



## **PIZZA PIZZA ROYALTY CORP.**

Consolidated Interim Condensed Financial Statements  
(Unaudited)  
For the three months ended March 31, 2017 and 2016

# Pizza Pizza Royalty Corp.

## Unaudited Interim Consolidated Statements of Financial Position

As at March 31, 2017 and December 31, 2016

(Expressed in thousands of Canadian dollars)

	March 31, 2017 \$	December 31, 2016 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	2,032	2,134
Short-term investments	2,750	2,750
Receivable from Pizza Pizza Limited (note 8)	3,096	3,311
Trade and other receivables	134	81
<b>Total current assets</b>	<b>8,012</b>	<b>8,276</b>
<b>Non-current assets</b>		
Pizza Pizza Rights and Marks (note 3)	267,338	262,703
Pizza 73 Rights and Marks (note 3)	73,796	73,667
<b>Total non-current assets</b>	<b>341,134</b>	<b>336,370</b>
<b>Total assets</b>	<b>349,146</b>	<b>344,646</b>
<b>Liabilities and shareholders' equity</b>		
<b>Current liabilities</b>		
Trade and other payables	439	480
Payable to Pizza Pizza Limited (note 8)	626	573
Dividends payable to shareholders	1,755	1,755
Income taxes payable	173	299
<b>Total current liabilities</b>	<b>2,993</b>	<b>3,107</b>
<b>Non-current liabilities</b>		
Borrowings (note 4)	46,979	46,977
Derivative financial instruments (note 10)	942	959
Deferred tax liability	18,404	18,207
<b>Total non-current liabilities</b>	<b>66,325</b>	<b>66,143</b>
<b>Shareholders' equity</b>		
Share capital (note 6)	242,030	242,030
Exchangeable Shares (notes 3 and 5)	70,265	65,501
Accumulated other comprehensive loss	(280)	(190)
Deficit	(32,187)	(31,945)
<b>Total shareholders' equity</b>	<b>279,828</b>	<b>275,396</b>
<b>Total liabilities and shareholders' equity</b>	<b>349,146</b>	<b>344,646</b>

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

# Pizza Pizza Royalty Corp.

## Unaudited Interim Consolidated Statements of Earnings

For the three months ended March 31, 2017 and 2016

(Expressed in thousands of Canadian dollars, except number of shares and per share amounts)

	March 31, 2017 \$	March 31, 2016 \$
Royalty Pool System Sales (note 7)	133,863	133,091
Royalty income (note 7)	8,673	8,642
Administrative expenses	(135)	(163)
<b>Operating earnings</b>	<b>8,538</b>	<b>8,479</b>
Interest expense on borrowings (note 4)	(209)	(213)
<b>Earnings for the period before income taxes</b>	<b>8,329</b>	<b>8,266</b>
Current tax expense	(1,375)	(1,375)
Deferred tax expense	(195)	(267)
<b>Earnings for the period attributable to shareholders</b>	<b>6,759</b>	<b>6,624</b>
Weighted average number of shares – basic and diluted (note 6)	31,213,495	30,921,241
<b>Basic and diluted earnings per share (note 6)</b>	<b>0.22</b>	<b>0.21</b>

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

# Pizza Pizza Royalty Corp.

## Unaudited Interim Consolidated Statements of Comprehensive Earnings

For the three months ended March 31, 2017 and 2016

(Expressed in thousands of Canadian dollars)

	March 31, 2017 \$	March 31, 2016 \$
<b>Earnings for the period</b>	<b>6,759</b>	<b>6,624</b>
<b>Other comprehensive earnings (loss)</b>		
Items that may be reclassified subsequently to net earnings:		
Cash flow hedges	(87)	(348)
Deferred tax impact of cash flow hedges	(3)	49
<b>Total comprehensive earnings</b>	<b>6,669</b>	<b>6,325</b>

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

# Pizza Pizza Royalty Corp.

*Unaudited Interim Consolidated Statements of Changes in Shareholders' Equity  
For the three months ended March 31, 2017 and 2016  
(Expressed in thousands of Canadian dollars)*

