



**PIZZA PIZZA ROYALTY CORP.**

Interim Condensed Consolidated Financial Statements  
(Unaudited)

For the three and nine months ended September 30, 2020 and 2019

# Pizza Pizza Royalty Corp.

Unaudited Interim Condensed Consolidated Statements of Financial Position

As at September 30, 2020 and December 31, 2019

(Expressed in thousands of Canadian dollars)

	September 30, 2020 \$	December 31, 2019 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash	1,445	535
Short-term investments	2,750	2,750
Receivable from Pizza Pizza Limited (note 8)	2,573	3,304
Trade and other receivables	105	91
<b>Total current assets</b>	<b>6,873</b>	<b>6,680</b>
<b>Non-current assets</b>		
Pizza Pizza Rights and Marks (note 3)	272,902	271,586
Pizza 73 Rights and Marks (note 3)	80,814	80,232
Derivative financial instruments (note 10)	-	510
<b>Total non-current assets</b>	<b>353,716</b>	<b>352,328</b>
<b>Total assets</b>	<b>360,589</b>	<b>359,008</b>
<b>Liabilities and shareholders' equity</b>		
<b>Current liabilities</b>		
Trade and other payables	368	481
Payable to Pizza Pizza Limited (note 8)	621	694
Dividends payable to shareholders	1,231	1,755
Income taxes payable	10	167
<b>Total current liabilities</b>	<b>2,230</b>	<b>3,097</b>
<b>Non-current liabilities</b>		
Borrowings (note 4)	46,919	46,909
Deferred tax liability	21,354	21,543
Derivative financial instruments (note 10)	2,311	-
<b>Total non-current liabilities</b>	<b>70,584</b>	<b>68,452</b>
<b>Shareholders' equity</b>		
Share capital	242,030	242,030
Exchangeable Shares (note 5)	82,847	80,949
Accumulated other comprehensive earnings	(1,833)	664
Deficit	(35,269)	(36,184)
<b>Total shareholders' equity</b>	<b>287,775</b>	<b>287,459</b>
<b>Total liabilities and shareholders' equity</b>	<b>360,589</b>	<b>359,008</b>

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

# Pizza Pizza Royalty Corp.

## Unaudited Interim Condensed Consolidated Statements of Earnings

For the three and nine months ended September 30, 2020 and 2019

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

	Three months ended September 30, 2020 \$	Three months ended September 30, 2019 \$	Nine months ended September 30, 2020 \$	Nine months ended September 30, 2019 \$
Royalty income (note 7)	8,145	8,966	23,760	26,405
Administrative expenses	(157)	(108)	(453)	(352)
<b>Operating earnings</b>	<b>7,988</b>	<b>8,858</b>	<b>23,307</b>	<b>26,053</b>
Interest expense on borrowings (note 4)	(324)	(336)	(904)	(997)
Swap expiry (note 10)	-	-	502	-
<b>Earnings for the period before income taxes</b>	<b>7,664</b>	<b>8,522</b>	<b>22,905</b>	<b>25,056</b>
Current tax expense	(1,307)	(1,471)	(3,792)	(4,314)
Deferred tax expense	(249)	(268)	(638)	(653)
<b>Earnings for the period attributable to shareholders</b>	<b>6,108</b>	<b>6,783</b>	<b>18,475</b>	<b>20,089</b>
Weighted average number of shares – basic and diluted (note 6)	32,177,276	31,967,706	32,177,276	31,967,706
<b>Basic and diluted earnings per share (note 6)</b>	<b>0.19</b>	<b>0.21</b>	<b>0.57</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 Condensed Consolidated Statements of Comprehensive Earnings

For the three and nine months ended September 30, 2020 and 2019

(Expressed in thousands of Canadian dollars)

	Three months ended September 30, 2020 \$	Three months ended September 30, 2019 \$	Nine months ended September 30, 2020 \$	Nine months ended September 30, 2019 \$
<b>Earnings for the period</b>	<b>6,108</b>	<b>6,783</b>	<b>18,475</b>	<b>20,089</b>
<b>Other comprehensive earnings (loss)</b>				
Items reclassified to net earnings:				
Cash flow hedges (note 10)	-	-	(502)	-
Deferred tax impact of cash flow hedges	-	-	255	-
Items that may be reclassified subsequently to net earnings:				
Cash flow hedges	89	326	(2,821)	173
Deferred tax impact of cash flow hedges	(18)	(68)	571	(37)
<b>Total comprehensive earnings</b>	<b>6,179</b>	<b>7,041</b>	<b>15,978</b>	<b>20,225</b>

