

PIZZA PIZZA ROYALTY INCOME FUND MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a discussion of the annual results of operations and financial condition of the Pizza Pizza Royalty Income Fund (the "Fund") for the year ended December 31, 2006. The consolidated financial statements of the Fund are prepared in accordance with Canadian generally accepted accounting principles. The financial results for the 52 week period ended December 31, 2006 are not directly comparable to the 26 weeks of the Fund's initial, formation year ended December 31, 2005. The Management's Discussion and Analysis has been prepared as of February 28, 2007. A copy of this report and additional information about the Fund is available at www.sedar.com or www.pizzapizzaroyaltyincomefund.com.

OVERVIEW AND BUSINESS OF THE FUND

The Fund completed its initial public offering in July 2005, and used the proceeds of the offering to indirectly acquire the trademarks owned by Pizza Pizza Limited ("Pizza Pizza") used in connection with the operation of all Pizza Pizza restaurants (the "PPL Rights"). The Fund also acquired, indirectly from a bank, a loan outstanding to Pizza Pizza in the principal amount of \$30 million (the "PPL Loan").

In July 2005, the Fund licensed the PPL Rights to Pizza Pizza, for which Pizza Pizza pays a 6% Royalty on the system sales of those Pizza Pizza restaurants included in the specific royalty pool (the "Royalty Pool"). There were 501 restaurants in the Royalty Pool for the year 2006.

From inception, the Fund adopted the guideline of Canadian Institute of Chartered Accountants referred to as "AcG-15", Consolidation of Variable Interest Entities. As a result, the Fund's subsidiary, the Pizza Pizza Royalty Limited Partnership (the "Partnership") which owns the PPL Rights, is accounted for on the equity basis. Pizza Pizza, the operating company that pays the 6% royalty to the Partnership, consolidates the Partnership based on this same guideline.

Annually, on January 1 (the "Adjustment Date"), an adjustment is made to the Royalty Pool 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. The change in the amount of the Royalty due to the Partnership as a result of changes in the system sales of the Royalty Pool will affect Pizza Pizza's retained interest through an adjustment to the rate at which the Class B Partnership units may ultimately be exchanged for units of the Fund. On the Adjustment Date, the adjustment to the Class B Exchange Multiplier (as defined in the License and Royalty Agreement) involves first calculating the "Determined Amount", which is defined as 92.5% of the royalty revenue added to the Royalty Pool, divided by the prevailing yield of the Fund units. The Determined Amount is multiplied by 80%, then divided by the current market price of the units, and then further divided by the number of Class B Partnership units outstanding. This fraction is added to the Class B Exchange Multiplier from the preceding year, which was "one" on the closing of the initial public offering. On the following Adjustment Date, a second adjustment to the Class B Exchange Multiplier will be made in the same manner once the system sales for new restaurants are known with certainty. The adjustment for new restaurants rolled into the Royalty Pool is designed to be accretive for current unitholders.

If, during a year, a restaurant is closed, the sales of the restaurant from the closing date would no longer be included in the calculation of the royalty payable to the Partnership by Pizza Pizza. To compensate for this, in certain circumstances, the License and Royalty Agreement and the Limited Partnership Agreement provide that an amount (the Make-Whole Payment) reflecting the reduction in the royalty resulting from the restaurant closure will be paid by Pizza Pizza to the Partnership for the balance of the year in which the restaurant was closed, commencing from the closing date. The Make-Whole Payment will be the sales of the closed restaurant for the first 52-week period in which it was included in the Royalty Pool multiplied by the royalty rate, payable as to one-twelfth per month.

Pizza Pizza has an effective 20.3% interest in the Fund as of December 31, 2006 and has agreed to maintain at least a 20% interest until June 30, 2007. Distributions on the 20% interest will be subordinated during the hold period pursuant to the terms of the Subordination Agreement.

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Pizza Pizza's 20.3% interest in the earnings of the Partnership arises from its ownership of Class B and Class C Partnership units. Subject to the Subordination Agreement, each Class B Unit can be exchanged indirectly for that number of units equal to the Class B Exchange Multiplier (as defined in the License and Royalty Agreement) applicable at the date of the exchange. Class C Units can be exchanged by requiring the Fund to purchase those Class C Units in consideration of the assumption by the Fund of an amount of the indebtedness under the PPL Loan equal to \$10.00 per Class C Unit transferred.

A key attribute of the Fund's structure is the fact that it is a "top-line" fund. Royalty income of the Fund is based on top-line system sales of the Royalty Pool restaurants and is not determined by the profitability of either Pizza Pizza or the Pizza Pizza restaurants in the Royalty Pool. Given this structure, the success of the Fund depends primarily on the ability of Pizza Pizza to maintain and increase system sales of the Royalty Pool.

