



PIZZA PIZZA ROYALTY CORP.

Consolidated Annual Financial Statements
For the years ended December 31, 2017 and 2016

INDEPENDENT AUDITORS' REPORT

To the Shareholders of **Pizza Pizza Royalty Corp.**

We have audited the accompanying consolidated financial statements of **Pizza Pizza Royalty Corp.**, which comprise the consolidated statements of financial position as at December 31, 2017 and 2016 and the consolidated statements of earnings, comprehensive earnings, changes in shareholders' equity and cash flows for the years then ended and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

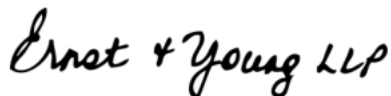
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain 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 consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Pizza Pizza Royalty Corp. as at December 31, 2017 and 2016, and its financial performance and its cash flows for the years ended December 31, 2017 and 2016 in accordance with International Financial Reporting Standards.



Chartered Professional Accountants
Licensed Public Accountants

Toronto, Canada,
February 28, 2018

Pizza Pizza Royalty Corp.

Consolidated Statements of Financial Position

As at December 31, 2017 and 2016

(Expressed in thousands of Canadian dollars)

	December 31, 2017 \$	December 31, 2016 \$
Assets		
Current assets		
Cash and cash equivalents	2,122	2,134
Short-term investments	2,750	2,750
Receivable from Pizza Pizza Limited (note 10)	3,288	3,311
Trade and other receivables	65	81
Total current assets	8,225	8,276
Non-current assets		
Pizza Pizza Rights and Marks (note 3)	267,338	262,703
Pizza 73 Rights and Marks (note 3)	73,796	73,667
Derivative financial instruments (note 12)	177	-
Total non-current assets	341,311	336,370
Total assets	349,536	344,646
Liabilities and shareholders' equity		
Current liabilities		
Trade and other payables (note 4)	485	480
Payable to Pizza Pizza Limited (note 10)	762	573
Dividends payable to shareholders	1,755	1,755
Income taxes payable	173	299
Total current liabilities	3,175	3,107
Non-current liabilities		
Borrowings (note 5)	46,985	46,977
Derivative financial instruments (note 12)	-	959
Deferred tax liability (note 7)	19,599	18,207
Total non-current liabilities	66,584	66,143
Shareholders' equity		
Share capital (note 8)	242,030	242,030
Exchangeable Shares (notes 3 and 6)	70,265	65,501
Accumulated other comprehensive earnings/(loss)	405	(190)
Deficit	(32,923)	(31,945)
Total shareholders' equity	279,777	275,396
Total liabilities and shareholders' equity	349,536	344,646

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

Pizza Pizza Royalty Corp.

Consolidated Statements of Earnings

For the years ended December 31, 2017 and 2016

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

	December 31, 2017 \$	December 31, 2016 \$
Royalty Pool System Sales (note 9)	551,127	544,888
Royalty income (note 9)	35,614	35,333
Administrative expenses	(645)	(678)
Operating earnings	34,969	34,655
Interest expense on borrowings (note 5)	(932)	(867)
Earnings for the year before income taxes	34,037	33,788
Current tax expense (note 7)	(5,754)	(5,649)
Deferred tax expense (note 7)	(1,235)	(1,408)
Earnings for the year attributable to shareholders	27,048	26,731
Weighted average number of shares – basic and diluted (note 8)	31,213,495	30,921,241
Basic and diluted earnings per share (note 8)	0.87	0.86

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

Pizza Pizza Royalty Corp.

Consolidated Statements of Comprehensive Earnings

For the years ended December 31, 2017 and 2016

(Expressed in thousands of Canadian dollars)

	December 31, 2017 \$	December 31, 2016 \$
Earnings for the year	27,048	26,731
Other comprehensive earnings (loss)		
Items that may be reclassified subsequently to net earnings:		
Cash flow hedges	752	254
Deferred tax impact of cash flow hedges (note 7)	(157)	(54)
Total comprehensive earnings	27,643	26,931

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

Pizza Pizza Royalty Corp.