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

# Pizza Pizza Royalty Corp.

*Unaudited Interim Condensed Consolidated Statements of Changes in Shareholders' Equity  
For the three and nine months ended September 30, 2020 and 2019  
(Expressed in thousands of Canadian dollars)*

	Share capital \$	Exchangeable Shares \$	Accumulated other comprehensive earnings (loss) \$	Deficit \$	Total shareholders' equity \$
<b>At December 31, 2019</b>	<b>242,030</b>	<b>80,949</b>	<b>664</b>	<b>(36,184)</b>	<b>287,459</b>
<b>Comprehensive earnings</b>					
Earnings for the period	-	-	-	18,475	18,475
Cash flow hedges	-	-	(3,323)	-	(3,323)
Deferred tax impact of cash flow hedges	-	-	826	-	826
<b>Total comprehensive earnings (loss)</b>	<b>-</b>	<b>-</b>	<b>(2,497)</b>	<b>18,475</b>	<b>15,978</b>
<b>Transactions with shareholders</b>					
Exchangeable Shares (note 5)	-	1,898	-	-	1,898
Dividends declared to shareholders	-	-	-	(12,651)	(12,651)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(4,909)	(4,909)
<b>Total transactions with shareholders</b>	<b>-</b>	<b>1,898</b>	<b>-</b>	<b>(17,560)</b>	<b>(15,662)</b>
<b>At September 30, 2020</b>	<b>242,030</b>	<b>82,847</b>	<b>(1,833)</b>	<b>(35,269)</b>	<b>287,775</b>
<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</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>

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

# Pizza Pizza Royalty Corp.

*Unaudited Interim Condensed Consolidated Statements of Cash Flows  
For the nine months ended September 30, 2020 and 2019  
(Expressed in thousands of Canadian dollars)*

	September 30, 2020 \$	September 30, 2019 \$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Earnings for the period	18,475	20,089
Amortization of deferred financing fees	10	6
Non-cash swap expiry (note 10)	(502)	-
Off-market swap payments	-	54
Deferred tax expense	638	653
Changes in non-cash working capital (note 9)	374	276
<b>Cash provided by operating activities</b>	<b>18,995</b>	<b>21,078</b>
<b>Financing activities</b>		
Debt refinancing fees	-	(38)
Dividends paid to shareholders	(13,176)	(15,798)
Distributions on Class B and Class D Exchangeable Shares	(4,909)	(5,836)
<b>Cash used in financing activities</b>	<b>(18,085)</b>	<b>(21,672)</b>
<b>Investing activities</b>		
Proceeds on redemption of short-term investment	500	-
Investment in short-term investment	(500)	-
<b>Cash provided by investing activities</b>	<b>-</b>	<b>-</b>
<b>Increase (Decrease) in cash</b>	<b>910</b>	<b>(594)</b>
<b>Cash, beginning of period</b>	<b>535</b>	<b>1,160</b>
<b>Cash, end of period</b>	<b>1,445</b>	<b>566</b>
<b>Supplementary information</b>		
Interest paid	894	936
Income taxes paid	3,950	4,320
	September 30, 2020 \$	December 31, 2019 \$
<b>Total cash and short-term investments</b>		
Cash	1,445	535
Short-term investments	2,750	2,750
<b>Total cash and short-term investments</b>	<b>4,195</b>	<b>3,285</b>

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

# Pizza Pizza Royalty Corp.

## *Notes to the Consolidated Financial Statements*

*For the three and nine months ended September 30, 2020 and 2019*

*(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 September 30, 2020, there were 645 Pizza Pizza restaurants and 104 Pizza 73 restaurants in the Royalty Pool (2019 – 660 and 112, 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, 2020, the Company declared dividends of \$0.5139 per share (2019 – \$0.6417 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 revenue from franchisees through the sale of franchise restaurants, food and supplies and royalties. PPL also derives revenue from company owned and jointly controlled restaurants through the sale of food products to retail customers. The Company’s revenue is earned from certain operations of PPL and, accordingly, the revenue 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.

### **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.

# Pizza Pizza Royalty Corp.

## Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2020 and 2019

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

### a. Statement of compliance

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, 2019.

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, 2019.

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, 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 11, 2020.

