



PIZZA PIZZA ROYALTY CORP.

Consolidated Interim Financial Statements
(Unaudited)
For the three and six months ended June 30, 2016

Pizza Pizza Royalty Corp.

Unaudited Interim Consolidated Statements of Financial Position

As at June 30, 2016 and December 31, 2015

(Expressed in thousands of Canadian dollars)

	June 30, 2016 \$	December 31, 2015 \$
Assets		
Current assets		
Cash and cash equivalents	1,614	2,236
Short-term investments	2,750	2,750
Receivable from Pizza Pizza Limited (note 8)	2,988	3,381
Trade and other receivables	114	120
Income taxes receivable	33	-
Total current assets	7,499	8,487
Non-current assets		
Pizza Pizza Rights and Marks (note 3)	262,703	261,712
Pizza 73 Rights and Marks (note 3)	73,667	72,187
Total non-current assets	336,370	333,899
Total assets	343,869	342,386
Liabilities and shareholders' equity		
Current liabilities		
Trade and other payables	410	487
Payable to Pizza Pizza Limited (note 8)	561	590
Dividends payable to shareholders	1,755	1,716
Income taxes payable	-	778
Total current liabilities	2,726	3,571
Non-current liabilities		
Borrowings (note 4)	46,958	46,937
Derivative financial instruments (note 10)	1,817	1,688
Deferred tax liability	17,330	16,744
Total non-current liabilities	66,105	65,369
Shareholders' equity		
Share capital (note 6)	242,030	242,030
Exchangeable Shares (notes 3 and 5)	65,501	63,030
Accumulated other comprehensive loss	(725)	(390)
Deficit	(31,768)	(31,224)
Total shareholders' equity	275,038	273,446
Total liabilities and shareholders' equity	343,869	342,386

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

Pizza Pizza Royalty Corp.

Unaudited Interim Consolidated Statements of Earnings

For the three and six months ended June 30, 2016 and 2015

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

	Three months ended June 30, 2016 \$	Three months ended June 30, 2015 \$	Six months ended June 30, 2016 \$	Six months ended June 30, 2015 \$
Royalty Pool System Sales (note 7)	132,253	130,263	265,344	259,116
Royalty income (note 7)	8,580	8,509	17,222	16,948
Administrative expenses	(162)	(139)	(326)	(264)
Operating earnings	8,418	8,370	16,896	16,684
Interest expense on borrowings (note 4)	(218)	(309)	(432)	(733)
Non-cash swap termination costs (note 10)	-	(1,245)	-	(1,245)
Earnings for the period before income taxes	8,200	6,816	16,464	14,706
Current income tax expense	(1,409)	(1,069)	(2,784)	(2,259)
Deferred tax expense	(346)	(419)	(613)	(673)
Earnings for the period attributable to shareholders	6,445	5,328	13,067	11,774
Weighted average shares – basic and diluted (note 6)	30,921,241	30,742,525	30,921,241	30,742,525
Basic and diluted earnings per share (note 6)	0.21	0.17	0.42	0.38

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

Pizza Pizza Royalty Corp.

Unaudited Interim Consolidated Statements of Comprehensive Earnings

For the three and six months ended June 30, 2016 and 2015

(Expressed in thousands of Canadian dollars)

	Three months ended June 30, 2016 \$	Three months ended June 30, 2015 \$	Six months ended June 30, 2016 \$	Six months ended June 30, 2015 \$
Earnings for the period	6,445	5,328	13,067	11,774
Other comprehensive earnings				
Items reclassified subsequently to net earnings:				
Cash flow hedges	-	1,245	-	1,245
Deferred tax impact of cash flow hedges	-	(263)	-	(263)
Items that may be reclassified subsequently to net earnings:				
Cash flow hedges	(15)	11	(363)	(324)
Deferred tax impact of cash flow hedges	(21)	42	28	133
Total comprehensive earnings	6,409	6,363	12,732	12,565

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

Pizza Pizza Royalty Corp.