Consolidated Statements of Changes in Shareholders' Equity

For the years ended December 31, 2017 and 2016

(Expressed in thousands of Canadian dollars)

	Share capital \$ (note 8)	Exchangeable Shares \$ (note 6)	Accumulated other comprehensive earnings (loss) \$	Deficit \$	Total shareholders' equity \$
At December 31, 2016	242,030	65,501	(190)	(31,945)	275,396
Comprehensive earnings					
Earnings for the year	-	-	-	27,048	27,048
Cash flow hedges	-	-	752	-	752
Deferred tax impact of cash flow hedges	-	-	(157)	-	(157)
Total comprehensive earnings	-	-	595	27,048	27,643
Transactions with shareholders					
Exchangeable Shares (note 6)	-	4,764	-	-	4,764
Dividends declared to shareholders	-	-	-	(21,063)	(21,063)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(6,963)	(6,963)
Total transactions with shareholders	-	4,764	-	(28,026)	(23,262)
At December 31, 2017	242,030	70,265	405	(32,923)	279,777
At December 31, 2015	242,030	63,030	(390)	(31,224)	273,446
Comprehensive earnings					
Earnings for the year	-	-	-	26,731	26,731
Cash flow hedges	-	-	254	-	254
Deferred tax impact of cash flow hedges	-	-	(54)	-	(54)
Total comprehensive earnings	-	-	200	26,731	26,931
Transactions with shareholders					
Exchangeable Shares (note 6)	-	2,471	-	-	2,471
Dividends declared to shareholders	-	-	-	(20,867)	(20,867)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(6,585)	(6,585)
Total transactions with shareholders	-	2,471	-	(27,452)	(24,981)
At December 31, 2016	242,030	65,501	(190)	(31,945)	275,396

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

Pizza Pizza Royalty Corp.

Consolidated Statements of Cash Flows

For the years ended December 31, 2017 and 2016

(Expressed in thousands of Canadian dollars)

	December 31, 2017 \$	December 31, 2016 \$
Cash provided by (used in)		
Operating activities		
Earnings for the year	27,048	26,731
Amortization of deferred financing fees	8	40
Off-market swap payments	(384)	(474)
Deferred tax expense (note 7)	1,235	1,408
Changes in non-cash working capital (note 11)	107	(394)
Cash provided by operating activities	28,014	27,311
Financing activities		
Dividends paid to shareholders	(21,063)	(20,828)
Distributions on Class B and Class D Exchangeable Shares	(6,963)	(6,585)
Cash used in financing activities	(28,026)	(27,413)
Decrease in cash and cash equivalents	(12)	(102)
Cash and cash equivalents, beginning of year	2,134	2,236
Cash and cash equivalents, end of year	2,122	2,134
Supplementary information		
Interest paid	1,308	1,301

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

Pizza Pizza Royalty Corp.

Notes to the Consolidated Financial Statements

For the years ended December 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 December 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 year ended December 31, 2017, the Company declared dividends of \$0.8556 per share (2016 – \$0.8476 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 Consolidated Financial Statements

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2. Significant accounting policies

The significant accounting policies applied in the preparation of these 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 consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The policies applied in these consolidated financial statements are based on IFRS standards, which have been applied consistently to all periods presented. These consolidated financial statements were issued and effective as at February 28, 2018, the date the Board of Directors approved the consolidated financial statements.

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 begun the process of evaluating the impact of this standard on its consolidated financial statements and does not anticipate material changes to the 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. The Company has completed its assessment of the anticipated impact of the amended standard on its consolidated financial statements, and the accounting for ongoing royalty revenues will not be impacted. The Company has formed a project team to evaluate and implement the standard and will adopt 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.

Pizza Pizza Royalty Corp.

