

Pizza Pizza Royalty Income Fund

**Consolidated Financial Statements
December 31, 2008 and 2007**

RSM Richter LLP
Chartered Accountants

200 King St. W., Suite 1100, P.O. Box 48
Toronto, ON M5H 3T4
Tel: (416) 932-8000 Fax: (416) 932-6200
www.rsmrichter.com

Auditors' Report

To the Trustees of
Pizza Pizza Royalty Income Fund

We have audited the consolidated balance sheets of Pizza Pizza Royalty Income Fund (the "Fund") as at December 31, 2008 and 2007 and the consolidated statements of earnings, deficit, comprehensive income, accumulated other comprehensive loss and cash flows for the years ended December 31, 2008 and 2007. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years ended December 31, 2008 and 2007 in accordance with Canadian generally accepted accounting principles.

RSM Richter LLP

Chartered Accountants
Licensed Public Accountants

Toronto, Ontario
March 16, 2009

Pizza Pizza Royalty Income Fund

CONSOLIDATED BALANCE SHEETS

December 31, 2008 and 2007

(Expressed in Thousands of Dollars)

	2008	2007
Assets		
Current assets:		
Receivable from Pizza Pizza Limited	\$ 150	\$ 150
Receivable from Pizza Pizza Royalty Limited Partnership	1,541	1,509
Total current assets	1,691	1,659
Loan receivable from Pizza Pizza Limited (note 5)	30,000	30,000
Investment in Pizza Pizza Royalty Limited Partnership (note 6)	188,635	180,984
	\$ 220,326	\$ 212,643
Liabilities and Unitholders' Equity		
Current liabilities:		
Distribution payable to Fund unitholders	1,691	1,658
Future income tax liability (note 7)	5,973	8,208
Unitholders' Equity:		
Fund units (note 8(b))	212,928	212,928
Contributed surplus (note 4(d))	14,103	5,401
	227,031	218,329
Accumulated other comprehensive loss	(3,166)	(362)
Deficit	(11,203)	(15,190)
	(14,369)	(15,552)
Total unitholders' equity	212,662	202,777
	\$ 220,326	\$ 212,643

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 Years Ended December 31, 2008 and 2007

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

	2008	2007
System Sales included in the Royalty Pool (note 4a))	\$ 470,623	\$ 409,499
Equity income in the Partnership before issuance costs (note 4(a))	20,079	16,819
Less share of Partnership issuance costs	-	(169)
Equity income in the Partnership (note 4(a))	20,079	16,650
Interest income	1,800	1,849
Earnings before income taxes	21,879	18,499
Provision (recovery) for future income taxes (note 7)	(2,235)	8,208
Net earnings	\$ 24,114	\$ 10,291
Weighted average Fund units (note 8(c))	21,818,392	19,568,409
Basic earnings per Fund unit	\$ 1.11	\$ 0.53
Weighted average diluted Fund units (note 8(c))	27,807,841	24,845,817
Diluted earnings per Fund unit (note 8(c))	\$ 1.07	\$ 0.53

CONSOLIDATED STATEMENTS OF DEFICIT

For the Years Ended December 31, 2008 and 2007

(Expressed in Thousands of Dollars Except Per Unit Amounts)

	2008	2007
Balance, beginning of year	\$ (15,190)	\$ (7,873)
Net earnings	24,114	10,291
Distributions declared (2008 – \$0.9225/unit; 2007 – \$0.8880/unit)	(20,127)	(17,608)
Balance, end of year	\$ (11,203)	\$ (15,190)

See accompanying notes to consolidated financial statements

Pizza Pizza Royalty Income Fund
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2008 and 2007
(Expressed in Thousands of Dollars)

	2008	2007
Net earnings	\$ 24,114	\$ 10,291
Other comprehensive loss		
Share of other comprehensive loss of the Partnership (notes 5 and 10)	(2,804)	(660)
Comprehensive income	\$ 21,310	\$ 9,631

CONSOLIDATED STATEMENTS OF ACCUMULATED OTHER COMPREHENSIVE LOSS
For the Years Ended December 31, 2008 and 2007
(Expressed in Thousands of Dollars)

	2008	2007
Balance, beginning of year	\$ (362)	\$ -
Accounting policy change	-	298
Other comprehensive loss (notes 5 and 10)	(2,804)	(660)
Balance, end of year, being the Fund's share of the fair value of a cash flow hedge	\$ (3,166)	\$ (362)

See accompanying notes to consolidated financial statements

Pizza Pizza Royalty Income Fund

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2008 and 2007

(Expressed in Thousands of Dollars)

