PIZZA PIZZA ROYALTY CORP.

Interim Condensed Consolidated Financial Statements
(Unaudited)
For the three and six months ended June 30, 2018 and 2017

Pizza Pizza Royalty Corp.

Unaudited Interim Consolidated Statements of Financial Position
As at June 30, 2018 and December 31, 2017
(Expressed in thousands of Canadian dollars)

	June 30, 2018 $	December 31, 2017 $
Assets		
Current assets		
Cash and cash equivalents	1,647	2,122
Short-term investments	2,750	2,750
Receivable from Pizza Pizza Limited (note 8)	2,935	3,288
Trade and other receivables	94	65
Income tax receivable	24	-
Total current assets	**7,450**	**8,225**
Non-current assets		
Pizza Pizza Rights and Marks (note 3)	270,225	267,338
Pizza 73 Rights and Marks (note 3)	78,191	73,796
Derivative financial instruments (note 10)	271	177
Total non-current assets	**348,687**	**341,311**
Total assets	**356,137**	**349,536**
Liabilities and shareholders' equity		
Current liabilities		
Trade and other payables	425	485
Payable to Pizza Pizza Limited (note 8)	1,030	762
Dividends payable to shareholders	1,755	1,755
Income taxes payable	-	173
Total current liabilities	**3,210**	**3,175**
Non-current liabilities		
Borrowings (note 4)	46,989	46,985
Deferred tax liability	19,972	19,599
Total non-current liabilities	**66,961**	**66,584**
Shareholders' equity		
Share capital (note 6)	242,030	242,030
Exchangeable Shares (notes 3 and 5)	77,547	70,265
Accumulated other comprehensive earnings	425	405
Deficit	(34,036)	(32,923)
Total shareholders' equity	**285,966**	**279,777**
Total liabilities and shareholders' equity	**356,137**	**349,536**

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 and six months ended June 30, 2018 and 2017
(Expressed in thousands of Canadian dollars, except number of shares and per share amounts)

	Three months ended June 30, 2018 $	Three months ended June 30, 2017 $	Six months ended June 30, 2018 $	Six months ended June 30, 2017 $
Royalty Pool System Sales (note 7)	131,056	134,562	266,404	268,426
Royalty income (note 7)	8,487	8,691	17,272	17,363
Administrative expenses	(131)	(176)	(276)	(314)
Operating earnings	**8,356**	**8,515**	**16,996**	**17,049**
Interest expense on borrowings (note 4)	(303)	(209)	(589)	(416)
Earnings for the period before income taxes	**8,053**	**8,306**	**16,407**	**16,633**
Current tax expense	(1,368)	(1,367)	(2,787)	(2,741)
Deferred tax expense	(299)	(320)	(368)	(515)
Earnings for the period attributable to shareholders	**6,386**	**6,619**	**13,252**	**13,377**
Weighted average number of shares – basic and diluted (note 6)	31,666,003	31,213,495	31,666,003	31,213,495
Basic and diluted earnings per share (note 6)	**0.20**	**0.21**	**0.42**	**0.43**

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Pizza Pizza Royalty Corp.

Unaudited Interim Consolidated Statements of Comprehensive Earnings
For the three and six months ended June 30, 2018 and 2017
(Expressed in thousands of Canadian dollars)

	Three months ended June 30, 2018 $	Three months ended June 30, 2017 $	Six months ended June 30, 2018 $	Six months ended June 30, 2017 $
Earnings for the period	**6,386**	**6,619**	**13,252**	**13,377**
Other comprehensive earnings (loss)				
Items that may be reclassified subsequently to net earnings:				
Cash flow hedges	(8)	298	26	210
Deferred tax impact of cash flow hedges	2	(88)	(6)	(91)
Total comprehensive earnings	**6,380**	**6,829**	**13,272**	**13,496**

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Pizza Pizza Royalty Corp.

Unaudited Interim Consolidated Statements of Changes in Shareholders' Equity
For the three and six months ended June 30, 2018 and 2017
(Expressed in thousands of Canadian dollars)