Notes to the Consolidated Financial Statements

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

c. Consolidation

The consolidated financial statements incorporate the assets and liabilities of the Company and its subsidiaries as at December 31, 2017 and 2016 and the results of these subsidiaries for the years ended December 31, 2017 and 2016. The Company's subsidiaries and its respective holdings at December 31, 2017 and 2016 are outlined below:

Subsidiary	December 31, 2017	December 31, 2016
Pizza Pizza GP Inc.	78.9%	79.6%
Pizza Pizza Royalty Limited Partnership	78.9%	79.6%

An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Furthermore, an investor controls an investee if and only if the investor has all the following: power over the investee; exposure, or rights to variable returns from its involvement with the investee and the ability to use its power over the investee to affect the amount of the investor's returns.

Subsidiaries are fully consolidated from the date on which control is transferred to the Company and de-consolidated from the date that control ceases. Inter-entity transactions, balances and unrealized gains/losses on transactions between entities are eliminated. There are no unconsolidated structured entities.

d. Functional and presentation currency

Items included in the consolidated financial statements are measured using the currency of the primary economic environment in which the Company operates (the "functional currency"). These consolidated financial statements are presented in Canadian dollars, which is the Company's functional and presentation currency and is also the functional currency of each of the Company's subsidiaries.

e. Financial assets and liabilities

A financial asset or liability is recognized if the Company becomes a party to the contractual provisions of the asset or liability. A financial asset or liability is recognized initially (at trade date) at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the instrument. Financial assets and liabilities carried at fair value through profit or loss are initially recognized at fair value and transaction costs are expensed in the consolidated statements of earnings.

After initial recognition, financial assets are measured at their fair values, except for loans and receivables and held-to-maturity financial assets, which are measured at amortized cost. After initial recognition, financial liabilities are measured at amortized cost except for financial liabilities at fair value through profit or loss which are measured at fair value.

The Company classifies its financial assets and liabilities according to their characteristics and management's choices and intentions related thereto for the purposes of ongoing measurement.

Classification choices for financial assets include:

- i) Fair value through profit or loss - measured at fair value with changes in fair value recorded in the consolidated statements of earnings;
- ii) Held-to-maturity - recorded at amortized cost with gains and losses recognized in the consolidated statement of earnings in the period that the asset is no longer recognized or impaired;

Pizza Pizza Royalty Corp.

Notes to the Consolidated Financial Statements

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

- iii) Available for sale - measured at fair value with changes in fair value recognized in other comprehensive income for the current period until realized through disposal or impairment; and
- iv) Loans and receivables - recorded at amortized cost with gains and losses recognized in profit or loss in the period that the asset is no longer recognized or impaired.

Classification choices for financial liabilities include:

- i) Fair value through profit or loss - measured at fair value with changes in fair value recorded in the consolidated statement of earnings; and
- ii) Other financial liabilities - measured at amortized cost with gains and losses recognized in the consolidated statement of earnings in the period that the liability is no longer recognized.

The Company's financial assets and liabilities are classified and measured as follows:

Assets/liabilities	Category	Measurement
Cash and cash equivalents	Loans and receivables	Amortized cost
Short-term investments	Loans and receivables	Amortized cost
Receivable from Pizza Pizza Limited	Loans and receivables	Amortized cost
Trade and other receivables	Loans and receivables	Amortized cost
Trade and other payables	Other financial liabilities	Amortized cost
Payable to Pizza Pizza Limited	Other financial liabilities	Amortized cost
Dividends payable to shareholders	Other financial liabilities	Amortized cost
Borrowings	Other financial liabilities	Amortized cost
Derivative financial instruments	Derivatives used for hedging	Fair value

Financial assets are derecognized if the Company's contractual rights to the cash flows from the financial assets expire or if the Company transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Financial liabilities are derecognized if the Company's obligations specified in the contract are cancelled, discharged or expire.

f. Impairment of financial assets

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets, other than those at fair value through profit or loss, is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The asset's carrying amount is reduced and the amount of the loss is recognized in the consolidated statements of earnings.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment losses are reversed.

g. Derivative financial instruments and hedging activities

Derivative financial instruments include interest rate swaps and are initially measured at fair value on the date the derivative contract is entered into and are subsequently remeasured at each reporting date at their fair value. The Company designates its interest rate swaps as cash flow hedges.