### b. Consolidation

The unaudited interim condensed consolidated financial statements incorporate the assets and liabilities of the Company and its subsidiaries as at September 30, 2020 and December 31, 2019 and the results of these subsidiaries for the three and nine months ended September 30, 2020 and 2019. The Company's subsidiaries and its respective holdings are outlined below:

<b>Subsidiary</b>	<b>September 30, 2020</b>	<b>December 31, 2019</b>
Pizza Pizza GP Inc.	76.5%	77.0%
Pizza Pizza Royalty Limited Partnership	76.5%	77.0%

### 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, 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 December 31, 2019</b>	<b>271,586</b>	<b>80,232</b>	<b>351,818</b>
Accretion of value – January 1, 2020 vend-in	15	-	15
Accretion of value – January 1, 2019 true-up	1,301	582	1,883
<b>Net book value at September 30, 2020</b>	<b>272,902</b>	<b>80,814</b>	<b>353,716</b>



# Pizza Pizza Royalty Corp.

## Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2020 and 2019

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

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, 2020, the Rights and Marks increased by \$15 in 2020 (2019 – \$1,840) and increased by \$1,883 related to the January 1, 2019 true-up (2019 – \$1,562).

Annually, the Company performs an impairment test on the Rights and Marks. In determining if the Rights and Marks are impaired requires an estimation of the recoverable amount of the Cash Generating Unit ("CGU") 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 CGU 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, 2019 are disclosed in the December 31, 2019 audited annual financial statements of the Company.

During the first quarter, the Partnership performed an impairment test of its investment in the Pizza Pizza and Pizza 73 Rights and Marks. As a result of this test, it was determined that there was no impairment. No trigger that would require testing was identified in the current quarter.

#### 4. Borrowings

	September 30, 2020	December 31, 2019
	\$	\$
Borrowings	47,000	47,000
Less: unamortized deferred financing fees	81	91
<b>Total borrowings</b>	<b>46,919</b>	<b>46,909</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

# Pizza Pizza Royalty Corp.

## Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2020 and 2019

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

subject to certain exceptions, in all present and acquired property of PPL, which may not be assigned without the prior consent of PPL and the bank.

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 facility bears interest at a fixed Bankers' Acceptance rate plus 0.875% to 1.375%, depending on the level of certain covenant calculations. 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 of 2019, the Partnership entered into a five year forward swap arrangement, which commenced April 2020. The credit facility has a new, effective interest rate of 2.685% comprised of a fixed rate of 1.81% plus a credit spread, currently at 0.875%, as of April 2020.

Interest expense incurred and paid on borrowings are as follows:

	Three months ended		Nine months ended	
	September	September	September	September
	30, 2020	30, 2019	30, 2020	30, 2019
	\$	\$	\$	\$
Interest expense	320	334	894	991
Loan fee amortization	4	2	10	6
Interest expense incurred on borrowings	324	336	904	997
Interest paid to (Interest received from) draw down swap termination and out-of-market costs	-	(9)	-	(55)
Interest paid on borrowings and loan fee amortization	324	327	904	942

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

The facility is subject to certain financial covenants, all of which have been met as at September 30, 2020. 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, 2020, PPL indirectly holds an effective 23.5% interest in the Company (December 31, 2019 – 23.0%) by holding all Class B and Class D Units of the Partnership. Subject to the Amended and Restated Exchange Agreement (“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” in the Exchange Agreement.

# Pizza Pizza Royalty Corp.

## Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2020 and 2019

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

Subject to the prior rights of the Company's Class C Units, a monthly distribution is paid to both PPL (as holders of the Class B and Class D Units) and the Company (as holders of the Class A Units), on a pro rata ownership basis. Distributions are subject to the discretion of the Pizza Pizza GP Inc., which the Company controls. Distributions made to PPL are recorded directly in equity. 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, 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 December 31, 2019</b>	<b>5,168,608</b>	<b>2,180,706</b>	<b>7,349,314</b>	<b>80,949</b>
Add: January 1, 2020 vend-in	1,536	-	1,536	15
Add: January 1, 2019 true-up	143,765	64,269	208,034	1,883
<b>At September 30, 2020</b>	<b>5,313,909</b>	<b>2,244,975</b>	<b>7,558,884</b>	<b>82,847</b>

### a. 2019 Royalty Pool Adjustment

In early January 2020 a second adjustment was made to the royalty payments and PPL's Class B Exchange Multiplier based on the actual performance of the 18 new restaurants added to the Royalty Pool on January 1, 2019. As a result of the adjustments, the Class B Exchange Multiplier is 2.117969 and Class B Units can be exchanged for 5,312,373 shares effective January 1, 2019.

