



## **PIZZA PIZZA ROYALTY INCOME FUND**

Consolidated Interim Financial Statements  
(Unaudited)  
For the three months ended March 31, 2009

# Pizza Pizza Royalty Income Fund

## CONSOLIDATED BALANCE SHEETS

March 31, 2009

(Expressed in Thousands of Dollars)

	March 31, 2009 (unaudited)	December 31, 2008 (audited)
<b>Assets</b>		
Current assets:		
Receivable from Pizza Pizza Limited	\$ 150	\$ 150
Receivable from Pizza Pizza Royalty Limited Partnership	1,541	1,541
Total current assets	1,691	1,691
Loan receivable from Pizza Pizza Limited	30,000	30,000
Investment in Pizza Pizza Royalty Limited Partnership (note 4)	194,235	188,635
	\$ 225,926	\$ 220,326
<b>Liabilities and Unitholders' Equity</b>		
Current liabilities:		
Distribution payable to Fund unitholders	1,691	1,691
Future income tax liability (note 5)	5,680	5,973
<b>Unitholders' Equity:</b>		
Fund units (note 6)	212,928	212,928
Contributed surplus (note 3(c))	19,863	14,103
	232,791	227,031
Accumulated other comprehensive loss	(3,077)	(3,166)
Deficit	(11,159)	(11,203)
	(14,236)	(14,369)
Total unitholders' equity	218,555	212,662
	\$ 225,926	\$ 220,326

See accompanying notes to consolidated financial statements

Approved by the Trustees:

(Signed) ROBERT NOBES  
Trustee

(Signed) ARNOLD CADER  
Trustee

(Signed) TERENCE REID  
Trustee

# Pizza Pizza Royalty Income Fund

## CONSOLIDATED STATEMENTS OF EARNINGS

For the Three Months Ended March 31, 2009 and 2008

(Expressed in Thousands of Dollars Except Number of Units and Per Unit Amounts)

	March 31, 2009 (unaudited)	March 31, 2008 (unaudited)
System Sales included in the Royalty Pool (note 3(a))	\$ 109,385	\$ 113,520
Equity income in the Partnership (note 3(a))	4,373	4,804
Interest income	450	450
Earnings before income taxes	4,823	5,254
Provision for (recovery of) future income taxes (note 5)	(293)	856
Net earnings	\$ 5,116	\$ 4,398
Weighted average Fund units (note 7)	21,818,392	21,818,392
Basic earnings per Fund unit	\$ 0.23	\$ 0.20
Weighted average diluted Fund units (note 7)	29,022,678	27,807,841
Diluted earnings per Fund unit (note 7)	\$ 0.23	\$ 0.20

## CONSOLIDATED STATEMENTS OF DEFICIT

For the Three Months Ended March 31, 2009 and 2008

(Expressed in Thousands of Dollars Except Per Unit Amounts)

	March 31, 2009 (unaudited)	March 31, 2008 (unaudited)
<b>Balance, beginning of period</b>	\$ (11,203)	\$ (15,190)
Net earnings	5,116	4,398
Distributions declared (2009 – \$0.2325/unit; 2008 – \$0.2280/unit)	(5,072)	(4,975)
<b>Balance, end of period</b>	\$ (11,159)	\$ (15,767)

See accompanying notes to consolidated financial statements

**Pizza Pizza Royalty Income Fund**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**For the Three Months Ended March 31, 2009 and 2008**  
**(Expressed in Thousands of Dollars)**

	March 31, 2009 (unaudited)	March 31, 2008 (unaudited)
<b>Net earnings</b>	\$ 5,116	\$ 4,398
<b>Other comprehensive loss</b>		
Share of other comprehensive income (loss) of the Partnership (notes 4 and 9)	89	(1,012)
<b>Comprehensive income</b>	<b>\$ 5,205</b>	<b>\$ 3,386</b>

**CONSOLIDATED STATEMENTS OF ACCUMULATED OTHER COMPREHENSIVE LOSS**  
**For the Three Months Ended March 31, 2009 and 2008**  
**(Expressed in Thousands of Dollars)**