	2008	2007
Cash provided by (used in):		
Operating activities		
Net earnings	\$ 24,114	\$ 10,291
Equity income, an item not affecting cash (note 4(a))	(20,079)	(16,650)
Distributions received	18,295	15,425
Future income tax expense (recovery)	(2,235)	8,208
	<u>20,095</u>	<u>17,274</u>
Financing activities		
Issue of Fund units (note 8(b))	-	30,803
Cost of issuance of Fund units (note 8(b))	-	(595)
Purchase of units of Pizza Pizza Royalty Limited Partnership (note 6)	-	(30,257)
Distributions paid to unitholders	(20,095)	(17,225)
	<u>(20,095)</u>	<u>(17,274)</u>
Increase (decrease) in cash	-	-
Cash, beginning of year	-	-
Cash, end of year	<u>\$ -</u>	<u>\$ -</u>

See supplementary cash flows information (note 12)

See accompanying notes to consolidated financial statements

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

(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") is an open-ended, limited purpose trust established under the laws of the Province of Ontario on May 26, 2005. The Fund was established to indirectly, through the Pizza Pizza Royalty Limited Partnership (the "Partnership"), acquire the trademarks, trade names, operating procedures and systems and other intellectual property and proprietary rights and all goodwill associated therewith owned by Pizza Pizza Limited ("Pizza Pizza") used in connection with the operation of all restaurants operated by Pizza Pizza, its subsidiaries and its franchisees (collectively, the "Pizza Pizza Rights").

Concurrent with the acquisition of the Pizza Pizza Rights on July 6, 2005, the Partnership granted Pizza Pizza an exclusive and unlimited licence to use the Pizza Pizza Rights 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 licence and royalty agreement.

On July 20, 2007, the Fund, 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").

Concurrent with the acquisition of the Pizza 73 Rights, the Partnership granted Pizza Pizza an exclusive and unlimited licence to use the Pizza 73 Rights for an initial term of 99 years for which Pizza Pizza 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 of December 31, 2008, there were 559 Pizza Pizza restaurants (2007 – 531) and 50 Pizza 73 restaurants (2007 – 41) in the Royalty Pool; the Royalty Pool is adjusted annually, on January 1. The Partnership declares monthly distributions, indirectly, to the Fund; the Fund pays monthly distributions directly to public unitholders. The Fund was also established to acquire indirectly through Pizza Pizza Holdings Trust (the "Trust") from a bank, certain debt of Pizza Pizza in the principal amount of \$30 million (the "PPL Loan").

Pizza Pizza, 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. Pizza Pizza derives revenues from franchisees through the sale of franchise restaurants, goods and supplies and royalties. The company also derives revenues from company owned and jointly-controlled restaurants through the sale of food products to retail customers.

The Fund's revenues are earned from certain operations of Pizza Pizza and, accordingly, the revenues of the Fund and its ability to pay distributions to unitholders is dependent on the ability of Pizza Pizza to generate and pay royalties to the Fund.

2. Significant Accounting Policies

a. Basis of Presentation

These consolidated financial statements include the accounts of the Fund; its wholly-owned subsidiary, the Trust and its 80% owned subsidiary, Pizza Pizza GP, Inc. (the "PPGP"). The Fund's investment in the Partnership is held through the Trust's Partnership holdings of Class A LP units.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. All significant intercompany transactions have been eliminated.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

2. Significant Accounting Policies, continued

The Fund has adopted the Canadian Institute of Chartered Accountants' Accounting Guideline, Consolidation of Variable Interest Entities ("AcG-15") and is effective from the initial public offering closing date. A variable interest entity ("VIE") is any type of legal structure in which consolidation is required due to contractual or other financial arrangements, as opposed to traditional voting rights, if certain conditions exist. The Partnership is considered a VIE and Pizza Pizza is the primary beneficiary of the Partnership. Accordingly, Pizza Pizza is required to consolidate the Partnership.

Since Pizza Pizza effectively controls the Partnership as defined by AcG-15, the Fund accounts for its effective 78.5% interest in the Partnership on an equity basis whereby the Fund's investment in the Partnership is increased by its 78.5% share of earnings or losses of the Partnership and reduced for distributions received. The investment in the Partnership is also adjusted to record the fair value of Fund units issued by the Fund in exchange for Partnership units held by Pizza Pizza.

b. Revenue Recognition

Equity income is earned by the Fund through the Trust's Partnership holdings of Class A LP units, representing an effective 78.5% interest in the Partnership.