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For the years ended December 31, 2017 and 2016

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

The Company documents, at the inception of the transaction, the relationship between the hedging instrument and the hedged item, as well as its risk management objectives and strategy for undertaking the hedging transaction. The Company also documents its assessment, both at inception and at each reporting date, of whether the derivative that is used has been highly effective in offsetting cash flows of hedged items.

The changes in fair value of the interest rate swaps are included in other comprehensive earnings to the extent the hedge continues to be highly effective. The related other comprehensive earnings (loss) amounts are allocated to the consolidated statements of earnings in the same period in which the hedged item affects earnings. To the extent the change in fair value of the derivative financial instruments is not completely offset by the change in the fair value of the hedged item, the ineffective portion of the hedging relationship is recorded immediately in the consolidated statements of earnings.

The fair value of the interest rate swaps is estimated based on the standard swap valuation methodology; that is, the value of the swap is calculated as the difference between the present values of the future cash flows associated with the floating-receive leg and the fixed-pay leg.

h. Cash and cash equivalents

Cash and cash equivalents consist of cash and short-term deposits with a maturity at acquisition of less than 90 days.

i. Short-term investments

The short-term investments include amounts invested in Guaranteed Investment Certificates with maturities at acquisition between 90 and 365 days.

j. Trade and other receivables

Trade and other receivables are initially recognized at fair value and subsequently measured at amortized cost using the effective interest method, less any provision for impairment. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets.

k. Pizza Pizza and Pizza 73 Rights and Marks

Rights and Marks that have an indefinite life are recorded at cost and are not being amortized. Management considers the Pizza Pizza and Pizza 73 Rights and Marks to be indefinite-life assets. Indefinite-life intangible assets principally comprise those trademarks for which there is no foreseeable limit to the period over which they are expected to generate net cash inflows. Rights and Marks are considered to have an indefinite life given the strength and durability of the brands and the level of marketing support. Brands that are classified as indefinite have been in the market for many years, and the nature of the industry PPL operates in is such that brand obsolescence is not common if appropriately supported by advertising and marketing spending.

A description of each of the Rights and Marks is as follows:

Pizza Pizza Rights and Marks

The Rights and Marks include the Pizza Pizza Marks and all goodwill associated therewith and the copyrights, the trade names, trade secrets, methods, systems and procedures for the construction, design or operation of Pizza Pizza restaurants using certain types of equipment, supplies, ingredients, recipes, merchandising, advertising and business techniques, together with the rights to order phone numbers and

Pizza Pizza Royalty Corp.

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

order website domain names that are currently owned by PPL and used in connection with the operation of Pizza Pizza restaurants.

The Marks include all trademarks that are registered or the subject of pending applications for registration under the Trade-marks Act (Canada) and other unregistered trademarks used in connection with the Pizza Pizza restaurant businesses.

Pizza 73 Rights and Marks

The Rights and Marks include all intellectual property rights, whether registered or not, including the Pizza 73 Marks and all goodwill associated therewith, all know-how and related technical knowledge and all other proprietary rights pertaining to or used in connection with the Pizza 73 business, including all copyrights, trade names, business names, trade secrets, confidential information, uniform standards, methods, systems and procedures for establishment, construction, design, operation or marketing of Pizza 73 Restaurants using certain types of equipment, supplies, ingredients, recipes, merchandising, advertising and business techniques, together with the rights to order phone numbers and order website domain names that are currently owned by Pizza 73 and used in connection with the operation of Pizza 73 Restaurants, and all copyrights in the operations manuals and similar manuals or documents for the Unit Companies, as amended from time to time, as well as all copyrights in all menus and advertising and promotional materials.

