



**PIZZA PIZZA ROYALTY CORP.**

Interim Condensed Consolidated Financial Statements  
(Unaudited)

For the three and nine months ended September 30, 2019 and 2018

# Pizza Pizza Royalty Corp.

## Unaudited Interim Consolidated Statements of Financial Position

As at September 30, 2019 and December 31, 2018

(Expressed in thousands of Canadian dollars)

	September 30, 2019 \$	December 31, 2018 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash	566	1,160
Short-term investments	2,750	2,750
Receivable from Pizza Pizza Limited (note 8)	2,879	3,156
Trade and other receivables	117	75
<b>Total current assets</b>	<b>6,312</b>	<b>7,141</b>
<b>Non-current assets</b>		
Pizza Pizza Rights and Marks (note 3)	271,586	270,225
Pizza 73 Rights and Marks (note 3)	80,232	78,191
Derivative financial instruments (note 10)	321	204
<b>Total non-current assets</b>	<b>352,139</b>	<b>348,620</b>
<b>Total assets</b>	<b>358,451</b>	<b>355,761</b>
<b>Liabilities and shareholders' equity</b>		
<b>Current liabilities</b>		
Trade and other payables	411	451
Payable to Pizza Pizza Limited (note 8)	775	687
Dividends payable to shareholders	1,755	1,755
Income taxes payable	30	37
<b>Total current liabilities</b>	<b>2,971</b>	<b>2,930</b>
<b>Non-current liabilities</b>		
Borrowings (note 4)	46,961	46,993
Deferred tax liability	21,233	20,545
<b>Total non-current liabilities</b>	<b>68,194</b>	<b>67,538</b>
<b>Shareholders' equity</b>		
Share capital	242,030	242,030
Exchangeable Shares (note 5)	80,949	77,547
Accumulated other comprehensive earnings	507	371
Deficit	(36,200)	(34,655)
<b>Total shareholders' equity</b>	<b>287,286</b>	<b>285,293</b>
<b>Total liabilities and shareholders' equity</b>	<b>358,451</b>	<b>355,761</b>

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

# Pizza Pizza Royalty Corp.

## Unaudited Interim Consolidated Statements of Earnings

For the three and nine months ended September 30, 2019 and 2018

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

	Three months ended September 30, 2019 \$	Three months ended September 30, 2018 \$	Nine months ended September 30, 2019 \$	Nine months ended September 30, 2018 \$
Royalty income (note 7)	8,966	8,946	26,405	26,218
Administrative expenses	(108)	(122)	(352)	(399)
<b>Operating earnings</b>	<b>8,858</b>	<b>8,824</b>	<b>26,053</b>	<b>25,819</b>
Interest expense on borrowings (note 4)	(336)	(321)	(997)	(910)
<b>Earnings for the period before income taxes</b>	<b>8,522</b>	<b>8,503</b>	<b>25,056</b>	<b>24,909</b>
Current tax expense	(1,471)	(1,447)	(4,314)	(4,235)
Deferred tax expense	(268)	(296)	(653)	(664)
<b>Earnings for the period attributable to shareholders</b>	<b>6,783</b>	<b>6,760</b>	<b>20,089</b>	<b>20,010</b>
Weighted average number of shares – basic and diluted (note 6)	31,967,706	31,666,003	31,967,706	31,666,003
<b>Basic and diluted earnings per share (note 6)</b>	<b>0.21</b>	<b>0.21</b>	<b>0.63</b>	<b>0.63</b>

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

# Pizza Pizza Royalty Corp.

## Unaudited Interim Consolidated Statements of Comprehensive Earnings

For the three and nine months ended September 30, 2019 and 2018

(Expressed in thousands of Canadian dollars)

	Three months ended September 30, 2019 \$	Three months ended September 30, 2018 \$	Nine months ended September 30, 2019 \$	Nine months ended September 30, 2018 \$
<b>Earnings for the period</b>	<b>6,783</b>	<b>6,760</b>	<b>20,089</b>	<b>20,010</b>
<b>Other comprehensive earnings (loss)</b>				
Items that may be reclassified subsequently to net earnings:				
Cash flow hedges	326	125	173	151
Deferred tax impact of cash flow hedges	(68)	(26)	(37)	(32)
<b>Total comprehensive earnings</b>	<b>7,041</b>	<b>6,859</b>	<b>20,225</b>	<b>20,129</b>