	Share capital \$ (note 6)	Exchangeable Shares \$ (note 5)	Accumulated other comprehensive loss \$	Deficit \$	Total shareholders' equity \$
<b>At December 31, 2016</b>	<b>242,030</b>	<b>65,501</b>	<b>(190)</b>	<b>(31,945)</b>	<b>275,396</b>
<b>Comprehensive earnings</b>					
Earnings for the period	-	-	-	6,759	6,759
Cash flow hedges	-	-	(87)	-	(87)
Deferred tax impact of cash flow hedges	-	-	(3)	-	(3)
<b>Total comprehensive earnings (loss)</b>	<b>-</b>	<b>-</b>	<b>(90)</b>	<b>6,759</b>	<b>6,669</b>
<b>Transactions with shareholders</b>					
Exchangeable Shares (note 5)	-	4,764	-	-	4,764
Dividends declared to shareholders	-	-	-	(5,266)	(5,266)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(1,735)	(1,735)
<b>Total transactions with shareholders</b>	<b>-</b>	<b>4,764</b>	<b>-</b>	<b>(7,001)</b>	<b>(2,237)</b>
<b>At March 31, 2017</b>	<b>242,030</b>	<b>70,265</b>	<b>(280)</b>	<b>(32,187)</b>	<b>279,828</b>
<b>At December 31, 2015</b>	<b>242,030</b>	<b>63,030</b>	<b>(390)</b>	<b>(31,224)</b>	<b>273,446</b>
<b>Comprehensive earnings</b>					
Earnings for the period	-	-	-	6,624	6,624
Cash flow hedges	-	-	(348)	-	(348)
Deferred tax impact of cash flow hedges	-	-	49	-	49
<b>Total comprehensive earnings (loss)</b>	<b>-</b>	<b>-</b>	<b>(299)</b>	<b>6,624</b>	<b>6,325</b>
<b>Transactions with shareholders</b>					
Exchangeable Shares (note 5)	-	2,471	-	-	2,471
Dividends declared to shareholders	-	-	-	(5,148)	(5,148)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(1,644)	(1,644)
<b>Total transactions with shareholders</b>	<b>-</b>	<b>2,471</b>	<b>-</b>	<b>(6,792)</b>	<b>(4,321)</b>
<b>At March 31, 2016</b>	<b>242,030</b>	<b>65,501</b>	<b>(689)</b>	<b>(31,392)</b>	<b>275,450</b>

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

# Pizza Pizza Royalty Corp.

*Unaudited Interim Consolidated Statements of Cash Flows  
For the three months ended March 31, 2017 and 2016  
(Expressed in thousands of Canadian dollars)*

	March 31, 2017 \$	March 31, 2016 \$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Earnings for the period	6,759	6,624
Amortization of deferred financing fees	2	10
Off-market swap payments	(105)	(119)
Deferred tax expense	195	267
Changes in non-cash working capital (note 9)	48	(684)
<b>Cash provided by operating activities</b>	<b>6,899</b>	<b>6,098</b>
<b>Financing activities</b>		
Dividends paid to shareholders	(5,266)	(5,148)
Distributions on Class B and Class D Exchangeable Shares	(1,735)	(1,644)
<b>Cash used in financing activities</b>	<b>(7,001)</b>	<b>(6,792)</b>
<b>Decrease in cash and cash equivalents</b>	<b>(102)</b>	<b>(694)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>2,134</b>	<b>2,236</b>
<b>Cash and cash equivalents, end of period</b>	<b>2,032</b>	<b>1,542</b>
<b>Supplementary information</b>		
Interest paid	312	322

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

# Pizza Pizza Royalty Corp.

## *Notes to the Unaudited Interim Condensed Consolidated Financial Statements*

*For the three months ended March 31, 2017 and 2016*

*(Expressed in thousands of Canadian dollars, except number of shares and per share amounts)*

### 1. General information

The Pizza Pizza Royalty Corp. (the “Company”) is governed by the *Business Corporations Act* (Ontario) pursuant to its articles of incorporation dated April 4, 2012 and articles of arrangement dated December 31, 2012. The Company’s common shares are traded on the Toronto Stock Exchange under the stock symbol PZA. The Company is incorporated and domiciled in Canada and the address of its registered office is 500 Kipling Avenue, Toronto, Ontario, Canada.

The Company acquired, through the Pizza Pizza Royalty Limited Partnership (the “Partnership”), the trademarks, trade names, operating procedures, systems and other intellectual property and proprietary rights associated therewith owned by Pizza Pizza Limited (“PPL”) used in connection with the operation of all restaurants operated by PPL, its subsidiaries and its franchisees (collectively, the “Pizza Pizza Rights and Marks”).

Concurrent with the acquisition of the Pizza Pizza Rights and Marks on July 6, 2005, the Partnership granted PPL an exclusive and unlimited licence to use the Pizza Pizza Rights and Marks for an initial term of 99 years for which PPL pays a royalty equal to 6% of system sales from all Pizza Pizza restaurants in the Royalty Pool, as defined in the Pizza Pizza Licence and Royalty Agreement.