In early January 2020, a second adjustment was made to the royalty payments and PPL's Class D Exchange Multiplier based on the actual performance of the seven Pizza 73 restaurants added to the Royalty Pool on January 1, 2019. As a result of the adjustments, the Class D Exchange Multiplier is 22.44976 and Class D Units can be exchanged for 2,244,975 shares effective January 1, 2019.

### b. 2020 Royalty Pool Adjustment – Class B Exchange Multiplier

On January 1, 2020, 15 net Pizza Pizza restaurants were removed from the Royalty Pool as a result of 19 new restaurants opening and 34 closing from January 1, 2019 to December 31, 2019. The total number of Pizza Pizza restaurants in the Royalty Pool has decreased to 645. The additional system sales from the 19 new restaurants are estimated at \$8,725 annually, less sales of \$8,687 from 34 permanently closed Pizza Pizza restaurants, resulting in net estimated Pizza Pizza sales of \$38 added to the Royalty Pool. The yield of the shares was determined to be 9.0% calculated using \$9.54 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, 2020. 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 0.000612; the new Class B Multiplier is 2.118582. 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, 2020, once the actual performance of the new restaurants is determined in early 2021.

### c. 2020 Royalty Pool Adjustment – Class D Exchange Multiplier

On January 1, 2020, eight net Pizza 73 restaurants were removed from the Royalty Pool as a result of one new restaurant opening between September 2, 2018 and September 1, 2019 and nine restaurants closing

# Pizza Pizza Royalty Corp.

## *Notes to the Consolidated Financial Statements*

*For the three and nine months ended September 30, 2020 and 2019*

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

between January 1, 2019 and December 31, 2019. The forecasted additional system sales from the one new restaurant is estimated at \$546 annually, less \$981 in system sales attributable to the nine closed Pizza 73 restaurants. As a result, a negative \$435 net, estimated Pizza 73 sales were removed from the Royalty Pool. The net estimated sales were further reduced by \$1,446 in system sales attributable to certain restaurants previously added to the Royalty Pool whose territory adjusted a previously existing restaurant. The total number of Pizza 73 restaurants in the Royalty Pool has decreased to 104.

Since the system sales of the closed Pizza 73 restaurants exceeded the additional system sales of the additional restaurant added to the Pizza 73 Royalty Pool, the Make-Whole Payment paid by PPL to the Partnership will be carried over, and continue to be paid for subsequent years, until on an Adjustment Date, additional system sales of additional restaurants are sufficient to offset the Pizza 73 system sales attributable to all closed Pizza 73 restaurants.

The yield of the shares was determined to be 9.0% calculated using \$9.54 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, 2020. 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 22.44976. The second adjustment to the Class D Exchange Multiplier will be adjusted to be effective January 1, 2020, once the actual performance of the new restaurant is determined in early 2021.

#### d. Pizza Pizza Royalty Corp. Outstanding Shares

In exchange for adding the forecasted Pizza Pizza system sales to the Royalty Pool, PPL has received 1,536 additional equivalent Shares (through the change to the Class B Exchange Multiplier). These represent 80% of the forecasted equivalent Shares entitlement to be received (1,920 equivalent Shares represent 100%), with the final equivalent Shares entitlement to be determined when the new restaurants' 2020 actual sales performance is known with certainty in early 2021.

PPL's Class D Equivalent Share entitlement is unchanged for 2020. 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 2020, no increase or decrease in the Exchange Multiplier is made. PPL will only have a Class D Equivalent Share entitlement for 2020 if the actual sales performance of the one new Pizza 73 restaurant, 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 2021.

After giving effect to PPL's entitlement to additional equivalent Shares at January 1, 2020, PPL owns equivalent Shares representing 23.5% of the Company's fully diluted 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, as if they have been converted, 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, 2020 or 2019.

