



PIZZA PIZZA ROYALTY CORP.

Interim Condensed Consolidated Financial Statements
(Unaudited)

For the three and nine months ended September 30, 2023 and 2022

Pizza Pizza Royalty Corp.

Unaudited Interim Condensed Consolidated Statements of Financial Position

As at September 30, 2023 and December 31, 2022

(Expressed in thousands of Canadian dollars)

	September 30, 2023 \$	December 31, 2022 \$
Assets		
Current assets		
Cash	2,068	1,936
Short-term investments	6,000	6,000
Receivable from Pizza Pizza Limited (note 8)	3,430	3,363
Trade and other receivables	323	283
Total current assets	11,821	11,582
Non-current assets		
Derivative financial instruments (note 10)	2,557	2,533
Pizza Pizza Rights and Marks (note 3)	275,082	272,902
Pizza 73 Rights and Marks (note 3)	80,814	80,814
Total non-current assets	358,453	356,249
Total assets	370,274	367,831
Liabilities and shareholders' equity		
Current liabilities		
Trade and other payables	461	457
Payable to Pizza Pizza Limited (note 8)	879	789
Dividends payable to shareholders	1,846	1,723
Income taxes payable	620	1,101
Total current liabilities	3,806	4,070
Non-current liabilities		
Borrowings (note 4)	46,972	46,958
Deferred tax liability	24,879	24,380
Total non-current liabilities	71,851	71,338
Shareholders' equity		
Share capital	242,030	242,030
Exchangeable Shares (note 5)	85,027	82,847
Accumulated other comprehensive earnings	2,050	2,030
Deficit	(34,490)	(34,484)
Total shareholders' equity	294,617	292,423
Total liabilities and shareholders' equity	370,274	367,831

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, 2023 and 2022

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

	Three months ended September 30, 2023 \$	Three months ended September 30, 2022 \$	Nine months ended September 30, 2023 \$	Nine months ended September 30, 2022 \$
Royalty income (note 7)	10,430	9,547	29,698	26,603
Administrative expenses	(123)	(119)	(414)	(399)
Operating earnings	10,307	9,428	29,284	26,204
Interest expense on borrowings (note 4)	(322)	(322)	(957)	(999)
Interest income	95	-	263	-
Earnings for the period before income taxes	10,080	9,106	28,590	25,205
Current tax expense	(1,833)	(1,663)	(5,168)	(4,463)
Deferred tax expense	(200)	(216)	(494)	(648)
Earnings for the period attributable to shareholders	8,047	7,227	22,928	20,094
Weighted average number of shares – basic and diluted (note 6)	32,337,580	32,177,276	32,337,580	32,177,276
Basic and diluted earnings per share (note 6)	0.25	0.22	0.71	0.62

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, 2023 and 2022

(Expressed in thousands of Canadian dollars)

	Three months ended September 30, 2023 \$	Three months ended September 30, 2022 \$	Nine months ended September 30, 2023 \$	Nine months ended September 30, 2022 \$
Earnings for the period	8,047	7,227	22,928	20,094
Other comprehensive earnings (loss)				
Items that may be reclassified subsequently to net earnings:				
Cash flow hedges	(140)	408	24	2,618
Deferred tax impact of cash flow hedges	28	(83)	(4)	(531)
Total comprehensive earnings	7,935	7,552	22,948	22,181

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 nine months ended September 30, 2023 and 2022
(Expressed in thousands of Canadian dollars)

	Share capital \$	Exchangeable Shares \$	Accumulated other comprehensive earnings (loss) \$	Deficit \$	Total shareholders' equity \$
At December 31, 2022	242,030	82,847	2,030	(34,484)	292,423
Comprehensive earnings					
Earnings for the period	-	-	-	22,928	22,928
Cash flow hedges	-	-	24	-	24
Deferred tax impact of cash flow hedges	-	-	(4)	-	(4)
Total comprehensive earnings (loss)	-	-	20	22,928	22,948
Transactions with shareholders					
Exchangeable Shares (note 5)	-	2,180	-	-	2,180
Dividends declared to shareholders	-	-	-	(16,187)	(16,187)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(6,747)	(6,747)
Total transactions with shareholders	-	2,180	-	(22,934)	(20,754)
At September 30, 2023	242,030	85,027	2,050	(34,490)	294,617
At December 31, 2021	242,030	82,847	(73)	(34,578)	290,226
Comprehensive earnings					
Earnings for the period	-	-	-	20,094	20,094
Cash flow hedges	-	-	2,618	-	2,618
Deferred tax impact of cash flow hedges	-	-	(531)	-	(531)
Total comprehensive earnings (loss)	-	-	2,087	20,094	22,181
Transactions with shareholders					
Exchangeable Shares (note 5)	-	-	-	-	-
Dividends declared to shareholders	-	-	-	(14,525)	(14,525)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(5,764)	(5,764)
Total transactions with shareholders	-	-	-	(20,289)	(20,289)
At September 30, 2022	242,030	82,847	2,014	(34,773)	292,118