On July 24, 2007, the Company, through the Partnership, acquired the trademarks, trade names, operating procedures and systems and other intellectual property and proprietary rights owned by Pizza 73, Inc. and its affiliated companies (together, “Pizza 73”) used in connection with the operation of all restaurants operated by Pizza 73, and its partners (collectively, the “Pizza 73 Rights and Marks”).

Concurrent with the acquisition of the Pizza 73 Rights and Marks, the Partnership granted PPL an exclusive and unlimited licence to use the Pizza 73 Rights and Marks for an initial term of 99 years for which PPL pays a royalty equal to 9% of system sales from all Pizza 73 restaurants in the Royalty Pool, as defined in the Pizza 73 Licence and Royalty Agreement.

As at March 31, 2017, there were 651 Pizza Pizza restaurants (2016 – 636) and 100 Pizza 73 restaurants (2016 – 100) in the Royalty Pool; the Royalty Pool is adjusted annually on January 1.

The Company pays monthly dividends directly to public shareholders. For the three months ended March 31, 2017, the Company declared dividends of \$0.2139 per share (2016 – \$0.2091 per share).

PPL, a privately owned corporation headquartered in Toronto, Ontario, operates in the food service industry primarily throughout Ontario and Alberta, and primarily franchises and operates quick-service restaurant businesses under the Pizza Pizza and Pizza 73 brands. PPL derives revenues from franchisees through the sale of franchise restaurants, food and supplies and royalties. PPL also derives revenues from company owned and jointly controlled restaurants through the sale of food products to retail customers. The Company’s revenues are earned from certain operations of PPL and, accordingly, the revenues of the Company and its ability to pay dividends to shareholders are dependent on the ability of PPL to generate and pay royalties to the Company.

Historically, PPL’s system sales experience a decrease in the first calendar quarter when compared to the fourth quarter, which has historically been the strongest quarter.

# Pizza Pizza Royalty Corp.

## Notes to the Unaudited Interim Condensed Consolidated Financial Statements

For the three months ended March 31, 2017 and 2016

(Expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### 2. Significant accounting policies

The principal accounting policies applied in the preparation of these unaudited interim condensed consolidated financial statements are set out below. These policies have been consistently applied to all periods presented unless otherwise stated.

#### a. Basis of preparation

The Company prepares its unaudited interim condensed consolidated financial statements in accordance with *IAS 34, Interim Financial Reporting* ("IAS 34"). Accordingly, these unaudited interim condensed consolidated financial statements do not include all disclosures required for annual financial statements and should be read in conjunction with the annual consolidated financial statements of the Company as at and for the year ended December 31, 2016.

The Company's preparation of financial statements in accordance with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements, were the same as those that applied to the Company's consolidated financial statements as at and for the year ended December 31, 2016.

These unaudited interim condensed consolidated financial statements were authorized for issue by the Board of the Directors on May 9, 2017.

The accounting policies adopted in the preparation of these unaudited interim condensed consolidated financial statements are consistent with those followed in the preparation of the Company's annual consolidated financial statements as at and for the year ended December 31, 2016.

#### b. Future changes in accounting policy and disclosure

Standards, amendments and interpretations to existing standards that are not yet effective and have not yet been early adopted by the Company:

##### IFRS 9, Financial Instruments ("IFRS 9")

IFRS 9, as issued in 2014, introduces new requirements for the classification and measurement of financial instruments, a new expected-loss impairment model that will require more timely recognition of expected credit losses and a substantially reformed model for hedge accounting, with enhanced disclosures about risk management activity. IFRS 9 also removes the volatility in profit or loss that was caused by changes in an entity's own credit risk for liabilities elected to be measured at fair value. IFRS 9 is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The Company has not yet begun the process of evaluating the impact of this standard on its consolidated financial statements.

##### IFRS 15, Revenue from Contracts with Customers ("IFRS 15")

In May 2014, the IASB issued IFRS 15, which covers principles for reporting about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. IFRS 15 becomes effective for annual periods beginning on or after January 1, 2018. The new revenue standards may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. While the Company is still in the process of assessing the anticipated impact of the amended standard on its consolidated financial statements, it



# Pizza Pizza Royalty Corp.

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generally anticipates that the accounting for ongoing royalty revenues will not materially change. The Company has formed a project team to evaluate and implement the standard and currently anticipates adopting this standard in its first quarter of 2018 without restatement of prior periods presented.