Interest income is recognized and accrued when earned.

c. Investment in the Partnership

Investment in the Partnership is accounted for on an equity basis, adjusted by equity income earned and monthly Partnership distributions received.

d. Distributions to Fund Unitholders

The amount of cash distributed to Fund unitholders is determined with reference to distributable cash, which is calculated within the Partnership as net earnings adjusted for amortization, other non-cash charges and repayment of principal and interest on the term loan. Distributions to Fund unitholders are recorded when declared, made monthly and are subject to the Fund and Partnership retaining such reasonable working capital reserves as may be considered appropriate by the Trustees of the Fund.

e. Earnings per Fund Unit

The earnings per Fund unit are based on the weighted average number of Fund units outstanding during the year.

f. Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires the Fund's management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues or expenses during the reporting year. Significant areas requiring the use of management estimates relate to the determination of impairment in the value of assets, and provisions for contingencies. Actual results could differ from those estimates.

g. Income Taxes

Income tax obligations related to distributions by the Fund are the obligations of the unitholders. As described in note 7, the Fund will not be liable for current income taxes until January 1, 2011.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

2. Significant Accounting Policies, continued

The Fund follows the liability method with respect to accounting for income taxes. Future tax assets and liabilities are determined based on differences between the carrying amount and the tax basis of assets and liabilities (temporary differences). Future income tax assets and liabilities are measured using the substantively enacted tax rates that will be in effect when these differences are expected to reverse. Future income tax assets, if any, are recognized only to the extent that, in the opinion of management, it is more likely than not that the assets will be realized.

h. Financial Instruments, Hedges and Comprehensive Income

All financial assets and financial liabilities are required to be carried at fair value in the Consolidated Balance Sheet, except loans and receivables, securities designated as held-to-maturity and non-trading financial liabilities, which are measured at amortized cost using the effective interest method.

i. *Financial Instruments*

All financial assets and financial liabilities are required to be carried at fair value in the Consolidated Balance Sheet, except loans and receivables, securities designated as held-to-maturity and non-trading financial liabilities.

The Fund has decided to elect its accounts receivable from Pizza Pizza Limited, receivable from Pizza Pizza Royalty Limited Partnership and loan receivable from Pizza Pizza Limited as a loan and receivable. The Fund has decided to elect its distributions payable to Fund unitholders as a financial liability not held for trading.

ii. *Hedges*

The Partnership's interest rate swap qualifies as a cash flow hedge and thus is being accounted for under this Handbook Section; thus the Fund has reflected the change in the investment in Partnership for the equity share of comprehensive income.

iii. *Comprehensive Income*

A Statement of Comprehensive Income displays current period net earnings and other comprehensive income.

Accumulated Other Comprehensive Loss is a separate component of unitholders' equity. The Consolidated Statement of Accumulated Other Comprehensive Loss reflects changes in accumulated other comprehensive loss, comprised of changes in unrealized gains and losses on available-for-sale assets as well as changes in the fair value of derivatives designated as cash flow hedges, to the extent they are effective.

3. Changes in Accounting Policies

a. General Standards on Financial Statement Presentation

Commencing January 1, 2008, the Fund has adopted the new recommendations of the Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 1400, General Standards on Financial Statement Presentation. Under these new recommendations, the Fund is required to assess and disclose its ability to continue as a going concern. The Fund's adoption of this standard did not have a material impact on disclosure in the Fund's financial statements.

b. Capital Disclosures

Commencing January 1, 2008, the Fund has adopted the new recommendations of the CICA Handbook Section 1535, Capital Disclosures. Under these new recommendations, the Fund is required to disclose

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

3. Changes in Accounting Policies, continued

its objectives, policies and processes for managing capital and whether the entity has complied with any capital requirements, and if it has not complied, the consequences of such non-compliance. The required disclosure is in note 8.

c. Financial Instruments - Disclosures

Commencing January 1, 2008, the Fund has adopted the new recommendations of the CICA Handbook Section 3862, Financial Instruments – Disclosures. Under these new recommendations, the Fund is required to increase the disclosure to enable users to evaluate the significance of financial instruments for the Fund's financial position and performance, including disclosure about fair value. In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about liquidity risk and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how net earnings and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable. The required disclosure is in note 11.

d. Financial Instrument - Presentation

Commencing January 1, 2008, the Fund has adopted the new recommendations of the CICA Handbook Section 3863, Financial Instrument – Presentation, which replaces the existing requirements on presentation of financial instruments which have been carried forward unchanged to this new section. The Fund's adoption of this standard did not have a material impact on disclosure in the Fund's financial statements.