	Share capital $	Exchangeable Shares $	Accumulated other comprehensive earnings (loss) $	Deficit $	Total shareholders' equity $
	(note 6)	**(note 5)**			
At December 31, 2017	**242,030**	**70,265**	**405**	**(32,923)**	**279,777**
Comprehensive earnings					
Earnings for the period	-	-	-	13,252	13,252
Cash flow hedges	-	-	26	-	26
Deferred tax impact of cash flow hedges	-	-	(6)	-	(6)
Total comprehensive earnings	**-**	**-**	**20**	**13,252**	**13,272**
Transactions with shareholders					
Exchangeable Shares (note 5)	-	7,282	-	-	7,282
Dividends declared to shareholders	-	-	-	(10,532)	(10,532)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(3,833)	(3,833)
Total transactions with shareholders	**-**	**7,282**	**-**	**(14,365)**	**(7,083)**
At June 30, 2018	**242,030**	**77,547**	**425**	**(34,036)**	**285,966**
At December 31, 2016	**242,030**	**65,501**	**(190)**	**(31,945)**	**275,396**
Comprehensive earnings					
Earnings for the period	-	-	-	13,377	13,377
Cash flow hedges	-	-	210	-	210
Deferred tax impact of cash flow hedges	-	-	(91)	-	(91)
Total comprehensive earnings	**-**	**-**	**119**	**13,377**	**13,496**
Transactions with shareholders					
Exchangeable Shares (note 5)	-	4,764	-	-	4,764
Dividends declared to shareholders	-	-	-	(10,532)	(10,532)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(3,477)	(3,477)
Total transactions with shareholders	**-**	**4,764**	**-**	**(14,009)**	**(9,245)**
At June 30, 2017	**242,030**	**70,265**	**(71)**	**(32,577)**	**279,647**

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Pizza Pizza Royalty Corp.

Unaudited Interim Consolidated Statements of Cash Flows
For the six months ended June 30, 2018 and 2017
(Expressed in thousands of Canadian dollars)

	June 30, 2018 $	June 30, 2017 $
Cash provided by (used in)		
Operating activities		
Earnings for the period	13,252	13,377
Amortization of deferred financing fees	4	4
Off-market swap payments	(69)	(226)
Deferred tax expense	368	515
Changes in non-cash working capital (note 9)	335	101
Cash provided by operating activities	**13,890**	**13,771**
Financing activities		
Dividends paid to shareholders	(10,532)	(10,532)
Distributions on Class B and Class D Exchangeable Shares	(3,833)	(3,477)
Cash used in financing activities	**(14,365)**	**(14,009)**
Decrease in cash and cash equivalents	**(475)**	**(238)**
Cash and cash equivalents, beginning of period	**2,122**	**2,134**
Cash and cash equivalents, end of period	**1,647**	**1,896**
Supplementary information		
Interest paid	654	639

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

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 June 30, 2018, there were 652 Pizza Pizza restaurants (2017 – 651) and 106 Pizza 73 restaurants (2017 – 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 six months ended June 30, 2018, the Company declared dividends of $0.4278 per share (2017 – $0.4278 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.

2. Significant accounting policies

The significant 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 and changes to accounting policies

The Company prepares its unaudited interim condensed consolidated financial statements in accordance with International Accounting Standard ("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, 2017.

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 unaudited interim condensed consolidated 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, 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, 2017, except for the adoption of new standards effective as of January 1, 2018. The Company has not adopted any other standard, interpretation or amendment that has been issued, but is not yet effective. These unaudited interim condensed consolidated financial statements were authorized for issue by the Board of the Directors on August 8, 2018.

On January 1, 2018, the Company adopted, for the first time, IFRS 15, *Revenue from Contracts with Customers* ("IFRS 15") and IFRS 9, *Financial Instruments* ("IFRS 9"). As required by IAS 34, the nature and effect of these changes are disclosed below.

b. IFRS 15, *Revenue from Contracts with Customers*

IFRS 15, establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The new standard establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognizing revenue.

The standard requires entities to exercise judgment, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract. The Company adopted IFRS 15 using the modified retrospective method and has elected to apply the standard retrospectively only to contracts that are not completed contracts at the date of initial application. The Company applied certain practical expedients, as permitted by the standard in determining the impact on transition.

The Company's accounting policy for revenue recognition is described below and was determined to be in compliance with the requirements of IFRS 15.

The Company collects royalty income from PPL based on system sales of Pizza Pizza and Pizza 73 restaurants. Prior to the adoption of IFRS 15, royalty income was recognized on an accrual basis equal to 6% of system sales from all Pizza Pizza restaurants in the Royalty Pool and 9% of system sales from all Pizza 73 restaurants in the Royalty Pool.

Under the new standard, there have been no changes to the recognition of royalty income and no retrospective restatements have been made. IFRS 15 includes an exception relating to the recognition of sales or usage based royalties from licenses of intellectual property, which the Company has applied.

c. IFRS 9, *Financial Instruments*

IFRS 9 replaces IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39") for annual periods beginning on or after January 1, 2018, bringing together all three aspects of the accounting for financial instruments: classification and measurement; impairment; and hedge accounting. The Company is applying IFRS 9 retrospectively, with no adjustment to retained earnings as of January 1, 2018.