*Unaudited Interim Consolidated Statements of Changes in Shareholders' Equity
For the six months ended June 30, 2016 and 2015
(Expressed in thousands of Canadian dollars)*

	Share capital \$ (note 6)	Exchangeable shares \$ (note 5)	Accumulated other comprehensive loss \$	Deficit \$	Total shareholders' equity \$
At December 31, 2015	242,030	63,030	(390)	(31,224)	273,446
Comprehensive earnings					
Earnings for the period	-	-	-	13,067	13,067
Cash flow hedges	-	-	(363)	-	(363)
Deferred tax impact of cash flow hedges	-	-	28	-	28
Total comprehensive earnings	-	-	(335)	13,067	12,732
Transactions with shareholders					
Exchangeable Shares (note 5)	-	2,471	-	-	2,471
Dividends declared to shareholders	-	-	-	(10,334)	(10,334)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(3,277)	(3,277)
Total transactions with shareholders	-	2,471	-	(13,611)	(11,140)
At June 30, 2016	242,030	65,501	(725)	(31,768)	275,038
At December 31, 2014	212,928	86,129	(738)	(24,346)	273,973
Comprehensive earnings					
Earnings for the period	-	-	-	11,774	11,774
Cash flow hedges	-	-	921	-	921
Deferred tax impact of cash flow hedges	-	-	(130)	-	(130)
Total comprehensive earnings	-	-	791	11,774	12,565
Transactions with shareholders					
Exchangeable Shares (note 5)	-	6,003	-	-	6,003
Conversion of Exchangeable Shares	29,102	(29,102)	-	-	-
Deferred tax impact of conversion of Exchangeable Shares	-	-	-	(5,649)	(5,649)
Dividends declared to shareholders	-	-	-	(9,575)	(9,575)
Distributions on Class B and Class D Exchangeable Shares	-	-	-	(3,631)	(3,631)
Total transactions with shareholders	29,102	(23,099)	-	(18,855)	(12,852)
At June 30, 2015	242,030	63,030	53	(31,427)	273,686

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

Pizza Pizza Royalty Corp.

*Unaudited Interim Consolidated Statements of Cash Flows
For the six months ended June 30, 2016 and 2015
(Expressed in thousands of Canadian dollars)*

	June 30, 2016 \$	June 30, 2015 \$
Cash provided by (used in)		
Operating activities		
Earnings for the period	13,067	11,774
Non-cash swap termination costs	-	1,245
Amortization of deferred financing fee	21	18
Swap termination cost	-	(61)
Off-market swap payments	(233)	(72)
Deferred tax expense	613	673
Change in non-cash working capital (note 9)	(518)	(251)
Cash provided by operating activities	12,950	13,326
Financing activities		
Dividends paid to shareholders	(10,295)	(9,388)
Distributions paid on Class B and Class D Exchangeable Shares	(3,277)	(3,631)
Cash used in financing activities	(13,572)	(13,019)
Investing activities		
Acquisition of Rights and Marks associated with the vend-in (note 3 and 5)	-	(38)
Cash used in investing activities	-	(38)
Increase/(Decrease) in cash and cash equivalents	(622)	269
Cash and cash equivalents, beginning of period	2,236	1,355
Cash and cash equivalents, end of period	1,614	1,624
Supplementary information		
Interest paid	644	841

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, 2016 and 2015

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

1. General information

The Pizza Pizza Royalty Corp. (the “Company”), formerly Pizza Pizza Royalty Income Fund (the “Fund”), 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 Pizza Pizza 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 license 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, 2016, there were 636 Pizza Pizza restaurants (2015 – 630) and 100 Pizza 73 restaurants (2015 – 100) in the Royalty Pool; 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, 2016, the Company declared dividends of \$0.4198 per share (2015 - \$0.4041 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 revenues from franchisees through the sale of franchise restaurants, food and supplies and royalties. PPL also derives revenues from company owned and jointly controlled restaurants through the sale of food products to retail customers. The Company’s revenues are earned from certain operations of PPL and, accordingly, the revenues 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.

Historically, PPL’s system sales experience a decrease in the first calendar quarter when compared to the fourth quarter, which has historically been the strongest quarter.