Increases in system sales are derived from both the development of new Pizza Pizza restaurants and same store sales growth ("SSSG"). The key metric for yield growth of the Fund is SSSG which is dependent on maintaining operational excellence within each Pizza Pizza restaurant, general market conditions, pricing, and marketing programs undertaken by Pizza Pizza. One of Pizza Pizza's competitive strengths in increasing SSSG is that over 95% of the restaurants in the chain are new or renovated within the past six years. Increased seating is available in these renovated restaurants, offering Franchisees the ability to concentrate on increasing "walk-in" sales, thereby potentially increasing same store sales. Management is focused on completing the renovation program over the next twelve months.

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FINANCIAL HIGHLIGHTS

The following tables set out selected financial information and other data of the Fund and should be read in conjunction with the attached audited consolidated financial statements of the Fund.

Equity earned by the Fund through its interest in the Partnership and interest income from the Pizza Pizza Limited Loan have been derived as shown in the table below:

Pizza Pizza Royalty Limited Partnership
Analysis of Distributable Cash

	January 1, 2006 to December 31, 2006	Period from July 6, 2005 to December 31, 2005
(in thousands of dollars, except number of restaurants, days in the period, and per unit amounts)		
Restaurants in Royalty Pool	501	500
Days in the Period	365	179
Same store sales growth	4.5%	6%
System sales reported by restaurants in the Royalty Pool	\$ 353,138	\$ 173,233
Royalty - 6% of system sales	\$ 21,188	\$ 10,394
Partnership expenses ⁽¹⁾	(1,710)	(781)
Partnership earnings for the period before under-noted Pizza Pizza's interest ⁽²⁾	19,478 (5,388)	9,613 (2,627)
Equity income related to Pizza Pizza royalties earned by Fund ⁽³⁾	14,090	6,985
Interest income ⁽⁴⁾	1,800	880
Net earnings ⁽³⁾	\$ 15,890	\$ 7,865
Earnings per Fund unit⁽³⁾	\$ 0.885	\$ 0.438
Distributions declared	\$ 15,108	\$ 7,041
Distributions per Fund unit	\$ 0.842	\$ 0.392
Payout ratio	95%	89%
	December 31, 2006	December 31, 2005
Total assets	\$ 171,796	\$ 170,363
Total liabilities	\$ 1,275	\$ 1,223

- (1) The Fund, indirectly through the Partnership, incurs administrative expenses and interest expense on the \$20 million outstanding bank loan. Interest expense on the bank loan for the current year was \$1.1 million.
- (2) Represents the interest of Pizza Pizza in the earnings of the Partnership from Class B and Class C Partnership units. The Class B units are exchangeable into Fund units based on value of the Class B Exchange Multiplier at the time of exchange as defined in the Licence and Royalty Agreement.
- (3) For December 31, 2005, earnings shown exclude structuring costs of \$9.5 million related to indirectly receiving proceeds from the Fund's initial public offering. The structuring costs were paid from the initial public offering proceeds and were expensed during 2005 since they were determined to be a cost without a future benefit.
- (4) The Fund indirectly earns interest income on the \$30 million loan to Pizza Pizza, with interest income accruing at 6% per annum, payable monthly.

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	Q4 2006	Q3 2006	Q2 2006	Q1 2006
(in thousands of dollars, except number of restaurants, days in the Period and per unit amounts)				
Restaurants in Royalty Pool	501	501	501	501
Days in the Period	92	92	91	90
Same store sales growth	5%	4%	4%	5%
System sales reported by restaurants in Royalty Pool	\$ 93,866	\$ 90,773	\$ 86,015	\$ 82,484
Royalty - 6% of system sales	\$ 5,632	\$ 5,446	\$ 5,161	\$ 4,949
Partnership expenses ⁽¹⁾	(426)	(390)	(455)	(439)
Partnership earnings for the period before under-noted	5,206	5,056	4,706	4,510
Pizza Pizza's interest ⁽²⁾	(1,414)	(1,385)	(1,314)	(1,275)
Equity income related to Pizza Pizza royalties earned by Fund ⁽³⁾	3,792	3,671	3,392	3,235
Interest income ⁽⁴⁾	450	450	450	450
Net earnings ⁽³⁾	\$ 4,242	\$ 4,121	\$ 3,842	\$ 3,685
Earnings per Fund unit⁽³⁾	\$ 0.237	\$ 0.229	\$ 0.214	\$ 0.205
Distributions declared	\$ 3,822	\$ 3,824	\$ 3,744	\$ 3,718
Distributions per Fund unit	\$ 0.213	\$ 0.213	\$ 0.209	\$ 0.207
Payout ratio	90%	93%	97%	101%

	Q4 2005	For the Period from July 6, to September 30, 2005
(in thousands of dollars, except number of restaurants, days in the Period and per unit amounts)		
Restaurants in Royalty Pool	500	500
Days in the Period	92	87
Same store sales growth	6%	6%
System sales reported by restaurants in the Royalty Pool	\$ 89,651	\$ 83,582
Royalty - 6% of system sales	\$ 5,379	\$ 5,015
Partnership expenses ⁽¹⁾	(418)	(363)
Partnership earnings for the period before under-noted ⁽³⁾	4,961	4,652
Pizza Pizza's interest ⁽²⁾	(1,352)	(1,275)
Equity income related to Pizza Pizza royalties earned by Fund ⁽³⁾	3,608	3,377
Interest income ⁽⁴⁾	450	430
Net earnings ⁽³⁾	\$ 4,058	\$ 3,807
Earnings per Fund unit⁽³⁾	\$ 0.226	\$ 0.212
Distributions declared	\$ 3,643	\$ 3,398
Distributions per Fund unit	\$ 0.203	\$ 0.189
Payout ratio	90%	89%