### IFRS 16, Leases ("IFRS 16")

In January 2016 the IASB has issued IFRS 16, its new leases standard that requires lessees to recognize assets and liabilities for most leases on their balance sheets. Lessees applying IFRS 16 will have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged. The new standard will be effective from January 1, 2019 with limited early application permitted. The Company has not yet begun the process of evaluating the impact of this standard on its consolidated financial statements.

### c. Consolidation

The unaudited interim condensed consolidated financial statements incorporate the assets and liabilities of the Company and its subsidiaries as at March 31, 2017 and December 31, 2016 and the results of these subsidiaries for the three months ended March 31, 2017 and 2016. The Company's subsidiaries and its respective holding at March 31, 2017 and 2017 are outlined below:

<b>Subsidiary</b>	<b>March 31, 2017</b>	<b>March 31, 2016</b>
Pizza Pizza GP Inc.	78.9%	79.6%
Pizza Pizza Royalty Limited Partnership	78.9%	79.6%

### 3. Pizza Pizza and Pizza 73 Rights and Marks

	Pizza Pizza Rights and Marks \$	Pizza 73 Rights and Marks \$	Total \$
<b>Net book value at December 31, 2015</b>	<b>261,712</b>	<b>72,187</b>	<b>333,899</b>
Accretion of value – January 1, 2016 vend-in	748	499	1,247
Accretion of value – January 1, 2015 true-up	243	981	1,224
<b>Net book value at December 31, 2016</b>	<b>262,703</b>	<b>73,667</b>	<b>336,370</b>
Accretion of value – January 1, 2017 vend-in	4,560	-	4,560
Accretion of value – January 1, 2016 true-up	75	129	204
<b>Net book value at March 31, 2017</b>	<b>267,338</b>	<b>73,796</b>	<b>341,134</b>

The Company, through its interest in the Partnership, acquired the Pizza Pizza Rights and Marks used in the Pizza Pizza quick service restaurant business in Canada in July 2005. Funding for the purchase came from the completion of the Pizza Pizza Royalty Income Fund's initial public offering in July 2005 and from proceeds of the term loan. Concurrent with the acquisition of the Pizza Pizza Rights and Marks, the Partnership granted PPL an exclusive and unlimited licence to use the Pizza Pizza Rights and Marks for an initial term of 99 years, for which PPL pays a royalty equal to 6% of system sales for all Pizza Pizza restaurants in the Royalty Pool, as defined in the Pizza Pizza Licence and Royalty Agreement.

In July 2007, the Company, through its interest in the Partnership, acquired the Pizza 73 Rights and Marks from Pizza 73. The purchase was funded by a public and private placement of Fund units and proceeds from the term loan. Concurrent with the acquisition of the Pizza 73 Rights and Marks, the Partnership granted PPL an

# Pizza Pizza Royalty Corp.

## Notes to the Unaudited Interim Condensed Consolidated Financial Statements

For the three months ended March 31, 2017 and 2016

(Expressed in thousands of Canadian dollars, except number of shares and per share amounts)

exclusive and unlimited licence to use the Pizza 73 Rights and Marks for an initial term of 99 years, for which PPL pays a royalty equal to 9% of system sales of all Pizza 73 restaurants included in the Royalty Pool, as defined in the Pizza 73 Licence and Royalty Agreement.

Annually, on January 1 (the "Adjustment Date"), the Royalty Pool is adjusted to include the forecasted system sales from new Pizza Pizza restaurants opened on or before December 31 of the prior year, less system sales from any Pizza Pizza restaurants that have been permanently closed during the year. Similarly, on the Adjustment Date, the Royalty Pool is adjusted to include the forecasted system sales from new Pizza 73 restaurants opened on or before September 1 of the prior year, less any Pizza 73 restaurants permanently closed during the calendar year. In return for adding net additional royalty revenue, PPL receives the right to indirectly acquire additional shares of the Company through an adjustment to the Class B and Class D Exchange Multiplier (see note 5).

As a result of adding new restaurants to the Royalty Pool on January 1, 2017, the Rights and Marks increased by \$4,560 in 2017 (2016 – \$1,247) and increased by \$204 related to the January 1, 2016 true-up (2016 – \$1,224).