The Marks include all trademarks that are registered or the subject of pending applications for registration under the Trade-marks Act (Canada) and other unregistered trademarks, trade dress, distinguishing guises, logos, slogans, brand names, domain names, commercial symbols and other indicia of origin used in connection with the Pizza 73 business.

I. Impairment of Rights and Marks

The Rights and Marks have an indefinite useful life, are not subject to amortization and are tested annually for impairment or more frequently if there are indications that the asset may be impaired. If the estimated recoverable amount of the Rights and Marks is less than their carrying amount, the Rights and Marks are written down to their estimated recoverable amount and an impairment loss is recognized in the Consolidated Statement of Earnings. The recoverable amount of the Rights and Marks is the higher of their fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units or CGUs). There are two CGUs: Pizza Pizza restaurants and Pizza 73 restaurants.

Rights and Marks on which an impairment had previously been recorded are reviewed for possible reversal of the impairment at each reporting date.

m. Trade and other payables

Trade and other payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade and other payables are classified as current liabilities if payment is due within one year or less.

n. Borrowings

Borrowings are initially recognized at fair value net of any financing fees. Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for more than 12 months. After initial recognition, borrowings are carried at amortized cost with any difference between the proceeds (net of financing fees) and the redemption value recognized in the Consolidated Statements of Earnings over the period of the borrowing using the effective interest method.

Pizza Pizza Royalty Corp.

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

o. Exchangeable Shares

The Class B Units and Class D Units of the Partnership qualify as equity under IAS 32 and are economically equivalent to, and exchangeable into, the common shares of the Company ("Exchangeable Shares"). Therefore, Exchangeable Shares are presented as part of parent equity.

p. Income taxes

Income tax expense for the year is comprised of current and deferred tax. Income tax is recognized in the Consolidated Statements of Earnings except to the extent it relates to items recognized in other comprehensive earnings or directly in equity.

Current income tax

Current income tax expense is based on the profit for the year as adjusted for items that are not taxable or not deductible. Current tax is calculated using tax rates and laws that were substantively enacted at the end of the reporting year. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred tax

Deferred tax is recognized using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements.

Deferred tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the consolidated balance sheet date and are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled. The measurement of deferred tax assets and liabilities reflect the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amounts of its assets and liabilities.

Deferred tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset and when the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority where there is an intention to settle the balances on a net basis.

q. Revenue recognition

Royalty income is recognized on an accrual basis equal to 6% of reported sales from specific Pizza Pizza restaurants and 9% of reported sales from specific Pizza 73 restaurants (collectively the "Royalty Pool") provided that it is probable that the economic benefits will flow to the Company and the amount can be measured reliably.

Interest income is recognized using the effective interest rate method.

r. Dividends to shareholders

The amount of dividends is determined with reference to distributable cash, which is calculated as earnings for the year adjusted for non-cash charges less payment of interest on the borrowings and current income tax expense. Dividends to shareholders are recorded when declared, and paid monthly.

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s. Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The Board of Directors is the chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segment. The Company has determined that it has one operating segment being the receipt of royalty income from the ownership of the Pizza Pizza and Pizza 73 Rights and Marks.

t. Critical accounting estimates and assumptions

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next period are addressed below.

i. Impairment of Rights and Marks

Determining whether the Rights and Marks are impaired requires an estimation of the recoverable amount of the cash generating unit in which the assets are included. The value-in-use calculation requires that the Company estimate the future cash flows expected to arise from the cash generating unit and a suitable discount rate in order to calculate present value. The significant estimates and assumptions used in the impairment tests performed at December 31, 2017 and December 31, 2016 are disclosed in note 3.

ii. Consolidation

Determining whether the Partnership is consolidated by the Company or PPL requires judgment. The significant judgments that were used to apply IFRS 10 included assessing which party had the power or current ability to direct decisions over the value creation and maintenance of the Pizza Pizza Rights and Marks and Pizza 73 Rights and Marks in the context of the purpose and design of the Partnership. Based on an assessment of the activities of the Partnership it was concluded that the Company controls the Partnership, and therefore consolidates its operations.

iii. Fair value of derivatives

The fair value of the interest rate swaps that are not traded in an active market is determined using valuation techniques. The Company uses its judgment to select a variety of methods and makes assumptions that are mainly based on market conditions existing at the end of each reporting period.