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Restaurants Added to the Royalty Pool

On January 1, 2006, one net, new restaurant was added to the Royalty Pool as a result of five new restaurants opening from March 14, 2005 to September 1, 2005 and four closing from March 14, 2005 to December 31, 2005. The additional system sales from the net, one new restaurant are estimated at \$1.4 million annually. The total number of restaurants in the Royalty Pool has increased to 501. The yield of the Fund units was determined to be 8.06% calculated using \$9.97 as a weighted average unit price based on the market price of the units traded on the TSX during the period of 20 consecutive days ending on the fifth trading day before January 1, 2006. 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 0.01674; the new Class B Multiplier is 1.01674. This adjustment will increase Pizza Pizza's entitlement to distributions of cash and allocations of income on the Class B Units from the Partnership. The second adjustment to the Class B Exchange Multiplier will be made effective as of January 1, 2006 once the actual performance of the new restaurant is determined in early 2007.

In lieu of converting the new entitlements into Fund units, Pizza Pizza has increased the Class B Exchange Multiplier. As a result, Pizza Pizza Limited now holds Class B Partnership units exchangeable into 4,563,120 Fund units which equates to 20.3% of the fully diluted units of the Fund, or an additional 0.3% Partnership ownership. The Fund reported an increase in its investment in the Partnership and a contributed surplus of \$599 to reflect the increase in value as a result of the vend-in of the new royalty stream.

On January 1, 2007, 30 net, new restaurants were added to the Royalty Pool as a result of 35 new restaurants opening between September 2, 2005 and December 31, 2006 and five closing during the year. For 2007, the pool will consist of 531 Pizza Pizza restaurants. See "Subsequent Event" for additional information surrounding the transaction.

Change to the Seasoning Period for New Restaurants Added to the Royalty Pool

During the current quarter, the Board of Trustees unanimously approved amendments to the License and Royalty Agreement with Pizza Pizza and amendments to related provisions of the Partnership Agreement of the Partnership that will result in a removal of the requirement that a restaurant be open for at least 120 consecutive days before it may be included in the Royalty Pool for the subsequent year. The removal of the 120-day seasoning period involves only a change in the timing of the inclusion of restaurants in the Royalty Pool and not the substance of the relationship between Pizza Pizza and the Fund. Previously, restaurants opened after September 1 of a given year would not be included in the Royalty Pool until January 1 of the second following year.

Pizza Pizza requested elimination of the 120-day seasoning period in order that the restaurant opening period would coincide with the fiscal year of the Fund. This change will benefit management's reporting of restaurant openings and closures in relation to the number of restaurants in the Royalty Pool. Existing safeguards, including the holdback arrangement described herein (see "Overview and Business of the Fund"), will continue to ensure that additional entitlements awarded to Pizza Pizza upon adding new restaurants to the Royalty Pool are reconciled based on actual system sales one year after being added to the Royalty Pool.

This change will affect the determination of the Royalty Pool as at January 1, 2007 and subsequent years and the corresponding entitlements of Pizza Pizza to indirectly acquire additional Fund units. For January 1, 2007, new restaurants opened between September 2, 2005 and December 31, 2006 will be added to the Royalty Pool. For each January 1 thereafter, restaurants opened between January 1 and December 31 of the prior year will be included in the calculation.

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Ownership of the Fund on a fully diluted basis is as follows:

	Issued & Outstanding units, and Exchangeable Equivalent units
<u>Units outstanding on December 31, 2006</u>	
Fund units held by public unitholders is 79.7% of total	17,952,000
Class B exchangeable units held by Pizza Pizza is 20.3% of total	4,563,120
Fully diluted units	<u>22,515,120</u>
 <u>Units outstanding on February 28, 2007</u>	
Fund units held by public unitholders is 77% of total	17,952,000
Class B exchangeable units held by Pizza Pizza is 23% of total	5,408,915
Fully diluted units	<u>23,360,915</u>

ROYALTY POOL SALES

System sales from the 501 restaurants in the Royalty Pool for the three months and year-ended December 31, 2006 were \$93.9 million and \$353.1 million respectively.

For the prior year comparative quarter and period from July 6, 2005 to December 31, 2005, system sales for the 500 restaurants in the Royalty Pool were \$89.7 million and \$173.2 million respectively.

Pizza Pizza's system sales for the quarter ended March 31 have generally been the softest quarter and the December 31 quarter system sales have been the strongest due to seasonality of the business.