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

2. Significant accounting policies

The principal accounting policies applied in the preparation of these unaudited interim condensed consolidated financial statements are set out below. These policies have been consistently applied to all periods presented unless otherwise stated.

a. Basis of preparation

The Company prepares its unaudited interim condensed consolidated financial statements in accordance with 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 for the year ended December 31, 2015.

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 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, 2015.

These unaudited interim condensed consolidated financial statements were authorized for issue by the Board of the Directors on August 9, 2016.

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 financial statements for the year ended December 31, 2015.

b. Future changes in accounting policy and disclosure

Standards, amendments and interpretations to existing standards that are not yet effective and have not yet been early adopted by the Company:

International Financial Reporting Standard 9, Financial Instruments (“IFRS 9”)

IFRS 9, as issued in 2014, introduces new requirements for the classification and measurement of financial instruments, a new expected-loss impairment model that will require more timely recognition of expected credit losses and a substantially reformed model for hedge accounting, with enhanced disclosures about risk management activity. IFRS 9 also removes the volatility in profit or loss that was caused by changes in an entity’s own credit risk for liabilities elected to be measured at fair value. IFRS 9 is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The Company has not yet begun the process of evaluating the impact of this standard on its consolidated financial statements.

IFRS 15 - Revenue from Contracts with Customers (“IFRS 15”)

In May 2014, “the International Accounting Standards Board (“IASB”) issued IFRS 15, which covers principles for reporting about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. On July 22, 2015, the IASB confirmed a one-year deferral of the effective date of the revenue Standard to January 1, 2018. The Company is in the process of reviewing the standard to determine the impact on the consolidated financial statements.

IFRS 16, Leases (“IFRS 16”)

In January 2016 the IASB has issued IFRS 16, its new leases standard that requires lessees to recognize assets and liabilities for most leases on their balance sheets. Lessees applying IFRS 16 will have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged. The

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new standard will be effective from January 1, 2019 with limited early application permitted. The Company has not yet begun the process of evaluating the impact of this standard on its consolidated financial statements.

c. Consolidation

The unaudited interim condensed consolidated financial statements incorporate the assets and liabilities of the Company and its subsidiaries as at June 30, 2016 and December 31, 2015 and the results of these subsidiaries for the three and six months ended June 30, 2016 and 2015. The Company's subsidiaries and its respective holding at June 30, 2016 and 2015 are outlined below:

Subsidiary	June 30, 2016	June 30, 2015
Pizza Pizza GP Inc.	79.6%	80.1%
Pizza Pizza Royalty Limited Partnership	79.6%	80.1%

3. Pizza Pizza and Pizza 73 Rights and Marks

	Pizza Pizza Rights and Marks \$	Pizza 73 Rights and Marks \$	Total \$
December 31, 2014	256,925	70,933	327,858
Accretion of value – January 1, 2015 vend-in	2,457	1,216	3,673
Accretion of value – January 1, 2014 true-up	2,330	38	2,368
Net book value at December 31, 2015	261,712	72,187	333,899
Accretion of value – January 1, 2016 vend-in	748	499	1,247
Accretion of value – January 1, 2015 true-up	243	981	1,224
Net book value at June 30, 2016	262,703	73,667	336,370

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 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 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 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

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closed during the calendar year. In return for adding net additional royalty revenue, PPL receives the right to indirectly acquire additional shares of the Company through an adjustment to the Class B and Class D Exchange Multiplier (see note 5).

As a result of adding new restaurants to the Royalty Pool on January 1, 2016, as described in note 5, the Rights and Marks increased by \$1,247 in 2016 (December 31, 2015 – \$3,673) and increased \$1,224 related to the January 1, 2015 true-up (December 31, 2015 – \$2,368).

4. Borrowings

	June 30, 2016 \$	December 31, 2015 \$
Borrowings	47,000	47,000
Less: deferred financing fees	42	63
Total borrowings	46,958	46,937

The borrowings are a committed, non-revolving, five-year facility maturing on April 24, 2020, 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. 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 previous credit facility was scheduled to mature on December 6, 2016; however, it was renewed early on April 24, 2015. Concurrent with the renewal, the Partnership terminated its then existing swap agreements and entered into two new interest rate swap agreements that fixed the facility interest rate until April 2020 at the Bankers' Acceptance rate of 1.875% plus a credit spread which was initially set at 0.875%. Included in the Bankers' Acceptance rate of 1.875% is 0.6% which relates to blending and extending the two previous swaps agreements.

