is defined as net income before interest expense, income taxes, depreciation and amortization and non-cash stock-based compensation expenses. Additionally, a minimum tangible net worth requirement of $148,628,800 is in place ($152.6 million at December 31, 2010). Tangible net worth is defined as subordinated debt plus shareholders equity. In order to acquire more royalties, the Corporation needs to access public equity markets to fund the acquisitions and manage the business within the bank covenants. The Corporation was in compliance with all debt covenants at December 31, 2010.

(e) Fair value of financial instruments:

The Corporation's financial instruments as at December 31, 2010 and December 31, 2009 include cash and cash equivalents, accounts receivable, investments, accounts payable and accrued liabilities, bank indebtedness and subordinated debt. The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and approximate their carrying amounts due to their short-terms to maturity.

Bank indebtedness bears interest at a floating market rate and accordingly the fair market value approximates the carrying value. The subordinated debt is due to the Corporation's largest shareholder and, accordingly, the fair value is not readily determinable. The fair values of the available for sale investments are not readily determinable with sufficient reliability due to the lack of similar instruments in the market.

10. Income taxes

Income tax expense is calculated by using the combined federal and provincial statutory income tax rates. The provision for income tax differs from that which would be expected by applying statutory rates. A reconciliation of the difference is as follows:

	Year ended December 31, 2010	Year ended December 31, 2009
Earnings before income taxes	$ 10,531,381	$ 11,601,281
Combined federal and provincial statutory income tax rate	28.00%	29.00%
Expected income tax provision	$ 2,948,787	$ 3,364,371
Non-deductible expense	529,305	498,997
Drawdown of deferred credit	(2,865,511)	(3,836,895)
Decrease in valuation allowance	–	(4,963,992)
Loss carryforwards expired	–	2,780,171
Net impact of investment tax credits	107,554	(3,407,676)
Rate changes and other	(174,526)	(338,487)
	$ 545,609	$ (5,903,511)

The valuation allowance was decreased as a result of the extension of expiry dates for investment tax credits in 2009.

The income tax effect of the temporary differences that give rise to the Corporation's future income tax assets and liabilities are as follows:

	Year ended December 31 2010	Year ended December 31, 2009
Future income tax assets (liabilities):		
Non-capital losses and unclaimed scientific research and development expenses ("SRED")	$ 24,124,259	$ 27,040,431
Equipment	90,527	93,943
Share issue costs	1,313,175	962,065
Intangible assets	(1,446,292)	(1,489,600)
Investment tax credits	(2,730,598)	(2,757,502)
	$ 21,351,072	$ 23,849,337

10. Income Taxes (continued):

The future income taxes as presented on the balance sheet are comprised of:

	Year ended December 31, 2010	Year ended December 31, 2009
Current assets	$ –	$ 2,996,000
Long-term assets	25,527,962	22,248,900
Current liabilities	–	(47,808)
Long-term liabilities	(4,176,890)	(1,347,755)
	$ 21,351,072	$ 23,849,337

As at December 31, 2010, the Corporation has non-capital losses available to reduce income tax in future years that expire from time to time as follows:

2012	$ 12,792,192
2013	21,537,689
2024 and later	3,202,748
	$ 37,532,629

As at December 31, 2010, the Corporation has unused federal income tax credits which expire from time to time as follows:

2017	$ 133,712
2018	150,798
2019	1,623,342
2020	1,935,046
2021	1,295,097
2022	3,296,237
2023	1,840,597
2024	647,624
	$ 10,922,453

The Corporation has research and development expenditures not deducted at the end of the year, to be deducted over an indefinite period for an amount of $58,131,473.

10. Income Taxes (continued):

As at December 31, 2010, the Corporation has a deferred credit of $19,701,627:

Opening deferred credit	$ 30,562,949
Drawdown in prior years	(6,901,931)
Drawdown in current year	(2,865,511)
	$ 20,795,507

11. Recent accounting pronouncements not yet adopted or adopted in 2010:

New pending adoption:

The CICA's Accounting Standards Board confirmed the changeover from Canadian GAAP to IFRS (International Financial Reporting Standards) will be required for publicly accountable enterprises beginning on January 1, 2011. The Corporation has developed an implementation plan that includes a preliminary GAAP assessment, detailed quantification of the differences between Canadian GAAP and IFRS, the preparation of an opening balance sheet under IFRS for January 1, 2010 and a transition plan for elections under IFRS 1.

12. Related party transactions:

During 2010, the Corporation repaid all of a $6.5 million demand loan with a company owned by its largest shareholder. For the year ended December 31, 2010, the Corporation paid interest of $410,515 to this company (Year ended December 31, 2009 - $845,000).

13. Earnings per share:

Weighted average number of common shares (diluted):

	Year ended December 31, 2010	Year ended December 31, 2009
Weighted average number of common shares	13,104,165	9,574,916
Effect of warrants on exercise	136,239	–
Effect of share options on issue	27,076	–
Effect of RSUs on issue	384,400	–
	13,651,879	9,574,916

At December 31, 2010, 219,150 options (2009 – 319,150) were excluded from the diluted weighted average number of common shares as their effect would have been anti-dilutive.

The average market value of the Corporation's common shares for purposes of calculating the dilutive effect of share options and warrants was based on quoted market prices for the period during which the share options and warrants were outstanding.

14. Commitments:

On March 25, 2009, the Corporation signed a seven-year lease at a new location that was to commence July 1, 2009 ending June 30, 2016. The commencement date was delayed until after December 1, 2009.

2011	$ 159,260
2012	159,851
2013	166,354
2014	166,354
2015	166,354
2016	152,491
	$ 970,666

15. Subsequent event:

Subsequent to December 31, 2010, shareholders exercised 477,400 warrants resulting in the issuance of 457,900 voting common shares at $7.50 per share for total proceeds of $3,580,500.

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