Same Store Sales Growth, the key driver of yield growth for unitholders of the Fund, increased by 5% for the quarter and increased 4.5% for the year-ended December 31, 2006 compared with the same period in 2005.

Industry statistics released by the Ontario Ministry of Tourism reported U.S. border crossings to Ontario decreased by 9.2% in the first eleven months of 2006 over the same period in 2005. A decrease in Ontario tourism, both U.S. and international, negatively impacted sales at a select number of our restaurants. Particularly affected during the summer months were sales at some of our outdoor-themed, nontraditional locations.

An independent audited statement of Royalty Pool system sales is performed and reported each year, the results of which follow:

System sales reported by Pizza Pizza Royalty Pool Restaurants
From January 1, 2006 to December 31, 2006

(in thousands of dollars)	
Total Pizza Pizza retail sales	\$ 360,534
New locations	(7,667)
Closed locations	271
2006 Royalty Pool System Sales	<u>\$ 353,138</u>

System sales (as defined in the License and Royalty Agreement between Pizza Pizza and the Partnership) reported by Pizza Pizza Restaurants include the gross sales of Company-owned and franchised restaurants, excluding (i) sales and goods and service tax or similar amounts levied by any

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governmental or administrative authority, and (ii) initial or renewal franchise fees charged by Pizza Pizza upon the establishment or renewal of franchises and franchise agreements.

Total Pizza Pizza retail sales for the 52-week period ended December 31, 2006, include sales reported by franchisees and sales from Company-owned locations during the reporting period. Sales from new locations include sales from franchise or Company-owned locations that were opened after September 2, 2005 and on or prior to December 31, 2006. Sales from closed locations include sales from restaurants that were closed after on or after January 1, 2006 and on or prior to December 31, 2006, and for which Pizza Pizza is required to pay a "Make-whole" payment.

In reference to the License and Royalty Agreement, the Royalty Pool (which at December 31, 2006 included 501 Pizza Pizza restaurants) will be adjusted annually, on January 1 of each calendar year (the "Adjustment Date"), commencing January 1, 2006, to include Pizza Pizza restaurants that were open on or prior to December 31 of the previous year and not permanently closed prior to the Adjustment Date and which were not previously included in the Royalty Pool. At the same time, the Royalty Pool will be adjusted to remove restaurants that were included in the Royalty Pool during the immediately preceding year but which have been permanently closed prior to the Adjustment Date.

Systems sales reported by Pizza Pizza Restaurants to the Company are self-assessed by each restaurant on a weekly reporting basis and are submitted without audit or other form of independent assurance.

OPERATING RESULTS

The operations of the Fund and Partnership are separately analyzed in the following information to provide a better appreciation of the financial condition and results of the Fund and should be read in conjunction with the Fund's consolidated financial statements and accompanying notes.

Partnership Operations

The Partnership, which is 79.7% owned by the Fund at December 31, 2006, earns a 6% royalty income on the Royalty Pool system sales of the Pizza Pizza restaurants. The Fund earns equity income from its investment in the Partnership. The Fund's equity income from the Partnership is calculated as the royalty income less the Partnership's operating expenses less earnings attributable to Pizza Pizza.

The following provides information on the Partnership performance for the quarter and year ended December 31, 2006.

Revenues

Royalty Income earned by the Partnership was \$5.6 million for the quarter and \$21.2 million for the year ended December 31, 2006. The 6% royalty is earned on the Royalty Pool of 501 Pizza Pizza restaurants reporting \$93.9 million in system sales for the quarter and \$353.1 million for the year ended December 31, 2006.

Royalty Income earned by the Partnership for the comparative quarter and prior year period from July 6, 2005 to December 31, 2005 was \$5.4 million and \$10.4 million respectively, and the 500 Pizza Pizza restaurants in the Royalty Pool reported system sales of \$89.7 million and \$173.2 million, respectively.

Expenses

The Partnership's operating expenses include administrative expenses, amortization of deferred financing fees and interest paid on a \$20 million bank term loan. [See "Liquidity and Capital Resources-Term Loan".]

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Operating expenses for the quarter were \$426,000, including \$267,000 of interest expense on its \$20 million credit facility, \$146,000 of administrative expenses, and \$13,000 in amortization of deferred financing fees. Operating expenses for the year were \$1.7 million including \$1.1 million of interest expense on its \$20 million credit facility, \$587,000 of administration expenses, and \$50,000 in amortization of deferred financing fees.

Operating expenses for the quarter ended December 31, 2005 were \$418,000 including \$311,000 of interest expense on its \$20 million credit facility, \$94,000 of administrative expenses, and \$13,000 in amortization of deferred financing fees. Operating expenses for the period from July 6, 2005 to December 31, 2005 were \$781,000 including \$544,000 of interest expense on its \$20 million credit facility, \$212,000 of administration expenses, and \$25,000 in amortization of deferred financing fees.