4. Partnership Operations

- a. Equity income earned by the Fund through its interest in the Partnership has been derived as shown in the table below:

	2008	2007
(in thousands of dollars, except number of restaurants in the Royalty Pool)		
Restaurants in Royalty Pool ⁽ⁱ⁾	609	572
System sales reported by Pizza Pizza restaurants in the Royalty Pool	\$ 389,518	\$ 376,375
System sales reported by Pizza 73 restaurants in the Royalty Pool	81,105	33,124
	470,623	409,499
Royalty - 6% on Pizza Pizza system sales	\$ 23,371	\$ 22,583
Royalty - 9% on Pizza 73 system sales	7,299	2,981
Total royalty on system sales	30,670	25,564
Partnership administrative and interest expenses	(3,280)	(2,545)
Partnership earnings for the period before undernoted Pizza Pizza interest and issuance costs	27,390	23,019
Pizza Pizza's interest	(7,311)	(6,200)
Equity income in the Partnership before issuance costs	20,079	16,819
Less share of Partnership issuance costs	-	(169)
Equity income in the Partnership	\$ 20,079	\$ 16,650

(i) On July 24, 2007, 41 Pizza 73 branded restaurants were added to the Royalty Pool.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

4. Partnership Operations, continued

- b. Annually, on January 1 (the "Adjustment Date"), the Royalty Pool is adjusted to include the forecasted system sales from new Pizza Pizza restaurants opened on or before December 31 of the prior year, less system sales from any Pizza Pizza restaurants that have been permanently closed during the year. Similarly, on the Adjustment Date, the Royalty Pool is adjusted to include the forecasted system sales from new Pizza 73 restaurants opened on or before September 1 of the prior year, less any Pizza 73 restaurants permanently closed during the calendar year.

At each annual Adjustment Date, the number of equivalent, Class B and Class D units held by Pizza Pizza are adjusted in accordance with a formula which determines the Class B and Class D Exchange Multipliers for the upcoming year. The formula and terms are defined in the Pizza Pizza and Pizza 73 Licence and Royalty Agreements. The formula, designed to be accretive to current unitholders, is based on the forecasted sales from new restaurants less sales from any closed restaurants, multiplied by the royalty rate, divided by the yield of the Fund's units, discounted 7.5%. On January 1, Pizza Pizza is entitled to receive 80% of the calculated, equivalent units and distributions thereon, with the balance of equivalent units to be determined when the full year's sales of the new restaurants have been verified by an independent sales audit.

Annually, on January 1 (the "Adjustment Date"), Pizza Pizza restaurants in the Royalty Pool, on which Pizza Pizza pays a Royalty to the Fund, are adjusted to include the forecasted system sales from new Pizza Pizza restaurants opened less system sales from any Pizza Pizza restaurants that have been permanently closed during the year.

- c. In early January 2007, adjustments to royalty payments and Pizza Pizza's Class B Exchange Multiplier were made based on the actual performance of the five restaurants added to the Royalty Pool on January 1, 2006. As a result of the adjustments, the new Class B Exchange Multiplier on January 1, 2006 was 1.02345 and Pizza Pizza's exchangeable units can be exchanged into 4,593,233 Fund units which is an increase of 30,113 Fund units, effective January 1, 2006.

On January 1, 2007, 30 net, new restaurants were added to the Royalty Pool as a result of 35 new Pizza Pizza restaurants opening from September 2, 2005 to December 31, 2006 and five closing from January 1, 2006 to December 31, 2006. The additional system sales from the 30 net, new restaurants were estimated at \$15.4 million annually. The total number of restaurants in the Royalty Pool 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 twenty 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. As a result of the Adjusted Class B Exchange Multiplier, Pizza Pizza Limited held Class B Partnership units exchangeable into 5,408,915 Fund units which equated to 23% of the fully diluted units of the Fund as of January 1, 2007.

In early January 2008, adjustments to royalty payments and Pizza Pizza's Class B Exchange Multiplier were made based on the actual performance of the 35 restaurants added to the Royalty Pool on January 1, 2007. As a result of the adjustments, the new Class B Exchange Multiplier was 1.23525 and Pizza Pizza's exchangeable units can be exchanged into 5,031,342 Fund units, which is an increase of 122,427 Fund units, effective January 1, 2007.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

4. Partnership Operations, continued

- d. On January 1, 2008, 28 net, new Pizza Pizza restaurants were added to the Royalty Pool as a result of 36 new restaurants opening and eight closing from January 1, 2007 to December 31, 2007. The additional system sales from the 28 net, new restaurants are estimated at \$7,987 annually. The total number of Pizza Pizza restaurants in the Royalty Pool has increased to 559. The yield of the Fund units was determined to be 9.0% calculated using \$9.87 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 twenty consecutive days ending on the fifth trading day before January 1, 2008. 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 0.09805; the new Class B Multiplier is 1.33330. This adjustment also increases the entitlement of the holders of the Class B units to distributions of cash and allocations of income from the Partnership. In early January 2009, the second adjustment to the Class B Exchange Multiplier has been adjusted to be effective January 1, 2008, with the actual performance of the new restaurants known (see note 14(a) – Subsequent Events).