	March 31, 2009 (unaudited)	March 31, 2008 (unaudited)
<b>Balance, beginning of period</b>	\$ (3,166)	\$ (362)
Other comprehensive income (loss) (notes 4 and 9)	89	(1,012)
<b>Balance, end of period, being the Fund's share of the fair value of a cash flow hedge</b>	<b>\$ (3,077)</b>	<b>\$ (1,374)</b>

See accompanying notes to consolidated financial statements

**Pizza Pizza Royalty Income Fund**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Three Months Ended March 31, 2009 and 2008**  
**(Expressed in Thousands of Dollars)**

	March 31, 2009 (unaudited)	March 31, 2008 (unaudited)
<b>Cash provided by (used in):</b>		
<b>Operating activities</b>		
Net earnings	\$ 5,116	\$ 4,398
Equity income, an item not affecting cash (note 3(a))	(4,373)	(4,804)
Distributions received	4,622	4,525
Future income tax expense (recovery)	(293)	856
	<u>5,072</u>	<u>4,975</u>
<b>Financing activity</b>		
Distributions paid to unitholders	(5,072)	(4,975)
<b>Increase (decrease) in cash</b>	-	-
Cash, beginning of period	-	-
<b>Cash, end of period</b>	<u>\$ -</u>	<u>\$ -</u>

See supplementary cash flows information (note 11)  
See accompanying notes to consolidated financial statements

# Pizza Pizza Royalty Income Fund

## Notes to Interim Consolidated Financial Statements

For the Three Months Ended March 31, 2009 and 2008

(Expressed in Thousands of Dollars Except Number of Units and Per Unit Amounts)

### 1. Organization and Nature of Operations

Pizza Pizza Royalty Income Fund (the "Fund") prepares its interim consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") on a basis consistent with those used and described in the annual consolidated financial statements for the year ended December 31, 2008. The disclosures contained in these interim consolidated financial statements do not include all requirements of Canadian GAAP for annual financial statements; however, all requirements for interim financial statements have been satisfied.

These interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2008.

### 2. Changes in Accounting Policy

Effective January 1, 2009, the Fund adopted Emerging Issues Committee Abstract 173 "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" (EIC 173). EIC 173 requires an entity's own credit risk and the credit risk of the counterparty be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The Fund has determined this change had no material effect on its financial statements.

### 3. Partnership Operations

- a. Equity income earned by the Fund through its interest in the Pizza Pizza Royalty Limited Partnership (the "Partnership") has been derived as shown in the table below:

	March 31, 2009	March 31, 2008
(in thousands of dollars, except number of restaurants in the Royalty Pool)		
Restaurants in Royalty Pool	637	609
System sales reported by Pizza Pizza restaurants in the Royalty Pool	\$ 88,033	\$ 93,970
System sales reported by Pizza 73 restaurants in the Royalty Pool	21,352	19,550
	109,385	113,520
Royalty - 6% on Pizza Pizza system sales	\$ 5,282	\$ 5,638
Royalty - 9% on Pizza 73 system sales	1,922	1,760
Total royalty on system sales	7,204	7,398
Partnership administrative and interest expenses	(788)	(825)
Partnership earnings for the period before undernoted Pizza Pizza Limited interest	6,416	6,573
Pizza Pizza Limited's interest	(2,043)	(1,769)
Equity income in the Partnership	\$ 4,373	\$ 4,804

- b. In early January 2009, adjustments to royalty payments and Pizza Pizza Limited's ("Pizza Pizza") Class B Exchange Multiplier were made based on the actual performance of the 36 Pizza Pizza restaurants added to the Royalty Pool on January 1, 2008. As a result of the adjustments, the new Class B Exchange Multiplier was 1.3737 and Pizza Pizza's exchangeable units can be exchanged into 5,595,241 Fund units which is an increase of 164,542 Fund units, effective January 1, 2008.