3. Pizza Pizza and Pizza 73 Rights and Marks

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

Pizza Pizza Royalty Corp.

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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 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 6).

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).

Impairment test on the Rights and Marks

The Company performed impairment tests for both the Pizza Pizza and Pizza 73 Rights and Marks at December, 31, 2017 and 2016 in accordance with the accounting policy as described in note 2. The recoverable amount of each CGU was determined based on value-in-use calculations. These calculations used cash flow projections based on financial budgets approved by the Board of Directors covering a one year period and extrapolated for three years. Cash flows beyond the four year period are estimated using a terminal growth rate as stated below.

The key assumptions used for the value-in-use calculation as at December 31, 2017 were as follows:

	Terminal Growth rate	Pre-tax discount rate
Pizza Pizza CGU	2.5%	9.1%
Pizza 73 CGU	2.5%	9.2%

The key assumptions used for the value-in-use calculation as at December 31, 2016 were as follows:

	Terminal Growth rate	Pre-tax discount rate
Pizza Pizza CGU	2.5%	9.1%
Pizza 73 CGU	2.5%	9.5%

The impairment tests performed resulted in no impairment of the Rights and Marks as at December 31, 2017 or 2016.

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4. Trade and Other Payables

	December 31, 2017	December 31, 2016
	\$	\$
Accruals	156	153
Other payables	329	327
Total trade and other payables	485	480

5. Borrowings

	December 31, 2017	December 31, 2016
	\$	\$
Borrowings	47,000	47,000
Less: deferred financing fees	15	23
Total borrowings	46,985	46,977

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 Partnership has entered into two 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 year ended December 31, 2017 amounted to \$932 (2016 – \$867). Principal repayments on borrowings of \$47,000 are due on April 24, 2020. The effective interest rate as at December 31, 2017 on the \$47,000 was 2.75% (2016 – 2.75%).

The facility is subject to certain financial covenants, all of which have been met as at December 31, 2017 and 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.

6. Exchangeable Shares

As at December 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 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.

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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	4,487,900	1,636,233	6,124,133	63,030
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
At December 31, 2016	4,559,542	1,743,307	6,302,849	65,501
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
At December 31, 2017	4,842,483	1,752,620	6,595,103	70,265

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. See Subsequent Events – Note 13.

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

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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. See Subsequent Events – Note 13.

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. See Subsequent Events – Note 13.

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. See Subsequent Events – Note 13.

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.

7. Income Taxes

The provision for income taxes differs from that which would be obtained by applying the statutory tax rate as a result of the following:

	December 31, 2017 \$	December 31, 2016 \$
Earnings for the year before income taxes	34,037	33,788
Combined Canadian federal and provincial rate	26.5%	26.5%
Computed expected income tax expense	9,020	8,954
Earnings not taxable in the Company	(1,903)	(1,827)
Other	(128)	(70)
Income tax expense	6,989	7,057

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The components of the deferred tax liability are as follows:

	December 31, 2017 \$	December 31, 2016 \$
Pizza Pizza and Pizza 73 Rights and Marks	19,301	18,142
Deferred financing fees	1	4
Interest rate swap	297	61
Deferred tax liability	19,599	18,207

An analysis of the deferred tax liabilities is as follows:

	December 31, 2017 \$	December 31, 2016 \$
Deferred tax liabilities to be settled after more than a year	19,598	18,203
Deferred tax liabilities to be settled within a year	1	4
Deferred tax liability	19,599	18,207

The movement in the deferred tax liabilities is as follows:

	December 31, 2017 \$	December 31, 2016 \$
Opening balance – deferred tax liability	18,207	16,744
Change in Other Comprehensive Earnings – interest rate swap	157	54
Change in temporary differences	1,235	1,409
Deferred tax liability	19,599	18,207

8. 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 December 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 rateably 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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b. Issued

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

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

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 year by the weighted average number of shares outstanding during the year. 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 years ended December 31, 2017 or 2016.