Classification and measurement

With the new standard, the Company notes there have been no changes in classification and measurement of its financial instruments. The classification is based on two criteria: the Company's business model for managing the assets; and whether the instruments' contractual cash flows represent "solely payments of principal and interest" on the principal amount outstanding (the "SPPI criterion"). Based on the Company's assessment, cash equivalents, short-term investments, receivable from PPL, and trade and other receivables are carried at amortized cost, as these financial assets are held within a business model with the objective to hold the financial assets in order to collect the contractual cash flows that meet the SPPI criterion.

The assessment of the Company's business models was made as of the date of initial application, January 1, 2018, and then applied retrospectively to those financial assets that were not derecognized before January 1, 2018. The assessment on whether contractual cash flows on debt instruments are solely comprised of principal and interest was made based on the facts and circumstances as at the initial recognition of the assets.

The accounting for the Company's financial liabilities remains largely the same as it was under IAS 39. Similar to the requirements of IAS 39, the Company continues to measure its financial liabilities at amortized cost.

Impairment

The adoption of IFRS 9 has changed the accounting for impairment losses, with respect to financial assets, by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss ("ECL") approach. However, given the nature of the Company's business, it is not expected that impairment losses will be materially different under IFRS 9, as compared to the incurred loss approach.

IFRS 9 requires the Company to record an allowance for expected credit losses ("ECLs") for all loans and other debt financial assets that are not held at fair value through profit and loss.

ECLs are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Company expects to receive. The shortfall is then discounted at an approximation to the asset's original effective interest rate.

The Company notes that its cash equivalents and short-term investments are high grade investments that are held with reputable financial institutions. As such, these assets are considered to be low credit risk investments. It is the Company's policy to measure such instruments on a 12-month ECL basis. In all cases, the Company will consider that there has been an increase in credit risk when contractual payments are past due.

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

For trade and other receivables as well as the receivable from PPL, the Company has applied the standard's simplified approach and has calculated ECLs based on lifetime expected credit losses. The Company has established a provision matrix that is based on the Company's historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment.

The adoption of the ECL requirements of IFRS 9 resulted in no changes to impairment allowances of the Company's financial assets. As such, there were no retrospective adjustments made upon transition.

Hedge accounting

The Company has applied hedge accounting prospectively. At the date of initial application, all of the Company's existing hedging relationships were eligible to be treated as continuing hedging relationships. Consistent with prior periods, the Company has continued to designate the change in fair value of the entire forward contract in the Company's cash flow hedge relationship and will continue to measure changes in fair value of the interest rate swaps in other comprehensive earnings (loss) 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 adoption of the new hedge accounting requirements resulted in no transitional adjustment to how the Company has applied hedge accounting under IFRS 9. As such, there were no retrospective adjustments made upon transition.

d. 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 are as follows:

IFRS 16, *Leases* ("IFRS 16")
In January 2016, the IASB 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 formed a project team and has begun the process of evaluating the impact of this standard on its consolidated financial statements.

e. Consolidation

The unaudited interim condensed consolidated financial statements incorporate the assets and liabilities of the Company and its subsidiaries as at June 30, 2018 and December 31, 2017 and the results of these subsidiaries for the three and six months ended June 30, 2018 and 2017. The Company's subsidiaries and its respective holdings at June 30, 2018 and December 31, 2017 are outlined below:

Subsidiary	**June 30, 2018**	**December 31, 2017**
Pizza Pizza GP Inc.	77.7%	78.9%
Pizza Pizza Royalty Limited Partnership	77.7%	78.9%

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

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, 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**
Accretion of value – January 1, 2018 vend-in	-	4,395	4,395
Accretion of value – January 1, 2017 true-up	2,887	-	2,887
Net book value at June 30, 2018	**270,225**	**78,191**	**348,416**

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 5).

As a result of adding new restaurants to the Royalty Pool on January 1, 2018, the Rights and Marks increased by $4,395 in 2018 (2017 – $4,560) and increased by $2,887 related to the January 1, 2017 true-up (2017 – $204).

4. Borrowings

	June 30, 2018 $	December 31, 2017 $
Borrowings	47,000	47,000
Less: deferred financing fees	11	15
Total borrowings	**46,989**	**46,985**

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

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 that was initially set at 0.875%. Included in the Bankers' Acceptance rate of 1.875% is 0.6% that relates to blending and extending the two previous swap agreements.