Interest expense incurred on borrowings for the three and six months ended June 30, 2016 amounted to \$218 and \$432, respectively (June 30, 2015 – \$309 and \$733, respectively). Principal repayments on borrowings of \$47,000 are due on April 24, 2020. The effective interest rate as at June 30, 2016 on the \$47,000 was 2.75% (December 31, 2015 – 2.75%).

The facility is subject to certain financial covenants, all of which have been met as at June 30, 2016 and December 31, 2015. 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 June 30, 2016, PPL indirectly holds an effective 20.4% interest in the Company (December 31, 2015 – 19.9%) by holding all Class B and Class D Units of the Partnership. Subject to the Amended and Restated Exchange Agreement, PPL has the right to exchange one Class B or Class D Unit indirectly for that number of shares equal to the Class B Exchange Multiplier or Class D Exchange Multiplier, respectively, applicable at the date of such exchange, as described under "Licence and Royalty Adjustment of the Royalty Pool Changes in the Restaurants in the Royalty Pool".

Subject to the prior rights of the Company's Class C Limited Partnership units, PPL's Class B and Class D Units are entitled to receive monthly distributions and the Company's Class A Limited Partnership units receive the remaining available, monthly distributable cash.

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Notes to the Unaudited Interim Condensed Consolidated Financial Statements

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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, 2014	6,934,272	1,548,071	8,482,343	86,129
Add: January 1, 2015 vend-in	178,183	88,162	266,345	3,673
Add: January 1, 2014 true-up	175,445	-	175,445	2,330
Less: March 23, 2015 conversion	(2,800,000)	-	(2,800,000)	(29,102)
At December 31, 2015	4,487,900	1,636,233	6,124,133	63,030
Add: January 1, 2016 vend-in	54,001	35,975	89,976	1,247
Add: January 1, 2015 true-up	17,641	71,099	88,740	1,224
At June 30, 2016	4,559,542	1,743,307	6,302,849	65,501

a. 2015 Royalty Pool Adjustment

In January 2016, adjustments to royalty payments and PPL's Class B Exchange Multiplier were made based on the actual performance of the 23 new restaurants added to the Royalty Pool on January 1, 2015. As a result of the adjustments, the new Class B Exchange Multiplier is 1.796297 and Class B Units can be exchanged for 4,505,541 shares, which is an increase of 17,641 shares, effective January 1, 2015.

In January 2016, adjustments to royalty payments and PPL's Class D Exchange Multiplier were made based on the actual performance of the eight Pizza 73 restaurants added to the Royalty Pool on January 1, 2015. As a result of the adjustments, the new Class D Exchange Multiplier is 17.07332 and Class D Units can be exchanged for 1,707,332 shares, which is an increase of 71,099 shares, effective January 1, 2015.

b. 2016 Royalty Pool Adjustment – Class B Exchange Multiplier

On January 1, 2016, six net Pizza Pizza restaurants were added to the Royalty Pool as a result of 24 new restaurants opening and 18 closing from January 1, 2015 to December 31, 2015. The additional system sales from the 24 new restaurants are estimated at \$4,887 annually less sales of \$3,630 from 18 permanently closed Pizza Pizza restaurants resulting in net estimated Pizza Pizza sales of \$1,257 added to the Royalty Pool. The total number of Pizza Pizza restaurants in the Royalty Pool has increased to 636. The yield of the shares was determined to be 5.89% calculated using \$13.85 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, 2016. 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 0.021529; the new Class B Multiplier is 1.817826. 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, 2016, once the actual performance of the new restaurants is determined in early 2017.