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

# Pizza Pizza Royalty Corp.

Unaudited Interim Consolidated Statements of Changes in Shareholders' Equity  
For the nine months ended September 30, 2019 and 2018  
(Expressed in thousands of Canadian dollars)

	Share capital \$	Exchangeable Shares \$	Accumulated other comprehensive earnings (loss) \$	Deficit \$	Total shareholders' equity \$
		(note 5)			
<b>At December 31, 2018</b>	<b>242,030</b>	<b>77,547</b>	<b>371</b>	<b>(34,655)</b>	<b>285,293</b>
<b>Comprehensive earnings</b>					
Earnings for the period	-	-	-	20,089	20,089
Cash flow hedges	-	-	173	-	173
Deferred tax impact of cash flow hedges	-	-	(37)	-	(37)
<b>Total comprehensive earnings (loss)</b>	<b>-</b>	<b>-</b>	<b>136</b>	<b>20,089</b>	<b>20,225</b>
<b>Transactions with shareholders</b>					
Exchangeable Shares (note 5)	-	3,402	-	-	3,402
Dividends declared to shareholders	-	-	-	(15,798)	(15,798)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(5,836)	(5,836)
<b>Total transactions with shareholders</b>	<b>-</b>	<b>3,402</b>	<b>-</b>	<b>(21,634)</b>	<b>(18,232)</b>
<b>At September 30, 2019</b>	<b>242,030</b>	<b>80,949</b>	<b>507</b>	<b>(36,200)</b>	<b>287,286</b>
<b>At December 31, 2017</b>	<b>242,030</b>	<b>70,265</b>	<b>405</b>	<b>(32,923)</b>	<b>279,777</b>
<b>Comprehensive earnings</b>					
Earnings for the period	-	-	-	20,010	20,010
Cash flow hedges	-	-	151	-	151
Deferred tax impact of cash flow hedges	-	-	(32)	-	(32)
<b>Total comprehensive earnings</b>	<b>-</b>	<b>-</b>	<b>119</b>	<b>20,010</b>	<b>20,129</b>
<b>Transactions with shareholders</b>					
Exchangeable Shares (note 5)	-	7,282	-	-	7,282
Dividends declared to shareholders	-	-	-	(15,798)	(15,798)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(5,694)	(5,694)
<b>Total transactions with shareholders</b>	<b>-</b>	<b>7,282</b>	<b>-</b>	<b>(21,492)</b>	<b>(14,210)</b>
<b>At September 30, 2018</b>	<b>242,030</b>	<b>77,547</b>	<b>524</b>	<b>(34,405)</b>	<b>285,696</b>

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

# Pizza Pizza Royalty Corp.

Unaudited Interim Consolidated Statements of Cash Flows  
For the nine months ended September 30, 2019 and 2018  
(Expressed in thousands of Canadian dollars)

	September 30, 2019 \$	September 30, 2018 \$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Earnings for the period	20,089	20,010
Amortization of deferred financing fees	6	6
Off-market swap payments	54	(83)
Deferred tax expense	653	664
Changes in non-cash working capital (note 9)	276	208
<b>Cash provided by operating activities</b>	<b>21,078</b>	<b>20,805</b>
<b>Financing activities</b>		
Debt refinancing fees	(38)	-
Dividends paid to shareholders	(15,798)	(15,798)
Distributions on Class B and Class D Exchangeable Shares	(5,836)	(5,694)
<b>Cash used in financing activities</b>	<b>(21,672)</b>	<b>(21,492)</b>
<b>Decrease in cash</b>	<b>(594)</b>	<b>(687)</b>
<b>Cash, beginning of period</b>	<b>1,160</b>	<b>2,122</b>
<b>Cash, end of period</b>	<b>566</b>	<b>1,435</b>
<b>Supplementary information</b>		
Interest paid	997	987
Income taxes paid	4,320	4,425
<b>Total cash and short-term investments</b>		
Cash	566	1,435
Short-term investments	2,750	2,750
<b>Total cash and short-term investments</b>	<b>3,316</b>	<b>4,185</b>

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

# Pizza Pizza Royalty Corp.

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

*For the three and nine months ended September 30, 2019 and 2018*

*(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 September 30, 2019, there were 660 Pizza Pizza restaurants and 112 Pizza 73 restaurants in the Royalty Pool (2018 – 652 and 106, respectively); the Royalty Pool is adjusted annually on January 1.