A one time expense for structuring costs incurred in 2005 of \$11.9 million, which related to the Fund's initial public offering ("IPO"), is not reflected in the financial highlights table of this Management's Discussion and Analysis. The structuring costs were deducted from the proceeds of the IPO before the Partnership purchased the PPL Rights. Therefore, there was no effect on the Partnership's cash from operations for the prior period. The structuring costs consist of underwriters' fees, legal and auditing costs, plus other expenses related to the Fund's IPO for which the Partnership was responsible; these costs were determined to be without future benefit and were expensed. The Partnership disclosed this transaction in the October 2, 2005, Pizza Pizza Limited year end consolidated financial statements.

Net earnings

The Partnership had net earnings for the quarter of \$5.2 million and \$19.5 million for the year ended December 31, 2006, which were allocated to the Fund and Pizza Pizza based on their respective interest in the Partnership.

The Partnership had net earnings before structuring costs for the comparative quarter of \$5 million and \$9.6 million for the period from July 6, 2005 to December 31, 2005, which were allocated to the Fund and Pizza Pizza based on their respective interest in the Partnership.

Selected Partnership balance sheet items

	(in thousands of dollars)	
	December 31, 2006	December 31, 2005
Current Assets	\$ 2,909	\$ 2,069
Total Assets	234,333	232,744
Current Liabilities	1,443	1,108
Loan Payable	20,000	20,000
Total Liabilities & Equity	234,333	232,744

Fund Operations

Equity income is earned by the Fund through limited partnership holdings of LP units representing its effective 79.7% interest in the Partnership. Interest income is earned on a \$30 million loan to Pizza Pizza Limited (the "PPL Loan") and is calculated at 6% per annum, payable monthly.

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Equity income in the Partnership

Equity Income earned for the quarter and the year ended December 31, 2006 by the Fund from its investment in the Partnership was \$3.8 million and \$14.1 million, respectively.

Equity Income earned for the comparative quarter and the period from July 6, 2005 to December 31, 2005 by the Fund from its investment in the Partnership was \$3.6 million and \$7 million, respectively.

Interest Income

The interest income for the quarter and year ended December 31, 2006 was \$450,000 and \$1.8 million, respectively, earned on the \$30 million loan from the Fund to Pizza Pizza, with interest paid monthly at 6% per annum.

Interest income for the prior year comparative quarter and period from July 6, 2005 to December 31, 2005 was \$450,000 and \$880,000 respectively.

Net earnings

Net earnings for the quarter were \$4.2 million or \$0.236 per unit; net earnings for the year ended December 31, 2006 were \$15.9 million, or \$0.885 per unit.

Net earnings before structuring costs for the comparative quarter and the prior period July 6, 2005 to December 31, 2005 were \$4.1 million or \$0.226 per unit and \$7.9 million or \$0.438 per unit, respectively. The structuring costs reduced the Fund's net earnings for the period from July 6, 2005 to December 31, 2005 to a net loss of \$1.6 million or \$0.09 per unit.

Distributions

The Fund declared distributions of \$3.8 million or \$0.213 per unit for the quarter, equating to a 90% payout ratio; the Fund declared distributions of \$15.1 million for the year ended December 31, 2006 or \$0.8416 per unit for a payout ratio equal to 95%. As of December 31, 2006, working capital of the Partnership was \$1.5 million, accumulated as a reserve to cover seasonality and any unusual administrative expenditures.

The Fund declared distributions of \$3.6 million or \$0.203 per unit for the comparative quarter, equating to a 90% payout ratio; the Fund declared distributions of \$7 million for the period of July 6, 2005 to December 31, 2005 or \$0.392 per unit for a payout ratio equal to 89%. As of December 31, 2005, working capital of the Partnership was \$961,000, accumulated as a cash reserve to cover seasonality and any unusual administrative expenditures.

For those unitholders holding units outside a tax deferred plan, the 2006 distributions will be treated as 49.46% taxable income and 50.54% as a tax-deferred return of capital.

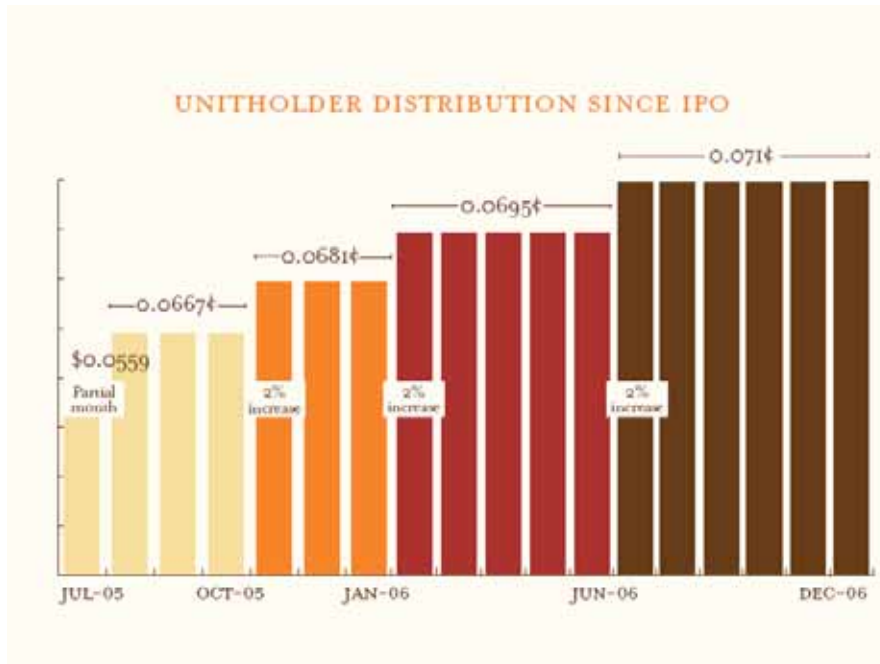
During the year, the Fund increased its monthly distribution on two occasions, in February (by 2%) and July (by 2%). Distributions declared for 2006 are as follows:

<u>Period</u>	<u>Payment Date</u>	<u>Amount/unit</u>
January 1-31, 2006	February 15, 2006	6.81¢
February 1-28, 2006	March 15, 2006	6.95¢
March 1-31, 2006	April 13, 2006	6.95¢
April 1-30, 2006	May 15, 2006	6.95¢
May 1-31, 2006	June 15, 2006	6.95¢
June 1-30, 2006	July 14, 2006	6.95¢

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July 1-31, 2006	August 15, 2006	7.10¢
August 1-31, 2006	September 15, 2006	7.10¢
September 1-30, 2006	October 13, 2006	7.10¢
October 1-31, 2006	November 15, 2006	7.10¢
November 1-30, 2006	December 15, 2006	7.10¢
December 1-31, 2006	January 15, 2007	<u>7.10¢</u>
Total		84.16¢

Distributions for the year were funded entirely by cash flow from operations. No debt was incurred at any point during the year to fund distributions.



LIQUIDITY & CAPITAL RESOURCES

The Fund's distribution policy is to distribute all available cash in order to maximize returns to Unitholders, after allowing for reasonable reserves held at the Partnership level. In light of seasonal variations that are inherent to the restaurant industry, the Fund's policy is to make equal distribution payments to Unitholders on a monthly basis in order to smooth out these fluctuations. Any further increase in distributions will be implemented in such a manner so that the continuity of uniform monthly distributions is maintained. It is expected that future distributions will continue to be funded entirely by cash flow from operations.

As of December 31, 2006, working capital of the Partnership was \$1.5 million (2005 - \$961,000), accumulated as a reserve to cover seasonality and any unusual administrative expenditures.

Term Loan and Operating Loan

The Partnership has a \$20 million non-revolving, three-year term loan facility, which was arranged during the initial public offering to partially finance the purchase of the PPL Rights from Pizza Pizza. As security for repayment of the facility, Pizza Pizza Limited granted to the Partnership a continuing, general security interest, subject to certain exceptions, in all present and acquired property of Pizza Pizza which may not be assigned without the prior consent of Pizza Pizza. The facility bears interest at Prime plus 0.50% to 0.75% or the Bankers Acceptance rate plus 1.75% to 2.00%, depending on the level of funded debt to EBITDA, defined as annualized earnings before interest, taxes, depreciation and amortization. During 2005, the interest rate on the facility was fixed with an interest rate swap through January 6, 2010 at

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3.55% plus 1.75% to 2% credit spread dependent upon the Fund's annualized EBITDA (calculated as set forth in the credit facility documentation). In the initial four quarters of operations, the interest rate swap was fixed at 3.55% plus 2%. During that year, the Fund achieved an annualized EBITDA in excess of \$20 million resulting in the credit spread being reduced to 1.75% and became effective April 1, 2006, reducing the effective fixed interest rate on the loan to 5.3%.

The Bank has also granted an extendable 364 day, committed, revolving operating facility for up to \$1 million; no funds have been drawn on this facility.

CONTROLS AND PROCEDURES

Internal controls and procedures are designed to provide reasonable assurance that relevant information is gathered and reported to senior management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") of Pizza Pizza GP Inc., managing general partner of the Partnership and administrator of the Fund, on a timely basis so that the appropriate decisions can be made regarding public disclosure.

During the fourth quarter ending December 31, 2006, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

As of December 31, 2006, an evaluation of the design of the Fund's internal controls and procedures, as defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* issued by the Canadian Securities Administrators, was carried out under the supervision of and with the participation of management, including the CEO and the CFO. Based on the evaluation, the CEO and the CFO concluded that the design of these controls and procedures are effective.