c. 2016 Royalty Pool Adjustment – Class D Exchange Multiplier

On January 1, 2016, the Pizza 73 Royalty Pool remained unchanged as a result of two new restaurants opening between September 2, 2014 and September 1, 2015 and two restaurants closing between January 1, 2015 and December 31, 2015. The forecasted additional system sales from the two new restaurants are estimated at \$1,070 annually less \$512 in system sales attributable to the two closed restaurants. The total number of Pizza 73 restaurants in the Royalty Pool remains at 100 for 2016. The yield of and the weighted

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average share price used in the calculation of the Class D multiplier is determined in the same manner as that of the Class B multiplier calculation at 5.89% and \$13.85, respectively. As a result of the contribution of the additional net sales to the Royalty Pool, the Class D Exchange Multiplier increased fractionally by 80% of the total adjustment or 0.35975; the new Class D Multiplier is 17.43307. 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, 2016, once the actual performance of the new restaurants is determined in early 2017.

Pizza Pizza Royalty Corp. Outstanding Shares

In exchange for adding the forecasted Pizza Pizza system sales to the Royalty Pool, PPL has received 54,001 additional equivalent Shares (through the change to the Class B Exchange Multiplier). These represent 80% of the forecasted equivalent Shares entitlement to be received (67,501 equivalent Shares represent 100%), with the final equivalent Shares entitlement to be determined when the new restaurants' 2016 actual sales performance is known with certainty in early 2017.

In exchange for adding the forecasted Pizza 73 system sales to the Royalty Pool, PPL has received 35,975 additional equivalent Shares (through the change to the Class D Exchange Multiplier). These represent 80% of the forecasted equivalent Shares entitlement to be received (44,969 equivalent Shares represent 100%), with the final equivalent Shares entitlement to be determined when the new restaurants' 2016 actual sales performance is known with certainty in early 2017.

After giving effect to PPL's entitlement to additional equivalent Shares at January 1, 2016, PPL owns equivalent Shares representing 20.4% of the Company's fully diluted shares.

6. Share capital

a. Authorized

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preference shares, issuable in series. As at June 30, 2016, 24,618,392 common shares and no preference shares are issued and fully paid. Each common share carries the right to one vote at meetings of shareholders, other than meetings of holders of another class of shares, and to participate equally and rateably in dividends of the Company, if any, and in the remaining property and assets of the Company upon its liquidation, dissolution or wind-up. Each series of preference shares issued shall have rights, privileges, restrictions and conditions as determined by the Board of Directors prior to their issuance. Preference shares may carry voting rights as determined by the Board and are entitled to a preference over the common shares in the remaining property and assets of the Company in the event of its liquidation, dissolution or wind-up.

b. Issued

On March 23, 2015, the Company issued 2,800,000 common shares through a private placement by Pizza Pizza Limited as part of the conversion of 1,564,889 Class B Partnership Units, equivalent to 2,800,000 common shares of the Company when applied against the Class B Exchange Multiplier. The common shares were not issued for cash consideration, but for a greater entitlement to the income of the Partnership. As at June 30, 2016, a total of 24,618,392 common shares, valued at \$242,030, were issued, fully paid and outstanding.

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

The following is a summary of the activity during the period:

	June 30, 2016		December 31, 2015	
	Number of Shares	Amount \$	Number of Shares	Amount \$
Shareholders' capital				
Shares, beginning of period	24,618,392	242,030	21,818,392	212,928
Private offering on March 23, 2015	-	-	2,800,000	29,102
Shares, end of period	24,618,392	242,030	24,618,392	242,030

The Company's objective when managing capital, which remained unchanged, is to:

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

The Company evaluates its capital as all components of equity, other than amounts in accumulated other comprehensive loss relating to the cash flow hedge.

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

c. Earnings per Share

The basic earnings per share is calculated by dividing earnings for the period by the weighted average number of shares outstanding during the period. The denominator in basic earnings per share includes PPL's Class B and Class D Exchangeable Shares, since they are exchangeable into and economically equivalent to the Company's common shares. There were no potentially dilutive instruments outstanding in the three and six months ended June 30, 2016 or in 2015.