#### 4. Borrowings

	March 31, 2017 \$	December 31, 2016 \$
Borrowings	47,000	47,000
Less: deferred financing fees	21	23
<b>Total borrowings</b>	<b>46,979</b>	<b>46,977</b>

The borrowings are a committed, non-revolving, five-year facility maturing on April 24, 2020, and were used to finance a portion of the acquisition costs of the Pizza Pizza Rights and Marks in 2005 and the Pizza 73 Rights and Marks in 2007. As security for repayment of the facility, PPL grants a continuing, general security interest subject to certain exceptions, in all present and acquired property of PPL which may not be assigned without the prior consent of PPL. The facility bears interest at a fixed Bankers' Acceptance rate plus 0.875% to 1.375%, depending on the level of certain covenant calculations. The previous credit facility was scheduled to mature on December 6, 2016; however, it was renewed early on April 24, 2015. Concurrent with the renewal, the Partnership terminated its then existing swap agreements and entered into two new interest rate swap agreements that fixed the facility interest rate until April 2020 at the Bankers' Acceptance rate of 1.875% plus a credit spread which was initially set at 0.875%. Included in the Bankers' Acceptance rate of 1.875% is 0.6% which relates to blending and extending the two previous swap agreements.

Interest expense incurred on borrowings for the three months ended March 31, 2017 amounted to \$209 (2016 – \$213). Principal repayments on borrowings of \$47,000 are due on April 24, 2020. The effective interest rate as at March 31, 2017 on the \$47,000 was 2.75% (March 31, 2016 – 2.75%).

The facility is subject to certain financial covenants, all of which have been met as at March 31, 2017 and December 31, 2016. The borrowings are held within the Partnership and therefore the financial covenants for the borrowings pertain only to the results of the Partnership and not the Company.

#### 5. Exchangeable Shares

As at March 31, 2017, PPL indirectly holds an effective 21.1% interest in the Company (December 31, 2016 – 20.4%) by holding all Class B and Class D Units of the Partnership. Subject to the Amended and Restated Exchange Agreement, PPL has the right to exchange one Class B or Class D Unit indirectly for that number of

# Pizza Pizza Royalty Corp.

## Notes to the Unaudited Interim Condensed Consolidated Financial Statements

For the three months ended March 31, 2017 and 2016

(Expressed in thousands of Canadian dollars, except number of shares and per share amounts)

shares equal to the Class B Exchange Multiplier or Class D Exchange Multiplier, respectively, applicable at the date of such exchange, as described under "Licence and Royalty Adjustment of the Royalty Pool Changes in the Restaurants in the Royalty Pool".

Subject to the prior rights of the Company's Class C Limited Partnership units, PPL's Class B and Class D Units are entitled to receive monthly distributions and the Company's Class A Limited Partnership units receive the remaining available, monthly distributable cash.

The equivalent number of Class B and Class D Exchangeable Shares outstanding are as follows:

	Number of Class B Exchangeable Shares	Number of Class D Exchangeable Shares	Total Number of Exchangeable Shares	Amount \$
At December 31, 2015	<b>4,487,900</b>	<b>1,636,233</b>	<b>6,124,133</b>	<b>63,030</b>
Add: January 1, 2016 vend-in	54,001	35,975	89,976	1,247
Add: January 1, 2015 true-up	17,641	71,099	88,740	1,224
<b>At December 31, 2016</b>	<b>4,559,542</b>	<b>1,743,307</b>	<b>6,302,849</b>	<b>65,501</b>
Add: January 1, 2017 vend-in	277,519	-	277,519	4,560
Add: January 1, 2016 true-up	5,422	9,313	14,735	204
<b>At March 31, 2017</b>	<b>4,842,483</b>	<b>1,752,620</b>	<b>6,595,103</b>	<b>70,265</b>

a. 2016 Royalty Pool Adjustment – true-up

In early January 2017, adjustments to royalty payments and PPL's Class B Exchange Multiplier were made based on the actual performance of the 24 new restaurants added to the Royalty Pool on January 1, 2016. As a result of the adjustments, the new Class B Exchange Multiplier is 1.819988 and Class B Units can be exchanged for 4,564,964 shares, which is an increase of 5,422 shares, effective January 1, 2016.

In early January 2017, adjustments to royalty payments and PPL's Class D Exchange Multiplier were made based on the actual performance of the two Pizza 73 restaurants added to the Royalty Pool on January 1, 2016. As a result of the adjustments, the new Class D Exchange Multiplier is 17.52620 and Class D Units can be exchanged for 1,752,620 shares, which is an increase of 9,313 shares, effective January 1, 2016.