CRITICAL ACCOUNTING ISSUES

The Fund's only critical accounting estimate is the valuation of its investment in the Partnership. As the Partnership's only significant assets are intangible assets consisting of the PPL Rights, the valuation of the Fund's investment is based primarily upon the valuation of intangible assets in the Partnership. The PPL Rights are not amortized as they have an indefinite life. The Pizza Pizza GP, Inc., as the general partner of the Partnership and administrator of the Fund, reviews the carrying values of the intangible assets in the Partnership and the Fund's investment at least annually, taking into consideration any events or circumstances which may have impaired the carrying values of these items. If permanent declines in the carrying amounts are determined, these items are written down to their estimated net recoverable amount. Pizza Pizza GP, Inc. believes that there have been no declines in either the carrying value of the intangible assets in the Partnership or in the carrying value of the Fund's investment in the Partnership as of December 31, 2006.

SUBSEQUENT EVENTS

Subsequent to the year ended December 31, 2006, the Fund increased its monthly distribution by 2.8% effective with the January distribution, from \$0.071 to \$0.073 per unit. The declared distributions are as follows:

<u>Period</u>	<u>Payment Date</u>	<u>Amount/unit</u>
January 1-31, 2007	February 15, 2007	7.30¢
February 1-28, 2007	March 15, 2007	7.30¢

In January 2007, adjustments to royalty payments and Pizza Pizza's Class B Exchange Multiplier were made based on the actual performance of the net, one restaurant added to the Royalty Pool on January 1, 2006. As a result of the adjustments, the new Class B Exchange Multiplier is 1.02345 and Pizza Pizza's exchangeable units increase by 30,113 to 4,593,233 Fund units, effective January 1, 2006, which equates to 20.37% of the fully diluted units of the Fund.

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Management's Discussion & Analysis

On January 1, 2007, 30 net, new restaurants were added to the Royalty Pool as a result of 35 new restaurants opening from September 2, 2005 to December 31, 2006 and five closings during 2006. The additional system sales from the 30 net, new restaurants are estimated at \$15.4 million annually. The total number of restaurants in the Royalty Pool has increased to 531. The yield of the Fund units was determined to be 10.56% calculated using \$7.94 as a weighted average unit price. Weighted average unit price is calculated based on the market price of the units traded on the TSX during the period of 20 consecutive days ending on the fifth trading day before January 1, 2007. 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 0.18174; the new Class B Multiplier is 1.20519. 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, 2007, once the actual performance of the new restaurants is determined in early 2008. As a result of the Adjusted Class B Exchange Multiplier, Pizza Pizza will hold Class B Partnership units exchangeable into 5,408,915 Fund units which equates to 23% of the fully diluted units of the Fund as of January 1, 2007. Pizza Pizza has agreed to maintain at least a 20% ownership in the Fund until June 30, 2007, with distributions on the 20% interest to be subordinated pursuant to the terms of a subordinated agreement.

OUTLOOK

Pizza Pizza management has advised the Trustees that in 2007 it expects to grow the number of restaurants in the Ontario network by 3% and to continue researching potential expansion opportunities outside its, predominantly, Ontario market, with any potential expansion coming either through organic growth or acquisitions. Pizza Pizza expects to continue franchising its remaining Company restaurants.

Same Store Sales Growth, the key driver of yield growth for Unitholders, was 5% for the quarter ended December 31, 2006 and 4.5% year-to-date, compared with the same period in 2005. With the continued increase in same store sales, the Fund increased its January 2007 distribution by 2.8%, from \$0.071 to \$0.073 per unit.

With over 95% of traditional restaurants expanded or relocated within the last six years, Pizza Pizza offers expanded seating capacity, thereby targeting additional day-parts and allowing for additional product offerings to enable restaurants to continue increasing same store sales. Management is focused on completing the renovation program over the next twelve months.

RISKS & UNCERTAINTIES

The Fund continues to recognize certain risks and uncertainties associated with the ordinary course of business, including those associated with the business and operations of Pizza Pizza, upon which the Fund relies solely for its income.

The Restaurant Industry

The performance of the Fund is directly dependent upon the royalty and interest payments received from Pizza Pizza. The amount of royalty received from Pizza Pizza is dependent on various external factors that may affect the limited service sector of the restaurant industry. The restaurant industry, generally, is intensely competitive with respect to price, service, location and food quality. Competitors include national and regional chains, as well as independently owned restaurants. If Pizza Pizza and Pizza Pizza franchisees are unable to successfully compete in the limited service sector, System Sales may be adversely affected, the amount of royalty reduced and the ability of Pizza Pizza to pay the royalty or interest on the PPL Loan may be impaired. Changes in demographic trends, traffic patterns, and the type, number, and location of competing restaurants also affect the restaurant industry. In addition, factors such as government regulations, smoking bylaws, inflation, publicity from any food borne illnesses, increased food, labour and benefits costs, and the availability of experienced management and

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hourly employees may adversely affect the restaurant industry in general and therefore, potentially, Pizza Pizza System Sales. Pizza Pizza's success also depends on numerous factors affecting discretionary spending, including economic conditions, disposable consumer income and consumer confidence. Adverse changes in these factors could reduce guest traffic or impose practical limits on pricing, either of which could reduce sales and operating income, which could adversely affect revenue, the royalty and the ability of Pizza Pizza to pay the royalty to the Fund or interest on the PPL Loan.