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

	December 31, 2017	December 31, 2016
Weighted average number of:		
Common shares	24,618,392	24,618,392
Exchangeable Shares (note 6)	6,595,103	6,302,849
Weighted average number of shares outstanding – basic and diluted	31,213,495	30,921,241
Basic and diluted earnings per share	\$0.87	\$0.86

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9. Royalty income

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

	December 31, 2017	December 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	466,249	456,899
System sales reported by Pizza 73 restaurants in the Royalty Pool	84,878	87,989
Total system sales	551,127	544,888
Royalty – 6% on Pizza Pizza system sales	27,975	27,414
Royalty – 9% on Pizza 73 system sales	7,639	7,919
Royalty income	35,614	35,333

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

10. 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 6.

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 December 31, 2017 of \$3,288 (December 31, 2016 - \$3,311) and a payable to PPL as at December 31, 2017 of \$762 (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 years ended December 31, 2017 or 2016.

11. Consolidated Statements of Cash Flows information

Changes in non-cash working capital are as follows:

	December 31, 2017	December 31, 2016
	\$	\$
Receivable from Pizza Pizza Limited	23	70
Trade and other receivables	16	39
Trade and other payables	5	(7)
Payable to Pizza Pizza Limited	189	(17)
Income taxes payable	(126)	(479)
Changes in non-cash working capital	107	(394)

Pizza Pizza Royalty Corp.

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12. 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	December 31, 2017		December 31, 2016		
	Carrying value	Fair value	Carrying value	Fair value	
	\$	\$	\$	\$	
Cash and cash equivalents	L&R	2,122	2,122	2,134	2,134
Short-term investments	L&R	2,750	2,750	2,750	2,750
Receivable from Pizza Pizza Limited	L&R	3,288	3,288	3,311	3,311
Trade and other receivables	L&R	65	65	81	81
Derivative financial instruments (Asset)	DFH	177	177	-	-
Trade and other payables	OFL	485	485	480	480
Dividends payable to shareholders	OFL	1,755	1,755	1,755	1,755
Payable to Pizza Pizza Limited	OFL	762	762	573	573
Borrowings	OFL	46,985	47,000	46,977	47,000
Derivative financial instruments (Liability)	DFH	-	-	959	959

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; and
- . Level 3: Inputs for the financial asset or financial liability that is not based on observable market data.

As at December 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

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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.

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, 2017.

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 \$191 as at December 31, 2017 (December 31, 2016 - \$284) based on movements in the fair value of the interest rate swaps.

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13. Subsequent Events

The chart below shows the Company shares that would be outstanding if all of the Class B and Class D Units held by PPL were converted to Company shares after accounting for their respective multipliers and adjustments as described below.

Shares outstanding & issuable on January 1, 2018		
Shares outstanding		24,618,392
Class B equivalent Shares held by PPL at December 31, 2017	4,842,483	
PPL additional Class B equivalent Shares - True-up Holdback as at December 31, 2017	175,727	
Additional PPL Class B equivalent Shares as of January 1, 2018	-	5,018,210
Class D equivalent Shares held by PPL at December 31, 2017	1,752,620	
PPL additional Class D equivalent Shares - True-up Holdback as at December 31, 2017	-	
Additional PPL Class D equivalent Shares as of January 1, 2018	276,781	2,029,401
Number of fully diluted shares		31,666,003
PPL's proportion of all shares outstanding and available for exchange		22.3%

a. 2017 Royalty Pool Adjustment

In early January 2018, adjustments to royalty payments and PPL's Class B Exchange Multiplier were made based on the actual performance of the 23 new restaurants added to the Royalty Pool on January 1, 2017. As a result of the adjustments, the new Class B Exchange Multiplier is 2.000691 and Class B Units can be exchanged for 5,018,210 shares, which is an increase of 175,727 shares, effective January 1, 2017.