The Company pays monthly dividends directly to public shareholders. For the nine months ended September 30, 2019, the Company declared dividends of \$0.6417 per share (2018 – \$0.6417 per share).

### 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

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, 2018.

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

# Pizza Pizza Royalty Corp.

## Notes to the Unaudited Interim Condensed Consolidated Financial Statements

For the three and nine months ended September 30, 2019 and 2018

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

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, 2018.

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, 2018, except for the adoption of new standards effective as of January 1, 2019. 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 November 6, 2019.

### b. Changes to accounting policies and disclosures

International Financial Reporting Standard 16, *Leases* ("IFRS 16")

In January 2016, the International Accounting Standards Board ("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 became effective from January 1, 2019 with early application permitted. Based on the Company's analysis, the Company has not identified any lease arrangements of more than 12 months that fall within the scope of the standard. As such, there is no impact upon transition to IFRS 16.

### c. Consolidation

The unaudited interim condensed consolidated financial statements incorporate the assets and liabilities of the Company and its subsidiaries as at September 30, 2019 and December 31, 2018 and the results of these subsidiaries for the three and nine months ended September 30, 2019 and 2018. The Company's subsidiaries and its respective holdings at September 30, 2019 and December 31, 2018 are outlined below:

Subsidiary	September 30, 2019	December 31, 2018
Pizza Pizza GP Inc.	77.0%	77.7%
Pizza Pizza Royalty Limited Partnership	77.0%	77.7%

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

	Pizza Pizza Rights and Marks \$	Pizza 73 Rights and Marks \$	Total \$
<b>Net book value at December 31, 2017</b>	<b>267,338</b>	<b>73,796</b>	<b>341,134</b>
Accretion of value – January 1, 2018 vend-in	-	4,395	4,395
Accretion of value – January 1, 2017 true-up	2,887	-	2,887
<b>Net book value at December 31, 2018</b>	<b>270,225</b>	<b>78,191</b>	<b>348,416</b>
Accretion of value – January 1, 2019 vend-in	1,361	479	1,840
Accretion of value – January 1, 2018 true-up	-	1,562	1,562
<b>Net book value at September 30, 2019</b>	<b>271,586</b>	<b>80,232</b>	<b>351,818</b>



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## Notes to the Unaudited Interim Condensed Consolidated Financial Statements

For the three and nine months ended September 30, 2019 and 2018

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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, 2019, the Rights and Marks increased by \$1,840 in 2019 (2018 – \$4,395) and increased by \$1,562 related to the January 1, 2018 true-up (2018 – \$2,887).

#### 4. Borrowings

	September 30, 2019 \$	December 31, 2018 \$
Borrowings	47,000	47,000
Less: unamortized deferred financing fees	39	7
<b>Total borrowings</b>	<b>46,961</b>	<b>46,993</b>

The borrowings are a committed, non-revolving, five-year facility maturing on April 24, 2025, 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.

On June 28, 2019, the Partnership amended and extended its \$47 million credit facility with a syndicate of chartered banks from April 2020 to April 2025. The Partnership's current interest rate is 2.75% and is projected to remain unchanged through April 2020 (2018 – 2.75%). The effective rate is comprised of a portion fixed with two interest rate swaps at 1.875% plus the credit spread, currently set at 0.875%. In the third quarter, the Partnership entered into a five year forward swap arrangement, commencing April 2020, at which time the credit facility will have a new, effective interest rate of 2.685% comprised of a fixed rate of 1.81% plus a credit spread, currently at 0.875%.

Interest expense incurred and paid on borrowings are as follows:

	Three months ended		Nine months ended	
	September 30, 2019 \$	September 30, 2018 \$	September 30, 2019 \$	September 30, 2018 \$
Interest expense	334	319	991	904
Loan fee amortization	2	2	6	6
Interest expense incurred on borrowings	336	321	997	910
Interest paid to draw down swap termination and out-of-market costs	(9)	13	(55)	83
Interest paid on borrowings and loan fee amortization	327	334	942	993

Principal repayments on borrowings of \$47,000 are due on April 24, 2025.

# Pizza Pizza Royalty Corp.

## Notes to the Unaudited Interim Condensed Consolidated Financial Statements

For the three and nine months ended September 30, 2019 and 2018

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

The facility is subject to certain financial covenants, all of which have been met as at September 30, 2019. The borrowings are held within the Partnership, and therefore, the financial covenants for the borrowings pertain only to the results of the Partnership and not the Company.