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, 2023 and 2022
(Expressed in thousands of Canadian dollars)*

	September 30, 2023 \$	September 30, 2022 \$
Cash provided by (used in)		
Operating activities		
Earnings for the period	22,928	20,094
Amortization of deferred financing fees	14	12
Deferred tax expense	494	648
Changes in non-cash working capital (note 9)	(494)	318
Cash provided by operating activities	22,942	21,072
Financing activities		
Dividends paid to shareholders	(16,063)	(14,340)
Distributions on Class B and Class D Exchangeable Shares	(6,747)	(5,764)
Cash used in financing activities	(22,810)	(20,104)
Investing activities		
Proceeds on redemption of short-term investment	-	-
Investment in short-term investment	-	(2,500)
Cash used in investing activities	-	(2,500)
Increase (Decrease) in cash	132	(1,532)
Cash, beginning of period	1,936	2,657
Cash, end of period	2,068	1,125
Supplementary information		
Interest paid	975	1,106
Income taxes paid	5,706	3,880
Total cash and short-term investments		
	September 30, 2023 \$	September 30, 2022 \$
Cash	2,068	1,125
Short-term investments	6,000	6,000
Total cash and short-term investments	8,068	7,125

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, 2023 and 2022

(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.

In November 2021, the Partnership and PPL entered into a licence and royalty agreement for international operations, under which PPL may be granted licences to use the Pizza Pizza Rights in connection with the business of franchising, licensing and/or operating restaurants dedicated to the sale of pizza and related products in designated territories outside of Canada, initially in Mexico. In consideration of the licence for Mexico, PPL is required to pay the Partnership, commencing with the first calendar month that is 18 months following the opening of the first traditional restaurant in Mexico, a fee calculated as 12.5% of the royalty received by PPL under the Master Franchise Agreement (without any deduction for withholding or any other taxes). The international licence and royalty agreement provides only for a cash royalty payment, and openings and closings of restaurants in Mexico will not result in changes to the Royalty Pool nor to the Class B and Class D Exchange Multipliers.

As at September 30, 2023, there were 644 Pizza Pizza restaurants and 99 Pizza 73 restaurants in the Royalty Pool (2022 – 624 and 103, 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, 2023, the Company declared dividends of \$0.6575 per share (2022 – \$0.59 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.

Pizza Pizza Royalty Corp.

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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. 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, 2022.

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, 2022.

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, 2022. 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 7, 2023.

b. Consolidation

The unaudited interim condensed consolidated financial statements incorporate the assets and liabilities of the Company and its subsidiaries as at September 30, 2023 and December 31, 2022 and the results of these subsidiaries for the three and nine months ended September 30, 2023 and 2022. The Company's subsidiaries and its respective holdings at September 30, 2023 and December 31, 2022 are outlined below:

Subsidiary	September 30, 2023	December 31, 2022
Pizza Pizza GP Inc.	76.1%	76.5%
Pizza Pizza Royalty Limited Partnership	76.1%	76.5%

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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)

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, 2021	272,902	80,814	353,716
Accretion of value – January 1, 2022 vend-in	-	-	-
Accretion of value – January 1, 2021 true-up	-	-	-
Net book value at December 31, 2022	272,902	80,814	353,716
Accretion of value – January 1, 2023 vend-in	2,180	-	2,180
Accretion of value – January 1, 2022 true-up	-	-	-
Net book value at September 30, 2023	275,082	80,814	355,896

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, 2023, the Rights and Marks increased by \$2,180 in 2023 (2022 - unchanged) and remained unchanged related to the January 1, 2022 true-up (2022 – unchanged).