In early January 2018, adjustments to royalty payments and PPL's Class D Exchange Multiplier were made based on the actual performance of the four Pizza 73 restaurants added to the Royalty Pool on January 1, 2017. As a result of the adjustments, the new Class D Exchange Multiplier remains unchanged at 17.52620 and Class D Units can be exchanged for 1,752,620 shares effective January 1, 2017.

b. 2018 Royalty Pool Adjustment – Class B Exchange Multiplier

On January 1, 2018, one net Pizza Pizza restaurant was added to the Royalty Pool as a result of 17 new restaurants opening and 16 closing from January 1, 2017 to December 31, 2017. The total number of Pizza Pizza restaurants in the Royalty Pool has increased to 652. The additional system sales from the 17 new restaurants are estimated at \$3,860 annually, less sales of \$3,861 from 16 permanently closed Pizza Pizza restaurants, resulting in the Estimated Determined Amount being (\$1). 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 B Exchange Multiplier remained unchanged at 2.000691. The second adjustment to the Class B Exchange Multiplier will be adjusted to be effective January 1, 2018, once the actual performance of the new restaurants is determined in early 2019.

c. 2018 Royalty Pool Adjustment – Class D Exchange Multiplier

On January 1, 2018, six net Pizza 73 restaurants were added to the Royalty Pool as a result of eight new restaurants opening between September 2, 2016 and September 1, 2017 and two restaurants closing between January 1, 2017 and December 31, 2017. The forecasted additional system sales from the eight new restaurants are estimated at \$4,836 annually, less \$260 in system sales attributable to the two closed

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Pizza 73 restaurants, resulting in net estimated Pizza 73 sales of \$4,576 added to the Royalty Pool. The total number of Pizza 73 restaurants in the Royalty Pool has increased to 106. The yield of the shares was determined to be 5.39% calculated using \$15.88 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, 2018. As a result of the contribution of the additional net sales to the Royalty Pool, the Class D Exchange Multiplier increased fractionally by 80% of the total adjustment or 2.76781; the new Class D Multiplier is 20.29401. This adjustment will also increase the entitlement of the holders of the Class D units to distributions of cash and allocations of income from the Partnership. The second adjustment to the Class D Exchange Multiplier will be adjusted to be effective January 1, 2018, once the actual performance of the new restaurants is determined in early 2019.

d. Pizza Pizza Royalty Corp. Outstanding Shares

PPL's Class B equivalent Share entitlement is unchanged for 2018, due to the fact that, in any year that the forecasted system sales (less closed restaurants sales and other adjustments) is negative, as was the case with the Class B equivalent Share entitlement calculation for 2018, no increase or decrease in the Exchange Multiplier is made. PPL will only have a Class B equivalent Share entitlement for 2018 if the actual sales performance of the 17 new Pizza Pizza restaurants, significantly exceeds forecasted system sales and yields net, positive sales which will be determined in early 2019.

In exchange for adding the forecasted Pizza 73 system sales to the Royalty Pool, PPL has received 276,781 additional equivalent Shares (through the change to the Class D Exchange Multiplier). These represent 80% of the forecasted equivalent Shares entitlement to be received (345,977 equivalent Shares represent 100%), with the final equivalent Shares entitlement to be determined when the new restaurants' 2018 actual sales performance is known with certainty in early 2019.

After giving effect to PPL's entitlement to additional equivalent Shares at January 1, 2018, PPL owns equivalent Shares representing 22.3% of the Company's fully diluted shares.