Interest expense incurred on borrowings for the three and six months ended June 30, 2018 amounted to $303 and $589, respectively (2017 – $209 and $416, respectively). Interest paid on borrowings for the three and six months ended June 30, 2018 amounted to $329 and $654, respectively (2017 – $328 and $639, respectively). Principal repayments on borrowings of $47,000 are due on April 24, 2020. The effective interest rate as at June 30, 2018 on the $47,000 was 2.75% (2017 – 2.75%).

The facility is subject to certain financial covenants, all of which have been met as at June 30, 2018. 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 June 30, 2018, PPL indirectly holds an effective 22.3% interest in the Company (December 31, 2017 – 21.1%) 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.

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, 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**
Add: January 1, 2018 vend-in	-	276,781	276,781	4,395
Add: January 1, 2017 true-up	175,727	-	175,727	2,887
At June 30, 2018	**5,018,210**	**2,029,401**	**7,047,611**	**77,547**

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 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 (or 276,781 exchangeable shares); the new Class D Multiplier is 20.29401 and the Class D Units can be exchanged for 2,029,401 shares effective January 1, 2018. 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.

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

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.

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 June 30, 2018, 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.

b. Issued

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

	June 30, 2018		December 31, 2017	
Share capital	Number of Shares	Amount $	Number of Shares	Amount $
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 objectives when managing capital, which remained unchanged, are 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 and six months ended June 30, 2018 or 2017.

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

	Three months ended June 30, 2018	Three months ended June 30, 2017	Six months ended June 30, 2018	Six months ended June 30, 2017
Weighted average number of:				
Common shares	24,618,392	24,618,392	24,618,392	24,618,392
Exchangeable Shares (note 5)	7,047,611	6,595,103	7,047,611	6,595,103
Weighted average number of shares outstanding – basic and diluted	31,666,003	31,213,495	31,666,003	31,213,495
Basic and diluted earnings per share	**$0.20**	**$0.21**	**$0.42**	**$0.43**

7. Royalty income

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

	Three months ended June 30, 2018	Three months ended June 30, 2017	Six months ended June 30, 2018	Six months ended June 30, 2017
(in thousands of dollars, except number of restaurants in the Royalty Pool)				
Restaurants in Royalty Pool	758	751	758	751
System sales reported by Pizza Pizza restaurants in the Royalty Pool	110,265	114,002	223,475	226,510
System sales reported by Pizza 73 restaurants in the Royalty Pool	20,791	20,560	42,929	41,916
Total system sales	**131,056**	**134,562**	**266,404**	**268,426**
Royalty – 6% on Pizza Pizza system sales	6,616	6,840	13,408	13,591
Royalty – 9% on Pizza 73 system sales	1,871	1,851	3,864	3,772
Royalty income	**8,487**	**8,691**	**17,272**	**17,363**

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 June 30, 2018 of $2,935 (December 31, 2017 – $3,288) and a payable to PPL as at June 30, 2018 of $1,030 (December 31, 2017 – $762). 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.

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

Transactions with related parties are in the normal course of operations. No amount of related party balances was written off during the three and six months ended June 30, 2018 and 2017.

9. Consolidated statements of cash flows information

Changes in non-cash working capital are as follows:

	Six months ended June 30, 2018 $	Six months ended June 30, 2017 $
Receivable from Pizza Pizza Limited	353	422
Trade and other receivables	(29)	(6)
Income tax receivable	(24)	(17)
Trade and other payables	(60)	(72)
Payable to Pizza Pizza Limited	268	73
Income taxes payable	(173)	(299)
Changes in non-cash working capital	**335**	**101**

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 unaudited interim 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:

	June 30, 2018		December 31, 2017	
	Carrying value $	Fair value $	Carrying value $	Fair value $
Cash and cash equivalents	1,647	1,647	2,122	2,122
Short-term investments	2,750	2,750	2,750	2,750
Receivable from Pizza Pizza Limited	2,935	2,935	3,288	3,288
Trade and other receivables	94	94	65	65
Derivative financial instruments (Asset)	271	271	177	177
Trade and other payables	425	425	485	485
Dividends payable to shareholders	1,755	1,755	1,755	1,755
Payable to Pizza Pizza Limited	1,030	1,030	762	762
Borrowings	46,989	47,000	46,985	47,000

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 are not based on observable market data.

As at June 30, 2018, 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 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 unaudited interim 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 June 30, 2018.

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 $149 as at June 30, 2018 (December 31, 2017 – $191) based on movements in the fair value of the interest rate swaps.