



PIZZA PIZZA ROYALTY CORP.

Interim Condensed Consolidated Financial Statements
(Unaudited)

For the three and six months ended June 30, 2021 and 2020

Pizza Pizza Royalty Corp.

Unaudited Interim Condensed Consolidated Statements of Financial Position
As at June 30, 2021 and December 31, 2020
(Expressed in thousands of Canadian dollars)

	June 30, 2021 \$	December 31, 2020 \$
Assets		
Current assets		
Cash	1,502	2,250
Short-term investments	3,500	2,750
Receivable from Pizza Pizza Limited (note 8)	2,655	2,753
Income taxes receivable	162	-
Trade and other receivables	75	76
Total current assets	7,894	7,829
Non-current assets		
Pizza Pizza Rights and Marks (note 3)	272,902	272,902
Pizza 73 Rights and Marks (note 3)	80,814	80,814
Total non-current assets	353,716	353,716
Total assets	361,610	361,545
Liabilities and shareholders' equity		
Current liabilities		
Trade and other payables	368	417
Payable to Pizza Pizza Limited (note 8)	788	644
Dividends payable to shareholders	1,354	1,354
Income taxes payable	-	26
Total current liabilities	2,510	2,441
Non-current liabilities		
Borrowings (note 4)	46,932	46,924

Pizza Pizza Royalty Corp.

*Unaudited Interim Condensed Consolidated Statements of Financial Position
As at June 30, 2021 and December 31, 2020
(Expressed in thousands of Canadian dollars)*

Deferred tax liability	22,343	21,641
Derivative financial instruments (note 10)	965	2,138
Total non-current liabilities	70,240	70,703
Shareholders' equity		
Share capital	242,030	242,030
Exchangeable Shares (note 5)	82,847	82,847
Accumulated other comprehensive earnings	(760)	(1,695)
Deficit	(35,257)	(34,781)
Total shareholders' equity	288,860	288,401
Total liabilities and shareholders' equity	361,610	361,545

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 six months ended June 30, 2021 and 2020

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

	Three months ended June 30, 2021 \$	Three months ended June 30, 2020 \$	Six months ended June 30, 2021 \$	Six months ended June 30, 2020 \$
Royalty income (note 7)	7,656	7,452	14,690	15,615
Administrative expenses	(159)	(181)	(261)	(296)
Operating earnings	7,497	7,271	14,429	15,319
Interest expense on borrowings (note 4)	(341)	(271)	(655)	(580)
Swap expiry (note 10)	-	502	-	502
Earnings for the period before income taxes	7,156	7,502	13,774	15,241
Current tax expense	(1,219)	(1,166)	(2,328)	(2,485)
Deferred tax expense	(232)	(251)	(464)	(389)
Earnings for the period attributable to shareholders	5,705	6,085	10,982	12,367
Weighted average number of shares – basic and diluted (note 6)	32,177,276	32,177,276	32,177,276	32,177,276
Basic and diluted earnings per share (note 6)	0.18	0.19	0.34	0.38

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 six months ended June 30, 2021 and 2020

(Expressed in thousands of Canadian dollars)

	Three months ended June 30, 2021 \$	Three months ended June 30, 2020 \$	Six months ended June 30, 2021 \$	Six months ended June 30, 2020 \$
Earnings for the period	5,705	6,085	10,982	12,367
Other comprehensive earnings (loss)				
Items reclassified to net earnings:				
Cash flow hedges (note 10)	-	(502)	-	(502)
Deferred tax impact of cash flow hedges	-	255	-	255
Items that may be reclassified subsequently to net earnings:				
Cash flow hedges	120	(346)	1,174	(2,910)
Deferred tax impact of cash flow hedges	(25)	70	(239)	589
Total comprehensive earnings	5,800	5,562	11,917	9,799

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 six months ended June 30, 2021 and 2020
(Expressed in thousands of Canadian dollars)

	Share capital \$	Exchangeabl e Shares \$	Accumulated other comprehensiv e earnings (loss) \$	Deficit \$	Total shareholders' equity \$
At December 31, 2020	242,030	82,847	(1,695)	(34,781)	288,401
Comprehensive earnings					
Earnings for the period	-	-	-	10,982	10,982
Cash flow hedges	-	-	1,174	-	1,174
Deferred tax impact of cash flow hedges	-	-	(239)	-	(239)
Total comprehensive earnings (loss)	-	-	935	10,982	11,917
Transactions with shareholders					
Exchangeable Shares (note 5)	-	-	-	-	-
Dividends declared to shareholders	-	-	-	(8,124)	(8,124)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(3,334)	(3,334)
Total transactions with shareholders	-	-	-	(11,458)	(11,458)
At June 30, 2021	242,030	82,847	(760)	(35,257)	288,860
At December 31, 2019					
At December 31, 2019	242,030	80,949	664	(36,184)	287,459
Comprehensive earnings					
Earnings for the period	-	-	-	12,367	12,367
Cash flow hedges	-	-	(3,412)	-	(3,412)
Deferred tax impact of cash flow hedges	-	-	844	-	844

Pizza Pizza Royalty Corp.