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

	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Weighted average number of:				
Common shares	24,618,392	24,618,392	24,618,392	23,365,353
Exchangeable Shares (note 5)	6,302,849	6,124,133	6,302,849	7,377,172
Weighted average number of shares outstanding – basic and diluted	30,921,241	30,742,525	30,921,241	30,742,525
Basic and diluted earnings per share	\$0.21	\$0.17	\$0.42	\$0.38

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For the three and six months ended June 30, 2016 and 2015

(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 for the periods ended:

	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
(in thousands of dollars, except number of restaurants in the Royalty Pool)				
Restaurants in Royalty Pool	736	730	736	730
System sales reported by Pizza Pizza restaurants in the Royalty Pool	110,769	107,138	221,978	212,403
System sales reported by Pizza 73 restaurants in the Royalty Pool	21,484	23,125	43,366	46,713
Total system sales	132,253	130,263	265,344	259,116
Royalty – 6% on Pizza Pizza system sales	6,646	6,428	13,319	12,744
Royalty – 9% on Pizza 73 system sales	1,934	2,081	3,903	4,204
Royalty income	8,580	8,509	17,222	16,948

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, 2016 of \$2,988 (December 31, 2015 - \$3,381) and a payable to PPL as at June 30, 2016 of \$561 (December 31, 2015 - \$590). This 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 were written off during the three and six months ended June 30, 2016 or 2015.

Pizza Pizza Royalty Corp.

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For the three and six months ended June 30, 2016 and 2015

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

9. Statements of Cash Flows information

Changes in non-cash working capital are as follows:

	Six months ended June 30, 2016	Six months ended June 30, 2015
	\$	\$
Receivable from Pizza Pizza Limited	393	285
Trade and other receivables	6	10
Income tax receivable	(33)	-
Trade and other payables	(77)	(1)
Payable to Pizza Pizza Limited	(29)	(484)
Income taxes payable	(778)	(61)
Total change in non-cash working capital	(518)	(251)

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 and cash equivalents, receivable from PPL, trade and other receivables, trade and other payables and dividends payable to shareholders 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:

Category	June 30, 2016		December 31, 2015		
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$	
Cash and cash equivalents	L&R	1,614	1,614	2,236	2,236
Short term investments	L&R	2,750	2,750	2,750	2,750
Receivable from Pizza Pizza Limited	L&R	2,988	2,988	3,381	3,381
Trade and other receivables	L&R	114	114	120	120
Trade and other payables	OFL	410	410	487	487
Dividends payable to shareholders	OFL	1,755	1,755	1,716	1,716
Payable to Pizza Pizza Limited	OFL	561	561	590	590
Borrowings	OFL	46,958	47,000	46,937	47,000
Derivative financial instruments	DFH	1,817	1,817	1,688	1,688

Pizza Pizza Royalty Corp.

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Financial instruments category guide:

- L&R - Loans and receivables
- DFH - Derivatives used for hedging
- OFL - Other financial liabilities

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;
- Level 3: Inputs for the financial asset or financial liability that is not based on observable market data.

As at June 30, 2016, inputs used to fair value the derivative financial instruments were Level 2 and based on observable inputs available for similar assets and liabilities in the active markets as provided by sources independent from the Company.

The fair value of the borrowings was determined using the discounted cash flow method, a generally accepted valuation technique. The discounted factor is based on market rates for debt with similar terms and remaining maturities and based on the Company's credit risk. The Company has no plans to prepay these instruments prior to maturity. The valuation is determined using Level 2 inputs which are observable inputs or inputs which 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 cash equivalents and derivative financial instruments with banks and financial institutions. The Company places its cash and cash equivalents 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 distributions 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.

The dividends payable to Company shareholders and trade and other payables are expected to be paid within 30 days of the consolidated statements of financial position date.

Pizza Pizza Royalty Corp.

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Interest rate risk

The Company's interest rate risk arises from borrowings. Borrowings issued at variable rates expose the Company to cash flow interest rate risk, which is offset by entering into interest rate swaps that fix the interest payable.

The designated hedging relationship was effective as at June 30, 2016.

The interest rate swaps eliminate the Company's cash flow interest rate 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 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 \$333 as at June 30, 2016 (December 31, 2015 - \$373) based on movements in the fair value of the interest rate swaps.