In early January 2009, adjustments to royalty payments and Pizza Pizza's Class D Exchange Multiplier were made based on the actual performance of the nine Pizza 73 restaurants added to the Royalty Pool on January 1, 2008. As a result of the adjustments, the new Class D Exchange Multiplier was 7.9961 and

# Pizza Pizza Royalty Income Fund

## Notes to Interim Consolidated Financial Statements

For the Three Months Ended March 31, 2009 and 2008

(Expressed in Thousands of Dollars Except Number of Units and Per Unit Amounts)

### 3. Partnership Operations, continued

Pizza Pizza's exchangeable units can be exchanged into 799,610 Fund units which is an increase of 240,860 Fund units, effective January 1, 2008.

- c. On January 1, 2009, nine net, new Pizza Pizza restaurants were added to the Royalty Pool as a result of 18 new restaurants opening and nine closing from January 1, 2008 to December 31, 2008. The additional system sales from the 18 new restaurants are estimated at \$4,698 annually less sales of \$1,609 from nine permanently closed Pizza Pizza restaurants resulting in net, estimated Pizza Pizza sales of \$3,089 added to the Royalty Pool. The total number of Pizza Pizza restaurants in the Royalty Pool has increased to 568. The yield of the Fund units was determined to be 15.3% calculated using \$6.04 as a weighted average unit price calculated based on the market price of the units traded on the TSX during the 20 consecutive days ending on the fifth trading day before January 1, 2009. As a result of the contribution of the additional net sales to the Royalty Pool, Pizza Pizza's Class B Exchange Multiplier increased fractionally by 80% of the total adjustment or 0.0365; the new Class B Multiplier is 1.4102. 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, 2009, once the actual performance of the new restaurants is determined in early 2010.

On January 1, 2009, 19 new Pizza 73 restaurants were added to the Royalty Pool as a result of new restaurants opening between September 2, 2007 and September 1, 2008. The additional system sales from the 19 new restaurants are estimated at \$14,075 annually, which was reduced by \$4,923 in system sales attributable to certain of the restaurants now added to the Royalty Pool whose territories resulted in adjustments to those of previously existing restaurants, resulting in net, estimated Pizza 73 sales of \$9,152 added to the Royalty Pool. The total number of Pizza 73 restaurants in the Royalty Pool has increased to 69. The yield of 15.3% and the weighted average unit price of \$6.04 used in the calculation of the Class D Multiplier is determined in the same manner as that of the Class B Multiplier. As a result of the contribution of the additional net sales to the Royalty Pool, Pizza Pizza's Class D Exchange Multiplier increased fractionally by 80% of the total adjustment or 6.6075; the new Class D Multiplier is 14.6036. This adjustment will also increase the entitlement of the holders of the Class D units to distributions of cash and allocations of income from the Partnership. The second adjustment to the Class D Exchange Multiplier will be adjusted to be effective January 1, 2009, once the actual performance of the new restaurants is determined in early 2010.

As a result of the Adjusted Class B and Class D Exchange Multiplier, Pizza Pizza currently holds Class B and Class D Partnership units Exchangeable into 7,204,286 Fund units. As at March 31, 2009, the Fund reported an increase in its investment in the Partnership and a contributed surplus of \$5,760 (2008 – \$8,702) to reflect the increase in value as a result of the vend-in of the new royalty stream.

# Pizza Pizza Royalty Income Fund

## Notes to Interim Consolidated Financial Statements For the Three Months Ended March 31, 2009 and 2008 (Expressed in Thousands of Dollars Except Number of Units and Per Unit Amounts)

### 4. Investment in Pizza Pizza Royalty Limited Partnership

	March 31, 2009	December 31, 2008
Balance – beginning of year	\$ 188,635	\$ 180,984
Equity income of the Partnership	4,373	20,079
Accretion of value on change in Royalty Pool	5,760	8,702
Share of other comprehensive income (loss) of the Partnership	89	(2,804)
Distributions declared from the Partnership	(4,622)	(18,326)
Balance - end of period	\$ 194,235	\$ 188,635

The business of the Partnership is the ownership and licensing of the “Pizza Pizza Rights” and the “Pizza 73 Rights” through two separate “Licence and Royalty Agreements” with Pizza Pizza, to exploit the use of the Pizza Pizza and Pizza 73 Rights by Pizza Pizza. Additionally, the Partnership will collect the royalty payable under each “Licence and Royalty Agreement” as well as perform the administration of the Fund pursuant to the “Administration Agreement”.