Audited Interim Consolidated Statements of Changes in Shareholders' Equity

For the three months ended March 31, 2016 and 2015

(Expressed in thousands of Canadian dollars)

Total comprehensive earnings (loss)	-	-	(2,568)	12,367	9,799
Transactions with shareholders					
Exchangeable Shares (note 5)	-	1,898	-	-	1,898
Dividends declared to shareholders	-	-	-	(8,959)	(8,959)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(3,525)	(3,525)
Total transactions with shareholders	-	1,898	-	(12,484)	(10,586)
At June 30, 2020	242,030	82,847	(1,904)	(36,301)	286,672

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 six months ended June 30, 2021 and 2020

(Expressed in thousands of Canadian dollars)

	June 30, 2021	June 30, 2020
	\$	\$
Cash provided by (used in)		
Operating activities		
Earnings for the period	10,982	12,367
Amortization of deferred financing fees	8	5
Non-cash swap expiry (note 10)	-	(502)
Deferred tax expense	464	389
Changes in non-cash working capital (note 9)	6	98
Cash provided by operating activities	11,460	12,357
Financing activities		
Dividends paid to shareholders	(8,124)	(9,483)
Distributions on Class B and Class D Exchangeable Shares	(3,334)	(3,525)
Cash used in financing activities	(11,458)	(13,008)
Investing activities		
Proceeds on redemption of short-term investment	1,750	500
Investment in short-term investment	(2,500)	-
Cash provided by investing activities	(750)	500
Decrease in cash	(748)	(151)
Cash, beginning of period	2,250	535
Cash, end of period	1,502	384

Supplementary information

Interest paid	647	574
Income taxes paid	2,550	2,685

	June 30, 2021	June 30, 2020
Total cash and short-term investments	\$	\$
Cash	1,502	384
Short-term investments	3,500	2,250
Total cash and short-term investments	5,002	2,634

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 six months ended June 30, 2021 and 2020

(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 June 30, 2021, there were 622 Pizza Pizza restaurants and 103 Pizza 73 restaurants in the Royalty Pool (2020 – 645 and 104, respectively); 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, 2021, the Company declared dividends of \$0.33 per share (2020 – \$0.3639 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 Unaudited Interim Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2021 and 2020

(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, 2020.

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, 2020.

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, 2020. 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 11, 2021.

b. Consolidation

The unaudited interim condensed consolidated financial statements incorporate the assets and liabilities of the Company and its subsidiaries as at June 30, 2021 and December 31, 2020 and the results of these subsidiaries for the three and six months ended June 30, 2021 and 2020. The Company’s subsidiaries and its respective holdings at June 30, 2021 and 2020 are outlined below:

Subsidiary	June 30, 2021	December 31, 2020
Pizza Pizza GP Inc.	76.5%	76.5%
Pizza Pizza Royalty Limited Partnership	76.5%	76.5%

Pizza Pizza Royalty Corp.

Notes to the Unaudited Interim Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2021 and 2020

(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, 2019	271,586	80,232	351,818
Accretion of value – January 1, 2020 vend-in	15	-	15
Accretion of value – January 1, 2019 true-up	1,301	582	1,883
Net book value at December 31, 2020	272,902	80,814	353,716
Accretion of value – January 1, 2021 vend-in	-	-	-
Accretion of value – January 1, 2020 true-up	-	-	-
Net book value at June 30, 2021	272,902	80,814	353,716

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 the adjustment to the Royalty Pool on January 1, 2021, the Rights and Marks remained unchanged in 2021 (2020 – increased \$15) and remained unchanged related to the January 1, 2020 true-up (2020 – increased \$1,883).

Annually, the Company performs an impairment test on the Rights and Marks. In determining if the Rights and

Pizza Pizza Royalty Corp.

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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, 2020 are disclosed in the December 31, 2020 audited annual financial statements of the Company.