Proposed Tax Changes

On October 31, 2006, the Minister of Finance (Canada) announced proposals to significantly change the income tax treatment of most publicly traded trusts and partnerships (other than certain real estate investment trusts) and the distributions and allocations, as the case may be, from these entities to their investors. The proposals were released in draft legislative form on December 21, 2006.

Under the proposals, certain income earned by these entities will be taxed in a manner similar to income earned by a corporation and distributions or allocations of such income made by these entities to investors will be taxed in a manner similar to dividends from taxable Canadian corporations. The deemed dividend will be eligible for the new enhanced dividend tax credit if paid or allocated to a resident of Canada. These proposals will be effective commencing in the 2011 taxation year for trusts and partnerships that were publicly traded prior to November 1, 2006, such as the Fund. However, the deferral until 2011 may be rescinded where the affected entity does not comply with the Department of Finance's "normal growth" guidelines.

For illustrative purposes, the consequence for an individual Unitholder, holding units outside a tax-deferred plan who received a \$1 distribution would be as follows, assuming that 25% of the distribution was a non-taxable return of capital:

	2006 Tax Measures	Proposed 2011 Tax Measures
Distributable amount before tax	\$1.00	\$1.00
Tax paid by the Fund ⁽¹⁾	\$0.00	\$0.24
Distribution after the Fund's tax	\$1.00	\$0.76
Tax paid by the unitholder	\$0.35 ⁽²⁾	\$0.11 ⁽³⁾
Net amount ⁽⁴⁾	\$0.65	\$0.65

Notes:

- (1) 31.5% on the taxable portion (75% of the \$1.00 distribution)
- (2) Assuming a 46.41% combined tax rate currently in effect in Ontario on 75% of the distribution treated as income
- (3) Assuming a 22.38% tax rate on the deemed dividend income, and assuming that Ontario adopts the reduction in the tax rate on dividends proposed by the Federal government

The Fund is currently considering these proposals and the guidelines and the possible impact they will have on the Fund and its investors. These measures do not have a force of law and could be modified or not adopted. These proposals are not expected to have an immediate impact on the Fund's tax treatment or distribution policy or the tax treatment of distributions to investors. Until the final legislation implementing the proposed changes is introduced, the exact impact of the changes to the Fund is unknown.

The foregoing presentation is based on the Fund's understanding of the proposals announced to date by the federal government, which are subject to change prior to the implementation of final legislation and related rules and interpretations by the Department of Finance. The tax consequences of these proposals to a Unitholder that is tax-exempt, holds units in a tax-deferred plan or is a non-resident of Canada would differ from the presentation set forth above. Unitholders are encouraged to consult their own tax advisors concerning the application of these proposals to their investment in units, with reference to their particular circumstances.

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Litigation

In the first quarter of 2006, Pizza Pizza Royalty Income Fund received an update from Pizza Pizza Limited ("PPL") regarding a potential claim disclosed in the Fund's 2005 initial public offering prospectus and PPL's subsequent financial statement filings.

The claim, which does not name the Fund or its subsidiaries, was formally served on PPL and certain of its associates by Lawrence Austin, a former consultant to PPL. In the claim, Mr. Austin asserts a right to \$45 million in damages and other amounts, including entitlements to a portion of the proceeds of the Fund's IPO that were directly or indirectly received by PPL and its associates.

PPL has advised the Fund that it believes the demand to be without merit and it will vigorously defend the claim. The Fund notes that Michael Overs, the Chairman and CEO of PPL, has agreed in an indemnity agreement to indemnify PPL and the Fund against any liabilities they may incur in this matter.

Other

For a more detailed list of risks and uncertainties please refer to the Fund's Annual Information Form which is available at www.sedar.com.

FORWARD LOOKING STATEMENTS

Certain statements in this report may constitute "forward-looking" statements which involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward looking statements. When used in this report, such statements include such words as "may", "will", "expect", "believe", "plan", and other similar terminology. These statements reflect management's current expectations regarding future events and operating performance and speak only as of the date of this report. These forward-looking statements involve a number of risks and uncertainties. The following are some factors that could cause actual results to differ materially from those expressed in or underlying such forward-looking statements: competition; changes in demographic trends; changing consumer preferences and discretionary spending patterns; changes in national and local business and economic conditions; legislation and governmental regulation; accounting policies and practices; and the results of operations and financial condition of Pizza Pizza. The foregoing list of factors is not exhaustive.

ADDITIONAL INFORMATION

Additional information about the Fund including the Fund's most recent Annual Information Form is available on SEDAR at www.sedar.com.

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UNITHOLDER INFORMATION

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(1) Denotes Audit Committee member

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Directors and Officers of the Pizza Pizza GP, Inc., the General Partner of
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Arnold Cader
Curt Feltner⁽¹⁾
Richard McCoy
Michael Overs⁽¹⁾
Terence Reid
Ronald Rogers
Daniel Vukovich⁽¹⁾
Elizabeth Wright
(1) Denotes members of Pizza Pizza Limited management team.