### 5. Future Income Taxes

On October 31, 2006, the Department of Finance (Canada) announced proposed tax legislation which included a provision to eliminate the deduction of distributions from taxable income for certain forms of publicly traded income trusts and partnerships. The proposed legislation became a substantively enacted law on June 12, 2007, at which time the Fund, in accordance with Canadian GAAP, must give accounting recognition to these new taxes.

As a result of the new legislation, the Fund is required to recognize future income tax assets and liabilities with a corresponding adjustment to future tax expense, based on temporary differences expected to reverse after January 1, 2011 at the substantively enacted tax rate applicable to the Fund in 2011 and later. The legislation imposes a rate of 31.5%, which was subsequently lowered to 28.25% for 2011 and 26.25% for 2012, 25.5% for 2013 and 25.0% thereafter. The future taxes will reverse in the period or periods in which the Rights and Marks in the Partnership are reduced by means of sale or some other event.

The future income tax liability arises as a result of the Fund’s proportionate share of the temporary difference between the accounting and tax basis, at the tax rate applicable to the Fund, on the Rights and Marks and financing expenses in the Partnership.

Future income tax expense is a non-cash item, which does not affect cash flow.

The Fund will not be liable for current income taxes until January 1, 2011.



# Pizza Pizza Royalty Income Fund

**Notes to Interim Consolidated Financial Statements  
For the Three Months Ended March 31, 2009 and 2008  
(Expressed in Thousands of Dollars Except Number of Units and Per Unit Amounts)**

## 6. Unitholders' Equity

	March 31, 2009		December 31, 2008	
	Units	Value	Units	Value
Fund units	21,818,392	\$ 212,928	21,818,392	\$ 212,928

The Fund's objective when managing capital is to:

- i) Safeguard its ability to continue as a going concern, so that it can continue to provide returns for unitholders and benefits for other stakeholders;
- ii) Provide an adequate return to unitholders, while maintaining adequate reserves at the Partnership level; and
- iii) Ensure sufficient liquidity to pursue its growth strategy, while taking a conservative approach towards financial leverage and management of financial risk.

The Fund evaluates its capital as all components of equity, other than amounts in accumulated other comprehensive loss relating to the cash flow hedge, and includes Pizza Pizza's Class B and Class D exchangeable partnership units, as they are convertible to Fund units at the respective Multiplier at the conversion date.

The Fund's amount of capital is set in proportion to risk. The Fund manages its structure and makes adjustments in light of changes in economic conditions and risk characteristics of the underlying assets. The Fund's primary use of capital was to finance acquisitions, supported by the credit facility at the Partnership level.

## 7. Earnings per Unit

Basic net earnings per unit is calculated by dividing net earnings by the weighted average number of units outstanding during the period. Diluted net earnings per unit includes Pizza Pizza Class B and Class D exchangeable partnership units using the "if converted" method. Under the "if converted" method, earnings are adjusted for earnings allocated to the Class B and Class D exchangeable partnership units interest and the weighted average number of units is adjusted for the conversion of the Pizza Pizza Class B and Class D exchangeable Partnership units. For the purposes of the weighted average number of units outstanding, units are determined to be outstanding from the date they are issued.