4. Borrowings

	June 30, 2021 \$	December 31, 2020 \$
Borrowings	47,000	47,000
Less: unamortized deferred financing fees	(68)	(76)
Total borrowings	46,932	46,924

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 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. In the third quarter of 2019, the Partnership entered into a five year forward swap arrangement, which commenced April 2020. The effective interest rate on the credit facility increased in April 2021 to 2.935% comprised of a fixed rate of 1.81% plus a credit spread of 1.125%. Prior to April 2021, the effective interest rate was 2.685% (2020 – 2.685%) comprised of a fixed rate of 1.81% plus a credit spread of 0.875% (2020 – 1.81% and 0.875%).

Interest expense incurred and paid on borrowings are as follows:

	Three months ended		Six months ended	
	June 30, 2021 \$	June 30, 2020 \$	June 30, 2021 \$	June 30, 2020 \$
Interest expense	337	268	647	574
Loan fee amortization	4	3	8	6
Interest paid on borrowings and loan fee amortization	341	271	655	580

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 June 30, 2021. 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.

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5. Exchangeable Shares

As at June 30, 2021, PPL indirectly holds an effective 23.5% interest in the Company (December 31, 2020 – 23.5%) 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.

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 \$
At December 31, 2019	5,168,608	2,180,706	7,349,314	80,949
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
At December 31, 2020	5,313,909	2,244,975	7,558,884	82,847
Add: January 1, 2021 vend-in	-	-	-	-
Add: January 1, 2020 true-up	-	-	-	-
At June 30, 2021	5,313,909	2,244,975	7,558,884	82,847

a. 2020 Royalty Pool Adjustment

In early January 2021 a second adjustment was made to the royalty payments and PPL’s Class B Exchange Multiplier based on the actual performance of the 19 new restaurants added to the Royalty Pool on January 1, 2020. The final 2020 Pizza Pizza Royalty Pool adjustment resulted in a Make-Whole Payment being made on \$781 of Royalty Pool sales. The Make-Whole Payment will continue to be paid for subsequent years, until on an Adjustment Date, additional system sales of additional restaurants are sufficient to offset the Pizza Pizza system sales attributable to all closed Pizza Pizza restaurants. As a result of the adjustments, the Class B Exchange Multiplier is unchanged at 2.118582 and Class B Units can be exchanged for 5,313,909 shares effective January 1, 2020.

In early January 2021, a second adjustment was made to the royalty payments and PPL’s Class D Exchange Multiplier based on the actual performance of the one Pizza 73 restaurant added to the Royalty Pool on January 1, 2020. The final 2020 Pizza 73 Royalty Pool adjustment resulted in a Make-Whole Payment being made on \$692 of Royalty Pool sales. The Make-Whole Payment will continue to be paid for subsequent years, until on an Adjustment Date, additional system sales of additional restaurants are sufficient to offset the Pizza Pizza system sales attributable to all closed Pizza 73 restaurants. As a result of

Pizza Pizza Royalty Corp.

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the adjustments, the Class D Exchange Multiplier is unchanged at 22.44976 and Class D Units can be exchanged for 2,244,975 shares effective January 1, 2020.

b. 2021 Royalty Pool Adjustment – Class B Exchange Multiplier

On January 1, 2021, 23 net Pizza Pizza restaurants were removed from the Royalty Pool as a result of nine new restaurants opening and 32 closing from January 1, 2020 to December 31, 2020. The total number of Pizza Pizza restaurants in the Royalty Pool has decreased to 622. The additional system sales from the nine new restaurants are estimated at \$4,056 annually, less sales of \$18,572 from the 32 permanently closed Pizza Pizza restaurants. As a result, a negative \$14,516 net, estimated Pizza Pizza sales were removed from the Royalty Pool.

Since the system sales of the closed Pizza Pizza restaurants exceeded the additional system sales of the additional restaurants added to the Pizza Pizza 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 Pizza system sales attributable to all closed Pizza Pizza restaurants.

The yield of the shares was determined to be 7.3% calculated using \$9.18 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, 2021. 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 2.118582. The second adjustment to the Class B Exchange Multiplier will be adjusted to be effective January 1, 2021, once the actual performance of the new restaurant is determined in early 2022.

c. 2021 Royalty Pool Adjustment – Class D Exchange Multiplier

On January 1, 2021, one net Pizza 73 restaurant was removed from the Royalty Pool as a result of one new restaurant opening between September 2, 2019 and September 1, 2020 and two restaurants closing between January 1, 2020 and December 31, 2020. The forecasted additional system sales from the one new restaurant is estimated at \$520 annually, less \$1,054 in system sales attributable to the two closed Pizza 73 restaurants. As a result, a negative \$534 net, estimated Pizza 73 sales were removed from the Royalty Pool. The total number of Pizza 73 restaurants in the Royalty Pool has decreased to 103.