### 5. Exchangeable Shares

As at September 30, 2019, PPL indirectly holds an effective 23.0% interest in the Company (December 31, 2018 – 22.3%) 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, subject to the discretion of the Pizza Pizza GP Inc.

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 \$
<b>At December 31, 2017</b>	<b>4,842,483</b>	<b>1,752,620</b>	<b>6,595,103</b>	<b>70,265</b>
Add: January 1, 2018 vend-in	-	276,781	276,781	4,395
Add: January 1, 2017 true-up	175,727	-	175,727	2,887
<b>At December 31, 2018</b>	<b>5,018,210</b>	<b>2,029,401</b>	<b>7,047,611</b>	<b>77,547</b>
Add: January 1, 2019 vend-in	150,398	52,925	203,323	1,840
Add: January 1, 2018 true-up	-	98,380	98,380	1,562
<b>At September 30, 2019</b>	<b>5,168,608</b>	<b>2,180,706</b>	<b>7,349,314</b>	<b>80,949</b>

#### a. 2018 Royalty Pool Adjustment

In early January 2019, adjustments to royalty payments and PPL's Class B Exchange Multiplier were made based on the actual performance of the 17 new restaurants added to the Royalty Pool on January 1, 2018. As a result of the adjustments, the Class B Exchange Multiplier remains unchanged at 2.000691 and Class B Units can be exchanged for 5,018,210 shares effective January 1, 2018.

In early January 2019, adjustments to royalty payments and PPL's Class D Exchange Multiplier were made based on the actual performance of the eight Pizza 73 restaurants added to the Royalty Pool on January 1, 2018. As a result of the adjustments, the Class D Exchange Multiplier is 21.27782 and Class D Units can be exchanged for 2,127,782 shares effective January 1, 2018.

#### b. 2019 Royalty Pool Adjustment – Class B Exchange Multiplier

On January 1, 2019, eight net Pizza Pizza restaurants were added to the Royalty Pool as a result of 18 new restaurants opening and 10 closing from January 1, 2018 to December 31, 2018. The total number of Pizza Pizza restaurants in the Royalty Pool has increased to 660. The additional system sales from the 18 new restaurants are estimated at \$5,860 annually, less sales of \$2,135 from 10 permanently closed Pizza Pizza restaurants, resulting in net estimated Pizza Pizza sales of \$3,725 added to the Royalty Pool. The yield of the shares was determined to be 9.5% calculated using \$9.05 as a weighted average share price.

# Pizza Pizza Royalty Corp.

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

*For the three and nine months ended September 30, 2019 and 2018*

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

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, 2019. 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 0.059961; the new Class B Multiplier is 2.060652. 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, 2019, once the actual performance of the new restaurants is determined in early 2020.

c. 2019 Royalty Pool Adjustment – Class D Exchange Multiplier

On January 1, 2019, six net Pizza 73 restaurants were added to the Royalty Pool as a result of seven new restaurants opening between September 2, 2017 and September 1, 2018 and one restaurant closing between January 1, 2018 and December 31, 2018. The forecasted additional system sales from the seven new restaurants are estimated at \$2,472 annually, less \$161 in system sales attributable to the one closed Pizza 73 restaurant. The net estimated sales were further reduced by \$1,438 in system sales attributable to certain restaurants previously added to the Royalty Pool whose territory adjusted a previously existing restaurant; resulting in overall net estimated Pizza 73 sales of \$873 added to the Royalty Pool. The total number of Pizza 73 restaurants in the Royalty Pool has increased to 112. The yield of the shares was determined to be 9.5% calculated using \$9.05 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, 2019. 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 0.52925; the new Class D Multiplier is 21.80706. 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, 2019, once the actual performance of the new restaurants is determined in early 2020.

d. Pizza Pizza Royalty Corp. Outstanding Shares

In exchange for adding the forecasted Pizza Pizza system sales to the Royalty Pool, PPL has received 150,398 additional equivalent Shares (through the change to the Class B Exchange Multiplier). These represent 80% of the forecasted equivalent Shares entitlement to be received (187,997 equivalent Shares represent 100%), with the final equivalent Shares entitlement to be determined when the new restaurants' 2019 actual sales performance is known with certainty in early 2020.