b. 2017 Royalty Pool Adjustment – Class B Exchange Multiplier

On January 1, 2017, 15 net Pizza Pizza restaurants were added to the Royalty Pool as a result of 23 new restaurants opening and eight closing from January 1, 2016 to December 31, 2016. The additional system sales from the 23 new restaurants are estimated at \$7,674 annually less sales of \$873 from eight permanently closed Pizza Pizza restaurants resulting in net estimated Pizza Pizza sales of \$6,801 added to the Royalty Pool. The total number of Pizza Pizza restaurants in the Royalty Pool has increased to 651. The yield of the shares was determined to be 5.16% calculated using \$16.43 as a weighted average share price. Weighted average share price is calculated based on the market price of the shares traded on the Toronto Stock Exchange during the period of twenty consecutive days ending on the fifth trading day before January 1, 2017. As a result of the contribution of the additional net sales to the Royalty Pool, the Class B Exchange Multiplier increased fractionally by 80% of the total adjustment or 0.110643; the new Class B Multiplier is 1.930631. This adjustment will also increase the entitlement of the holders of the Class B units to distributions of cash and allocations of income from the Partnership. The second adjustment to the Class B Exchange Multiplier will be adjusted to be effective January 1, 2017, once the actual performance of the new restaurants is determined in early 2018.

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*For the three months ended March 31, 2017 and 2016*

*(Expressed in thousands of Canadian dollars, except number of shares and per share amounts)*

c. 2017 Royalty Pool Adjustment – Class D Exchange Multiplier

On January 1, 2017, the Pizza 73 Royalty Pool remained unchanged as a result of four new restaurants opening between September 2, 2015 and September 1, 2016 and four restaurants closing between January 1, 2016 and December 31, 2016. The forecasted additional system sales from the four new restaurants are estimated at \$1,226 annually less \$179 in system sales attributable to the four closed Pizza 73 restaurants resulting in net estimated Pizza 73 sales of \$1,047 added to the Royalty Pool. The net estimated sales were further reduced by \$2,086 in system sales attributable to certain restaurants previously added to the Royalty Pool whose territory adjusted a previously existing restaurant, resulting in a negative Pizza 73 Estimated Determined Amount. As per the Pizza Pizza Royalty Limited Partnership agreement, whenever the Estimated Determined Amount is negative it shall be deemed to be zero. Accordingly, the Class D Exchange Multiplier remained unchanged at 17.52620. The total number of Pizza 73 restaurants in the Royalty Pool remains at 100 for 2017. Once the actual performance of the new restaurants is determined in early 2018, the Class D Exchange Multiplier may be adjusted to be effective January 1, 2017.

d. Pizza Pizza Royalty Corp. Outstanding Shares

In exchange for adding the forecasted Pizza Pizza system sales to the Royalty Pool, PPL has received 277,519 additional equivalent Shares (through the change to the Class B Exchange Multiplier). These represent 80% of the forecasted equivalent Shares entitlement to be received (346,899 equivalent Shares represent 100%), with the final equivalent Shares entitlement to be determined when the new restaurants' 2017 actual sales performance is known with certainty in early 2018.

PPL's Class D equivalent Share entitlement is unchanged for 2017. In any year that the forecasted system sales (less closed restaurants sales and other adjustments) is negative, as was the case with the Class D equivalent Share entitlement calculation for 2017, no increase or decrease in the Exchange Multiplier is made. PPL will only have a Class D equivalent Share entitlement for 2017 if the actual sales performance of the four new Pizza 73 restaurants, less the sales of adjustment restaurants, significantly exceeds forecasted system sales and yields net, positive sales when the actual sales performance is known with certainty in early 2018.

After giving effect to PPL's entitlement to additional equivalent Shares at January 1, 2017, PPL owns equivalent Shares representing 21.1% of the Company's fully diluted shares.

## 6. Share capital

a. Authorized

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preference shares, issuable in series. As at March 31, 2017, 24,618,392 common shares and no preference shares are issued and fully paid. Each common share carries the right to one vote at meetings of shareholders, other than meetings of holders of another class of shares, and to participate equally and ratably in dividends of the Company, if any, and in the remaining property and assets of the Company upon its liquidation, dissolution or wind-up. Each series of preference shares issued shall have rights, privileges, restrictions and conditions as determined by the Board of Directors prior to their issuance. Preference shares may carry voting rights as determined by the Board of Directors and are entitled to a preference over the common shares in the remaining property and assets of the Company in the event of its liquidation, dissolution or wind-up.

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(Expressed in thousands of Canadian dollars, except number of shares and per share amounts)

### b. Issued

The following is a summary of the activity during the period:

	March 31, 2017		December 31, 2016	
	Number of Shares	Amount \$	Number of Shares	Amount \$
<b>Share capital</b>				
Shares, beginning of period	24,618,392	242,030	24,618,392	242,030
<b>Shares, end of period</b>	<b>24,618,392</b>	<b>242,030</b>	<b>24,618,392</b>	<b>242,030</b>

The Company's objective when managing capital, which remained unchanged, is to:

- i) Safeguard its ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders;
- ii) Provide an adequate return to shareholders while maintaining adequate reserves; and
- iii) Ensure sufficient liquidity to pursue its growth strategy while taking a conservative approach towards financial leverage and management of financial risk.