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 7.3% calculated using \$9.18 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, 2021. 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, 2021, once the actual performance of the new restaurant is determined in early 2022.

d. Pizza Pizza Royalty Corp. Outstanding Shares

PPL's Class B and Class D equivalent Share entitlement is unchanged for 2021. In any year that the forecasted system sales (less closed restaurants sales and other adjustments) is negative, as was the case

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

with the Class B and Class D equivalent Share entitlement calculation for 2021, no increase or decrease in the Exchange Multiplier is made. PPL will only have a Class B or D equivalent Share entitlement for 2021 if the actual sales performance of the new restaurants, less the sales of adjustment restaurants, significantly exceeds forecasted system sales and yields net, positive sales when the actual sales performance is known with certainty in early 2022.

After giving effect to PPL's entitlement to additional equivalent Shares at January 1, 2021, 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 or six months ended June 30, 2021 and 2020.

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

	Three months ended June 30, 2021 \$	Three months ended June 30, 2020 \$	Six months ended June 30, 2021 \$	Six months ended June 30, 2020 \$
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	7,558,884	7,558,884	7,558,884
Weighted average number of shares outstanding – basic and diluted	32,177,276	32,177,276	32,177,276	32,177,276
Basic and diluted earnings per share	\$0.18	\$0.19	\$0.34	\$0.38

Pizza Pizza Royalty Corp.

Notes to the Unaudited Interim Condensed Consolidated Financial Statements

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

7. Royalty income

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

	Three months ended June 30, 2021 \$	Three months ended June 30, 2020 \$	Six months ended June 30, 2021 \$	Six months ended June 30, 2020 \$
Restaurants in Royalty Pool	725	749	725	749
System sales reported by Pizza Pizza restaurants in the Royalty Pool	98,647	92,113	188,872	197,283
System sales reported by Pizza 73 restaurants in the Royalty Pool	19,304	21,393	37,313	41,974
Total system sales	117,951	113,506	226,185	239,257
Royalty – 6% on Pizza Pizza system sales	5,919	5,527	11,332	11,837
Royalty – 9% on Pizza 73 system sales	1,737	1,925	3,358	3,778
Royalty income	7,656	7,452	14,690	15,615

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 June 30, 2021 of \$2,655 (December 31, 2020 – \$2,753) and a payable to PPL as at June 30, 2021 of \$788 (December 31, 2020 – \$644). 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.

Transactions with related parties are in the normal course of operations. No amount of related party balances was written off during the period ended June 30, 2021 and 2020.

Total director compensation for the three and six months ended June 30, 2021 was \$48 and \$95, respectively (June 30, 2020 - \$50 and \$101, respectively).

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

9. Consolidated statements of cash flows information

Changes in non-cash working capital are as follows:

	June 30, 2021 \$	June 30, 2020 \$
Receivable from Pizza Pizza Limited	98	620
Trade and other receivables	1	-
Income taxes receivable	(162)	(33)
Trade and other payables	(49)	(140)
Payable to Pizza Pizza Limited	144	(182)
Income taxes payable	(26)	(167)
Changes in non-cash working capital	6	98

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:

	June 30, 2021		December 31, 2020	
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$
Cash	1,502	1,502	2,250	2,250
Short-term investments	3,500	3,500	2,750	2,750
Receivable from Pizza Pizza Limited	2,655	2,655	2,753	2,753
Trade and other receivables	75	75	76	76

Pizza Pizza Royalty Corp.

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

Trade and other payables	368	368	417	417
Payable to Pizza Pizza Limited	788	788	644	644
Dividends payable to shareholders	1,354	1,354	1,354	1,354
Borrowings	46,932	47,000	46,924	47,000
Derivative financial instruments - liability	965	965	2,138	2,138

Pizza Pizza Royalty Corp.

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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 June 30, 2021, 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, 2020 – \$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.

Credit risk also arises from cash and derivative financial instruments with banks and financial institutions. The Company places its cash 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 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

Pizza Pizza Royalty Corp.

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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 \$307 as at June 30, 2021 (December 31, 2020 – \$363) based on movements in the fair value of the interest rate swaps.

11. Subsequent Events

The Company has announced that its monthly dividend will increase to \$0.06 per share from \$0.055 per share beginning with the August 2021 dividend. The dividend will be payable to shareholders of record at the close of business on August 31, 2021, and will be paid on September 15, 2021.