4. Borrowings

	September 30, 2023 \$	December 31, 2022 \$
Borrowings	47,000	47,000
Less: unamortized deferred financing fees	28	42
Total borrowings	46,972	46,958

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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.

The \$47 million credit facility with a syndicate of chartered banks matures April 24, 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 Partnership entered into a five year forward swap arrangement, which commenced April 2020. The effective interest rate on the credit facility decreased in April 2022 to 2.685% comprised of a fixed rate of 1.81% plus a credit spread of 0.875%. From April 2021 to March 2022, the effective interest rate was 2.935% comprised of a fixed rate of 1.81% plus a credit spread of 1.125%.

The Company is currently making interest-only payments until the loan matures on April 24, 2025.

The facility is subject to certain financial covenants, all of which have been met as at September 30, 2023. 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, 2023, PPL indirectly holds an effective 23.9% interest in the Company (December 31, 2022 – 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, 2021	5,313,909	2,244,975	7,558,884	82,847
Add: January 1, 2022 vend-in	-	-	-	-
Add: January 1, 2021 true-up	-	-	-	-
At December 31, 2022	5,313,909	2,244,975	7,558,884	82,847
Add: January 1, 2023 vend-in	160,304	-	160,304	2,180
Add: January 1, 2022 true-up	-	-	-	-
At September 30, 2023	5,474,213	2,244,975	7,719,188	85,027

a. 2022 Royalty Pool Adjustment

In early January 2023, a second adjustment was made to the royalty payments and PPL's Class B Exchange Multiplier based on the actual performance of the 34 new restaurants added to the Royalty Pool on January 1, 2022. The final 2022 Pizza Pizza Royalty Pool adjustment confirmed that the net additional system sales

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added to the Royalty Pool were \$12,531 and were applied against the opening Make-Whole Carryover Amount of \$15,257. As a result, the Make-Whole Payment for 2022 is to be paid and calculated as a percentage of \$2,726 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, 2022.

In early January 2023, a second adjustment was made to the royalty payments and PPL's Class D Exchange Multiplier based on the actual performance of the three Pizza 73 restaurants added to the Royalty Pool on January 1, 2022. The final 2022 Pizza 73 Royalty Pool adjustment confirmed that the net additional system sales added to the Royalty Pool were \$885 and were applied against the opening Make-Whole Carryover Amount of \$1,341. As a result, the Make-Whole Payment for 2022 is to be paid and calculated as a percentage of \$457 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 73 system sales attributable to all closed Pizza 73 restaurants. As a result of 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, 2022.

b. 2023 Royalty Pool Adjustment – Class B Exchange Multiplier

On January 1, 2023, 20 net Pizza Pizza restaurants were added to the Royalty Pool as a result of 43 new restaurants opening and 23 closing from January 1, 2022 to December 31, 2022. The total number of Pizza Pizza restaurants in the Royalty Pool has increased to 644. The additional system sales from the 43 new restaurants are estimated at \$13,802 annually, less sales of \$7,282 from the 23 permanently closed Pizza Pizza restaurants. As a result, \$6,520 net, estimated Pizza Pizza sales were added to the Royalty Pool and applied against the \$2,726 Make-Whole Carryforward Amount, resulting in an Estimated Determined Amount of \$3,794 added to the Royalty Pool.

The yield of the shares was determined to be 5.9% calculated using \$13.60 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, 2023. 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 0.063911; the new Class B Multiplier is 2.182493. 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, 2023, once the actual performance of the new restaurants is determined in early 2024.

c. 2023 Royalty Pool Adjustment – Class D Exchange Multiplier

On January 1, 2023, four net Pizza 73 restaurants were removed from the Royalty Pool as a result of two new restaurants opening between September 2, 2021 and September 1, 2022 and six restaurants closing between January 1, 2022 and December 31, 2022. The forecasted additional system sales from the two new restaurants are estimated at \$520 annually, less \$1,423 in system sales attributable to the six closed Pizza 73 restaurants. As a result, a negative \$903 net, estimated Pizza 73 sales were removed from the Royalty Pool.

The \$903 of Pizza 73 sales removed from the Royalty Pool are added to the \$457 Make-Whole Carryover Amount at the end of 2022. The cumulative Make-Whole Carryover Amount of \$1,360 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 total number of Pizza 73 restaurants in the Royalty Pool has decreased to 99.