The Company evaluates its capital as all components of equity, other than amounts in accumulated other comprehensive loss relating to the cash flow hedges.

The Company's amount of capital is set in proportion to risk. The Company manages its structure and makes adjustments in light of changes in economic conditions and risk characteristics of the underlying assets. The Company's primary use of capital was to finance acquisitions, supported by the credit facility at the Partnership level.

### c. Earnings per Share

The basic earnings per share is calculated by dividing earnings for the period by the weighted average number of shares outstanding during the period. The denominator in basic earnings per share includes PPL's Class B and Class D Exchangeable Shares, since they are exchangeable into and economically equivalent to the Company's common shares. There were no potentially dilutive instruments outstanding during the three months ended March 31, 2017 or 2016.

The following table illustrates the computation of basic and diluted earnings per share:

	Three months ended March 31, 2017	Three months ended March 31, 2016
Weighted average number of:		
Common shares	24,618,392	24,618,392
Exchangeable Shares (note 5)	6,595,103	6,302,849
Weighted average number of shares outstanding – basic and diluted	31,213,495	30,921,241
<b>Basic and diluted earnings per share</b>	<b>\$0.22</b>	<b>\$0.21</b>

# Pizza Pizza Royalty Corp.

Notes to the Unaudited Interim Condensed Consolidated Financial Statements

For the three months ended March 31, 2017 and 2016

(Expressed in thousands of Canadian dollars, except number of shares and per share amounts)

## 7. Royalty income

Royalty income earned by the Company has been derived as shown in the table below:

	Three months ended March 31, 2017	Three months ended March 31, 2016
(in thousands of dollars, except number of restaurants in the Royalty Pool)		
Restaurants in Royalty Pool	751	736
System sales reported by Pizza Pizza restaurants in the Royalty Pool	112,508	111,210
System sales reported by Pizza 73 restaurants in the Royalty Pool	21,355	21,881
<b>Total system sales</b>	<b>133,863</b>	<b>133,091</b>
Royalty – 6% on Pizza Pizza system sales	6,751	6,673
Royalty – 9% on Pizza 73 system sales	1,922	1,969
<b>Royalty income</b>	<b>8,673</b>	<b>8,642</b>

System sales do not represent the consolidated operating results of the Company but are used to calculate the royalty income as presented above.

## 8. Related party transactions and balances

PPL is a related party by virtue of holding Class B and Class D Exchangeable Shares that are exchangeable into Shares of the Company. Disclosure related to these Exchangeable Shares is provided in note 5.

PPL, pursuant to the Partnership Agreement, is providing certain administrative services to the Company. The fee for these services, which on an annual basis shall not exceed \$25, has been waived for the year.

The Company has a receivable from PPL as at March 31, 2017 of \$3,096 (December 31, 2016 - \$3,311) and a payable to PPL as at March 31, 2017 of \$626 (December 31, 2016 - \$573). This receivable relates to royalty amounts receivable from the Royalty Pool system sales, while the payable to PPL relates to distributions payable to PPL by virtue of holding Class B and Class D Exchangeable Shares and other expenses paid by PPL on behalf of the Partnership.

Transactions with related parties are in the normal course of operations. No amount of related party balances were written off during the three months ended March 31, 2017 or 2016.

# Pizza Pizza Royalty Corp.

## Notes to the Unaudited Interim Condensed Consolidated Financial Statements

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### 9. Statements of Cash Flows information

Changes in non-cash working capital are as follows:

	Three months ended March 31, 2017 \$	Three months ended March 31, 2016 \$
Receivable from Pizza Pizza Limited	215	186
Trade and other receivables	(53)	(38)
Trade and other payables	(41)	(81)
Payable to Pizza Pizza Limited	53	(46)
Income taxes payable	(126)	(705)
<b>Changes in non-cash working capital</b>	<b>48</b>	<b>(684)</b>

### 10. Financial risk management

#### Fair value

The following table presents the carrying amount and the fair value of the Company's financial instruments. Amortized cost is calculated using the effective interest rate method. Fair value is estimated as disclosed below. These amounts represent point-in-time estimates and may not reflect fair value in the future. These calculations are subjective in nature, involve uncertainties and are a matter of significant judgment. The only financial instruments carried at fair value in the consolidated statements of financial position are the derivative financial instruments.