The following table reconciles the basic net earnings to the diluted net earnings:

	March 31, 2009	March 31, 2008
Basic net earnings	\$ 5,116	\$ 4,398
Equity adjustment allocated to Class B and Class D exchangeable partnership units	1,593	1,319
Adjusted net earnings	\$ 6,709	\$ 5,717

# Pizza Pizza Royalty Income Fund

## Notes to Interim Consolidated Financial Statements For the Three Months Ended March 31, 2009 and 2008 (Expressed in Thousands of Dollars Except Number of Units and Per Unit Amounts)

### 7. Earnings per Unit, continued

The following table reconciles the basic weighted average number of units outstanding to the diluted weighted average of units outstanding:

	March 31, 2009	March 31, 2008
Weighted average number of:		
Fund units	21,818,392	21,818,392
Pizza Pizza Class B and Class D Partnership units	7,204,286	5,989,449
Weighted average number of units outstanding - diluted	29,022,678	27,807,841
Diluted earnings per Fund unit	\$ 0.23	\$ 0.21

For the quarter ended March 31, 2008, the Class B and D Partnership units are anti-dilutive. Accordingly, the diluted earnings per Fund unit equals the basic earnings per Fund unit.

### 8. Related Party Transactions

The Fund has an administration agreement with the Partnership, whereby the Partnership provides or arranges for the provision of services required in the administration of the Fund. Pizza Pizza, as general partner of the Partnership, and pursuant to the Partnership Agreement, is providing certain of these services. The fee for these services, which on an annual basis shall not exceed \$25, has been waived for the period.

Pizza Pizza is a related party by virtue of holding Class B and Class D Partnership units which are exchangeable into units of the Fund.

Other transactions with Pizza Pizza are referred to elsewhere in these consolidated financial statements. Transactions with related parties are in the normal course of operations and are recorded at the exchange amounts.

### 9. Cash Flow Hedges

The following is information about the Partnership's cash flow hedges:

	Notional Amount	March 31, 2009 Fair Value	December 31, 2008 Fair Value	Contract Expires
Interest rate swap	\$ 20,000	\$ (554)	\$ (513)	January 6, 2010
Interest rate swap	10,000	(1,311)	(1,303)	July 23, 2012
Interest rate swap	17,000	(2,227)	(2,217)	July 23, 2012

The Fund uses equity accounting for its interest in the Partnership's earnings and has recorded its share, effectively 75.2%, of the other comprehensive income (loss) generated by the Partnership.

# Pizza Pizza Royalty Income Fund

## Notes to Interim Consolidated Financial Statements

For the Three Months Ended March 31, 2009 and 2008

(Expressed in Thousands of Dollars Except Number of Units and Per Unit Amounts)

### 9. Cash Flow Hedges, continued

The Partnership has entered into three Interest Rate Swap Agreements to mitigate the risk associated with the fact that the \$47,000 bank loan bears interest at floating rates. The notional amounts of the Swaps are \$20,000, \$10,000 and \$17,000. On the \$20,000 Swap, the Partnership is obligated to pay the Swap Counterparty an amount based upon a fixed interest rate of 3.55% per annum plus a fee of 1.25% and the Swap Counterparty is obligated to pay the Partnership an amount equal to the Canadian Banker's Acceptance rate. On the \$10,000 and \$17,000 Swaps, the Partnership is obligated to pay the Swap Counterparty a fixed interest rate of 5.05% plus a fee of 1.25% and the Swap Counterparty is obligated to pay the Partnership an amount equal to the Canadian Banker's Acceptance rate.

Fair values of the above-noted items were determined using estimated future discounted cash flows using a comparable current market rate of interest, and the change in values have been accounted for in other comprehensive income.

### 10. Financial Instruments

#### Financial Risk Management

The Fund has minimal financial risk as all financial instruments, with the exception of the loan receivable from Pizza Pizza, are short-term in nature. The Fund is dependent upon the royalty payments generated by the sales of Pizza Pizza and Pizza 73 restaurants. Accordingly, the Fund manages its financial risk on the loans receivable from Pizza Pizza by monitoring the financial results of Pizza Pizza.

#### Fair Value

The carrying amounts of receivable from Pizza Pizza, receivable from the Partnership and distributions payable to Fund unitholders approximates fair value given the short-term maturity of these instruments.

The fair value of the loan receivable from Pizza Pizza is based on the estimated future discounted cash flows using a comparable market rate of interest.