# Pizza Pizza Royalty Corp.

## Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2020 and 2019

(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, 2020 \$	Three months ended September 30, 2019 \$	Nine months ended September 30, 2020 \$	Nine months ended September 30, 2019 \$
Weighted average number of:				
Common shares	24,618,392	24,618,392	24,618,392	24,618,392
Exchangeable Shares (note 5)	7,558,884	7,349,314	7,558,884	7,349,314
Weighted average number of shares outstanding – basic and diluted	32,177,276	31,967,706	32,177,276	31,967,706
<b>Basic and diluted earnings per share</b>	<b>\$0.19</b>	<b>\$0.21</b>	<b>\$0.57</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, 2020 \$	Three months ended September 30, 2019 \$	Nine months ended September 30, 2020 \$	Nine months ended September 30, 2019 \$
Restaurants in Royalty Pool	749	772	749	772
System sales reported by Pizza Pizza restaurants in the Royalty Pool	104,653	116,506	301,936	339,712
System sales reported by Pizza 73 restaurants in the Royalty Pool	20,731	21,957	62,704	66,914
<b>Total system sales</b>	<b>125,384</b>	<b>138,463</b>	<b>364,640</b>	<b>406,626</b>
Royalty – 6% on Pizza Pizza system sales	6,279	6,990	18,116	20,383
Royalty – 9% on Pizza 73 system sales	1,866	1,976	5,644	6,022
<b>Royalty income</b>	<b>8,145</b>	<b>8,966</b>	<b>23,760</b>	<b>26,405</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, 2020 of \$2,573 (December 31, 2019 – \$3,304) and a payable to PPL as at September 30, 2020 of \$621 (December 31, 2019 – \$694). 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 Consolidated Financial Statements

For the three and nine months ended September 30, 2020 and 2019

(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 or nine months ended September 30, 2020 and 2019.

Total director compensation for the three and nine months ended September 30, 2020 was \$50 and \$151, respectively (September 30, 2019 - \$53 and \$154).

### 9. Consolidated statements of cash flows information

Changes in non-cash working capital are as follows:

	September 30, 2020 \$	September 30, 2019 \$
Receivable from Pizza Pizza Limited	731	277
Trade and other receivables	(14)	(42)
Income taxes receivable	-	-
Trade and other payables	(113)	(40)
Payable to Pizza Pizza Limited	(73)	88
Income taxes payable	(157)	(7)
<b>Changes in non-cash working capital</b>	<b>374</b>	<b>276</b>

### 10. Financial risk management

#### Fair value

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

The carrying amounts of the cash, short-term investments, receivable from PPL, trade and other receivables, trade and other payables, 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:

	September 30, 2020		December 31, 2019	
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$
Short-term investments	2,750	2,750	2,750	2,750
Receivable from Pizza Pizza Limited	2,573	2,573	3,304	3,304
Trade and other receivables	105	105	91	91
Derivative financial instruments - asset	-	-	510	510
Trade and other payables	370	370	481	481
Payable to Pizza Pizza Limited	621	621	694	694
Dividends payable to shareholders	1,231	1,231	1,755	1,755
Borrowings	46,919	47,000	46,909	47,000
Derivative financial instruments - liability	2,311	2,311	-	-

# Pizza Pizza Royalty Corp.

## *Notes to the Consolidated Financial Statements*

*For the three and nine months ended September 30, 2020 and 2019*

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

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.

As at September 30, 2020, 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 balance, which equals the principal amount outstanding, is \$47 million (December 31, 2019 – \$47 million) since the debt has variable interest rates at terms that the Company believes are reflective of currently available terms. 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.

### **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. In the event of a reduction of the Company's royalty income, the Company has the discretion to reduce the distributions payable on the Partnership Units.

### **Liquidity risk**

The Company is subject to liquidity risk with respect to trade and other payables, borrowings, provision for other charges and funding the dividends 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. To mitigate its liquidity risk, the Company has the discretion to reduce the dividends payable to the Company's shareholders in the event of a reduction of the Company's royalty income.

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 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 \$384 as at September 30, 2020 (December 31, 2019 – \$490) based on movements in the fair value of the interest rate swaps.

# **Pizza Pizza Royalty Corp.**

## ***Notes to the Consolidated Financial Statements***

***For the three and nine months ended September 30, 2020 and 2019***

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

In April 2020, the Company's previous interest rate swaps expired. As a result, the remaining hedge reserve of \$502 was reclassified from accumulated other comprehensive income to the statement of earnings. This reclassification does not represent a cash inflow during the quarter. The Company's new swaps became effective in April 2020 (note 4).

### **11. Subsequent Events**

The Company has announced that its monthly dividend will increase to \$0.055 per share from \$0.05 per share beginning with the November 2020 dividend. The dividend will be payable to shareholders of record at the close of business on November 30, 2020, and will be paid on December 15, 2020.