The carrying amounts of the cash and cash equivalents, short-term investments, receivable from PPL, trade and other receivables, trade and other payables and dividends payable to shareholders and payable to PPL all approximate their fair value given the short-term maturity of these financial instruments.

The carrying value and fair value of all financial instruments are as follows:

Category	March 31, 2017		December 31, 2016	
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$
Cash and cash equivalents	L&R 2,032	2,032	2,134	2,134
Short-term investments	L&R 2,750	2,750	2,750	2,750
Receivable from Pizza Pizza Limited	L&R 3,096	3,096	3,311	3,311
Trade and other receivables	L&R 134	134	81	81
Trade and other payables	OFL 439	439	480	480
Dividends payable to shareholders	OFL 1,755	1,755	1,755	1,755
Payable to Pizza Pizza Limited	OFL 626	626	573	573
Borrowings	OFL 46,979	47,000	46,977	47,000
Derivative financial instruments	DFH 942	942	959	959

# Pizza Pizza Royalty Corp.

## *Notes to the Unaudited Interim Condensed Consolidated Financial Statements*

*For the three months ended March 31, 2017 and 2016*

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Financial instruments category guide:

- L&R - Loans and receivables
- DFH - Derivatives used for hedging
- OFL - Other financial liabilities

The different fair value hierarchy levels are as follows:

- . Level 1: Quoted prices (unadjusted) in active markets for identical financial assets or financial liabilities;
- . Level 2: Inputs other than quoted prices included within Level 1 that are observable for the financial asset or financial liability, either directly or indirectly;
- . Level 3: Inputs for the financial asset or financial liability that is not based on observable market data.

As at March 31, 2017, inputs used to fair value the derivative financial instruments were Level 2 and based on observable inputs available for similar assets and liabilities in the active markets as provided by sources independent from the Company.

The fair value of the borrowings was determined using the discounted cash flow method, a generally accepted valuation technique. The discounted factor is based on market rates for debt with similar terms and remaining maturities and based on the Company's credit risk. The Company has no plans to prepay these instruments prior to maturity. The valuation is determined using Level 2 inputs which are observable inputs or inputs which can be corroborated by observable market data for substantially the full term of the asset or liability.

### **Credit risk**

The Company is exposed to credit risk in the event of non-payment by PPL and due to the fact that PPL's operations are all within the same segment, commercial food services. The credit risk is mitigated since monthly royalty payments are received from PPL based on sales generated by a large number of Pizza Pizza and Pizza 73 restaurants in diverse geographical regions. These royalty payments are used to fund monthly distributions to the Company on its Class A and C Limited Partnership Units and to fund distributions to PPL on its Class B and D Partnership Units. All trade and other receivables and the amount receivable from PPL are current and no amounts have been written off or provided for during the year.

Credit risk also arises from cash and cash equivalents and derivative financial instruments with banks and financial institutions. The Company places its cash and cash equivalents and transacts in derivative financial instruments with institutions of high creditworthiness.

Maximum credit risk exposure, which is equivalent to the carrying amount represents the loss that would be incurred if all of the Company's counterparties were to default at the same time.

### **Liquidity risk**

The Company is subject to liquidity risk with respect to trade and other payables, borrowings, provision for other charges and funding the distributions payable to Company shareholders. The Company receives monthly royalties from PPL and the Company is of the opinion that this risk is mitigated by the large number of Pizza Pizza and Pizza 73 restaurants in diverse geographical areas that generate the royalties used to fund the monthly royalties.

The dividends payable to Company shareholders and trade and other payables are expected to be paid within 30 days of the date of the consolidated statements of financial position.



# **Pizza Pizza Royalty Corp.**

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## **Interest rate risk**

The Company's interest rate risk arises from borrowings. Borrowings issued at variable rates expose the Company to interest rate cash flow risk, which is offset by entering into interest rate swaps that fix the interest payable.

The designated hedging relationship was effective as at December 31, 2016.

The interest rate swaps eliminate the Company's interest rate cash flow risk by fixing the rate of interest that is paid on the borrowings. However, the Company is still exposed to fair value interest rate risk as a result of fair value movements in the value of the interest rate swaps that are recorded in other comprehensive earnings/(loss) to the extent that the interest rate swaps are highly effective as cash flow hedges. If interest rates changed by plus/minus 10% of the existing rate, total comprehensive earnings and equity would change by plus/minus \$263 as at March 31, 2017 (December 31, 2016 - \$284) based on movements in the fair value of the interest rate swaps.