The carrying value and fair value of the financial instruments is as follows:

	Carrying Value	Fair Value
Receivable from Pizza Pizza Limited	\$ 150	\$ 150
Receivable from Pizza Pizza Royalty Limited Partnership	1,541	1,541
Loan receivable from Pizza Pizza Limited	30,000	35,800
Distribution payable to Fund unitholders	1,691	1,691

#### Credit Risk

The Fund is exposed to credit risk in the event of non-payment by Pizza Pizza and the Partnership and that Pizza Pizza's operations are within the same segment, commercial food services. The Fund is of the opinion that this credit risk is mitigated since the Partnership receives monthly royalty payments from Pizza Pizza 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 the first priority distribution from the Partnership to Pizza Pizza, which is used to fund the interest owing to the Fund on its loan receivable from Pizza Pizza. The remaining royalty payments are used to fund the monthly distribution to the unitholders of the Partnership of which the Fund owns 75.2%. Furthermore, the Fund has reduced its credit risk with Pizza Pizza by obtaining security for its loan.

# Pizza Pizza Royalty Income Fund

## Notes to Interim Consolidated Financial Statements For the Three Months Ended March 31, 2009 and 2008 (Expressed in Thousands of Dollars Except Number of Units and Per Unit Amounts)

### 10. Financial Instruments, continued

#### Liquidity Risk

The Fund is subject to liquidity risk with respect to funding the distributions payable to Fund unitholders. The Fund receives monthly distributions and interest payments from the Partnership and Pizza Pizza, respectively. The Fund 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 distributions and interest received each month.

#### Cash Flow Risk

The Fund is subject to cash flow risk as it is dependent upon the level of sales generated by the Pizza Pizza and Pizza 73 restaurants to generate the royalties used to fund the cash flows to the Fund. The risk, however, is offset as the Fund cannot distribute more cash than it receives.

#### Interest Rate Risk

The fair value of the loan receivable from Pizza Pizza will fluctuate based on the general level of interest rates in the economy and the credit worthiness of Pizza Pizza.

If the interest rate was to change by plus/minus 10% of the existing rate, the other comprehensive loss would change by approximately plus/minus \$372.

### 11. Supplementary Cash Flow Information

	March 31, 2009	March 31, 2008
Supplementary information:		
Interest received	\$ 450	\$ 450

Total cash distributions disclosed in the statements of cash flows are discretionary.

### 12. Recent Accounting Pronouncements

Recent accounting pronouncements issued and not yet effective:

#### *Business Combinations*

CICA Handbook Section 1582, Business Combinations, which replaces CICA Handbook Section 1581, Business Combinations, establishes standards for the accounting for a business combination. It is the Canadian equivalent to International Financial Reporting Standard IFRS 3, Business Combinations. This standard is effective for the Fund for interim and annual financial statements beginning on January 1, 2011. The Fund has not yet determined the impact of the adoption of this change on its financial statements.

#### *Consolidated Financial Statements and Non-controlling Interests*

CICA Handbook Sections 1601, Consolidated Financial Statements and 1602, Non-controlling Interests, replace CICA Handbook Section 1600, Consolidated Financial Statements. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for

# Pizza Pizza Royalty Income Fund

## Notes to Interim Consolidated Financial Statements For the Three Months Ended March 31, 2009 and 2008 (Expressed in Thousands of Dollars Except Number of Units and Per Unit Amounts)

### 12. Recent Accounting Pronouncements, continued

accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. Section 1602 is equivalent to the corresponding provisions of International Financial Reporting Standard IAS 27, Consolidated and Separate Financial Statements. These standards are effective for the Fund for interim and annual financial statements beginning on January 1, 2011. The Fund has not yet determined the impact of the adoption of these changes on its financial statements.

#### *International Financial Reporting Standards*

The CICA plans to converge Canadian GAAP with International Financial Reporting Standards ("IFRS") effective January 1, 2011. The impact of the transition to IFRS on the Fund's financial statements is not yet determinable.