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The yield of the shares was determined to be 5.9% calculated using \$13.60 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, 2023. 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, 2023, once the actual performance of the new restaurant is determined in early 2024.

d. Pizza Pizza Royalty Corp. Outstanding Shares

In exchange for adding the forecasted Pizza Pizza system sales to the Royalty Pool, PPL has received 160,304 additional equivalent Shares (through the change to the Class B Exchange Multiplier). These represent 80% of the forecasted equivalent Shares entitlement to be received (200,380 equivalent Shares represent 100%), with the final equivalent Shares entitlement to be determined when the new restaurants' 2023 actual sales performance is known with certainty in early 2024.

PPL's Class D equivalent Share entitlement is unchanged for 2023. 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 2023 no increase or decrease in the Exchange Multiplier is made. PPL will only have a Class D equivalent Share entitlement for 2023 if the actual sales performance of the new restaurants exceeds the Make-Whole Carryforward Amount when the actual sales performance is known with certainty in early 2024.

After giving effect to PPL's entitlement to additional equivalent Shares at January 1, 2023, PPL owns equivalent Shares representing 23.9% 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, 2023 and 2022.

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

	Three months ended September 30, 2023 \$	Three months ended September 30, 2022 \$	Nine months ended September 30, 2023 \$	Nine months ended September 30, 2022 \$
Weighted average number of:				
Common shares	24,618,392	24,618,392	24,618,392	24,618,392
Exchangeable Shares (note 5)	7,719,188	7,558,884	7,719,188	7,558,884
Weighted average number of shares outstanding – basic and diluted	32,337,580	32,177,276	32,337,580	32,177,276
Basic and diluted earnings per share	\$0.25	\$0.22	\$0.71	\$0.62

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7. Royalty income

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

	Three months ended September 30, 2023 \$	Three months ended September 30, 2022 \$	Nine months ended September 30, 2023 \$	Nine months ended September 30, 2022 \$
Restaurants in Royalty Pool	743	727	743	727
System sales reported by Pizza Pizza restaurants in the Royalty Pool	141,995	130,794	403,337	358,518
System sales reported by Pizza 73 restaurants in the Royalty Pool	21,219	18,881	61,088	56,579
Total system sales	163,214	149,675	464,425	415,097
Royalty – 6% on Pizza Pizza system sales	8,520	7,848	24,200	21,511
Royalty – 9% on Pizza 73 system sales	1,910	1,699	5,498	5,092
Royalty income	10,430	9,547	29,698	26,603

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, 2023 of \$3,430 (December 31, 2022 – \$3,363) and a payable to PPL as at September 30, 2023 of \$879 (December 31, 2022 – \$789). 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 periods ended September 30, 2023 and 2022.

Total director compensation for the three and nine months ended September 30, 2023 was \$48 and \$149, respectively (September 30, 2022 - \$48 and \$152, 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:

	September 30, 2023	September 30, 2022
	\$	\$
Receivable from Pizza Pizza Limited	(67)	22
Trade and other receivables	(40)	(173)
Trade and other payables	4	29
Payable to Pizza Pizza Limited	90	(142)
Income taxes payable	(481)	582
Changes in non-cash working capital	(494)	318

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, 2023		December 31, 2022	
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$
Cash	2,068	2,068	1,936	1,936
Short-term investments	6,000	6,000	6,000	6,000
Receivable from Pizza Pizza Limited	3,430	3,430	3,363	3,363
Trade and other receivables	323	323	283	283
Derivative financial instruments - asset	2,557	2,557	2,533	2,533
Trade and other payables	461	461	457	457
Payable to Pizza Pizza Limited	879	879	789	789
Dividends payable to shareholders	1,846	1,846	1,723	1,723
Borrowings	46,972	47,000	46,958	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.

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As at September 30, 2023, 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, 2022 – \$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 period.

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

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 effective as cash flow hedges. If interest rates changed by plus/minus 10% of the existing rate, total comprehensive earnings and shareholders' equity would change by plus/minus \$118 as at September 30, 2023 (December 31, 2022 – \$175) based on movements in the fair value of the interest rate swaps.

Pizza Pizza Royalty Corp.

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11. Subsequent events

The Company has announced that its monthly dividend will increase to \$0.0775 per share from \$0.075 per share beginning with the November 2023 dividend. The dividend will be payable to shareholders of record at the close of business on November 30, 2023, and will be paid on December 15, 2023.