In exchange for adding the forecasted Pizza 73 system sales to the Royalty Pool, PPL has received 52,925 additional equivalent Shares (through the change to the Class D Exchange Multiplier). These represent 80% of the forecasted equivalent Shares entitlement to be received (66,156 equivalent Shares represent 100%), with the final equivalent Shares entitlement to be determined when the new restaurants' 2019 actual sales performance is known with certainty in early 2020.

After giving effect to PPL's entitlement to additional equivalent Shares at January 1, 2019, PPL owns equivalent Shares representing 23.0% of the Company's fully diluted common shares.

## 6. 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 nine months ended September 30, 2019 and 2018.

# Pizza Pizza Royalty Corp.

## Notes to the Unaudited Interim Condensed Consolidated Financial Statements

For the three and nine months ended September 30, 2019 and 2018

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

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

	Three months ended September 30, 2019	Three months ended September 30, 2018	Nine months ended September 30, 2019	Nine months ended September 30, 2018
Weighted average number of:				
Common shares	24,618,392	24,618,392	24,618,392	24,618,392
Exchangeable Shares (note 5)	7,349,314	7,047,611	7,349,314	7,047,611
Weighted average number of shares outstanding – basic and diluted	31,967,706	31,666,003	31,967,706	31,666,003
<b>Basic and diluted earnings per share</b>	<b>\$0.21</b>	<b>\$0.21</b>	<b>\$0.63</b>	<b>\$0.63</b>

## 7. Royalty income

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

	Three months ended September 30, 2019	Three months ended September 30, 2018	Nine months ended September 30, 2019	Nine months ended September 30, 2018
(in thousands of dollars, except number of restaurants in the Royalty Pool)				
Restaurants in Royalty Pool	772	758	772	758
System sales reported by Pizza Pizza restaurants in the Royalty Pool	116,506	117,189	339,712	340,664
System sales reported by Pizza 73 restaurants in the Royalty Pool	21,957	21,268	66,914	64,198
<b>Total system sales</b>	<b>138,463</b>	<b>138,457</b>	<b>406,626</b>	<b>404,862</b>
Royalty – 6% on Pizza Pizza system sales	6,990	7,031	20,383	20,440
Royalty – 9% on Pizza 73 system sales	1,976	1,915	6,022	5,778
<b>Royalty income</b>	<b>8,966</b>	<b>8,946</b>	<b>26,405</b>	<b>26,218</b>

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

## 8. Related party transactions and balances

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

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

The Company has a receivable from PPL as at September 30, 2019 of \$2,879 (December 31, 2018 – \$3,156) and a payable to PPL as at September 30, 2019 of \$775 (December 31, 2018 – \$687). The 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.

# Pizza Pizza Royalty Corp.

## Notes to the Unaudited Interim Condensed Consolidated Financial Statements

For the three and nine months ended September 30, 2019 and 2018

(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 nine months ended September 30, 2019 and 2018.

### 9. Consolidated statements of cash flows information

Changes in non-cash working capital are as follows:

	Nine months ended September 30, 2019 \$	Nine months ended September 30, 2018 \$
Receivable from Pizza Pizza Limited	277	342
Trade and other receivables	(42)	(43)
Income taxes receivable	-	(17)
Trade and other payables	(40)	(58)
Payable to Pizza Pizza Limited	88	157
Income taxes payable	(7)	(173)
<b>Changes in non-cash working capital</b>	<b>276</b>	<b>208</b>

### 10. Financial risk management

#### Fair value

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

	September 30, 2019		December 31, 2018	
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$
Cash	566	566	1,160	1,160
Short-term investments	2,750	2,750	2,750	2,750
Receivable from Pizza Pizza Limited	2,879	2,879	3,156	3,156
Trade and other receivables	117	117	75	75
Derivative financial instruments	321	321	204	204
Trade and other payables	411	411	451	451
Payable to Pizza Pizza Limited	775	775	687	687
Dividends payable to shareholders	1,755	1,755	1,755	1,755
Borrowings	46,961	47,000	46,993	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 assets or financial liabilities that are not based on observable market data.

# **Pizza Pizza Royalty Corp.**

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

***For the three and nine months ended September 30, 2019 and 2018***

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

As at September 30, 2019, 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 discount 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 that can be corroborated by observable market data for substantially the full term of the asset or liability.

### **Interest rate risk**

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 \$141 as at September 30, 2019 (December 31, 2018 – \$108) based on movements in the fair value of the interest rate swaps.