On January 1, 2008, nine net, new Pizza 73 restaurants were added to the Royalty Pool as a result of two new restaurants opening between July 24, 2007 and September 1, 2007 and the inclusion of seven restaurants originally held out from the Royalty Pool when the Pizza 73 Rights were acquired. The additional system sales from the nine net, new restaurants are estimated at \$7,450 annually. The total number of Pizza 73 restaurants in the Royalty Pool has increased to 50. The yield of and the weighted average unit 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 9.0% and \$9.87, respectively. 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 5.58750; the new Class D Multiplier is 5.58750. This adjustment also increases the entitlement of the holders of the Class D units to distributions of cash and allocations of income from the Partnership. In early January 2009, the second adjustment to the Class D Exchange Multiplier has been adjusted to be effective January 1, 2008, with the actual performance of the new restaurants known (see note 14 (a) – Subsequent Events).

As a result of the Adjusted Class B and Class D Exchange Multiplier, Pizza Pizza Limited currently holds Class B and Class D Partnership units exchangeable into 5,989,449 Fund units. As at December 31, 2008, the Fund reported an increase in its investment in the Partnership and a contributed surplus of \$8,702 (2007 – \$5,352) to reflect the increase in value as a result of the vend-in of the new royalty stream.

5. Loan Receivable from Pizza Pizza Limited

	2008	2007
Loan receivable with interest payable monthly at 6% per annum, due July 6, 2025.	\$ 30,000	\$ 30,000

The loan arose at the time of the acquisition of the Pizza Pizza Rights from Pizza Pizza in July 2005. The loan is secured by a general security agreement and may not be assigned without the prior consent of Pizza Pizza.

Pizza Pizza, as the holder of 3,000,000 Class C Partnership units, has the right to transfer such units to the Trust in consideration for the assumption by the Trust of, and the concurrent release of Pizza Pizza of its obligations with respect to, an amount of the indebtedness under the PPL Loan equal to \$10.00 for each Class C Partnership unit transferred.

The effective interest rate of the loan receivable is 6% (2007 – 6%).

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

6. Investment in Pizza Pizza Royalty Limited Partnership

	2008	2007
Balance – beginning of year	\$ 180,984	\$ 140,520
Accounting policy change	-	298
Balance – beginning of year, restated	180,984	140,818
Investment in the Partnership, at cost, on July 24, 2007	-	30,257
Investment in the Partnership, at cost, on September 27, 2007	-	4,375
	180,984	175,450
Equity income of the Partnership	20,079	16,650
Accretion of value on change in Royalty Pool	8,702	5,352
Share of other comprehensive loss of the Partnership	(2,804)	(660)
Distributions declared from the Partnership	(18,326)	(15,808)
Balance - end of period	\$ 188,635	\$ 180,984

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”.

On July 24, 2007, the Fund, through the Pizza Pizza Holdings Trust, acquired 3,031,093.6 additional Class A Partnership units valued at \$30,257 to enable the Partnership to acquire the Pizza 73 Rights. To fund the acquisition of Partnership units, the Fund issued 2,600,000 units to the public at \$9.15 per unit for gross proceeds of \$23,790 and 766,392 units at \$9.15 per unit through a private placement with the ultimate shareholder of Pizza Pizza and the vendors of Pizza 73 for gross proceeds of approximately \$7,013 (note 8(b)).

On September 27, 2007, Pizza Pizza converted 414,872 of its Class B Partnership units, which are equivalent to 500,000 Class B Partnership units, to Fund units. As a result of this transaction, the Fund, through the Holdings Trust increased its investment in the Class A units of the Partnership by 500,000 units valued at \$4,375 and the Fund issued an additional 500,000 units at \$9.85 per unit (note 8(b)).

7. 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 30.5% for 2011 and 29% for 2012 and 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.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

7. Future Income Taxes, continued

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.

The reconciliation to the statutory tax rate is as follows:

	2008	2007
Earnings before income taxes	\$ 21,879	\$ 18,499
Combined Canadian federal and provincial rate	33.5%	34%
Computed expected income tax expense	7,329	6,290
Earnings not taxable	(7,329)	(6,290)
Initial recognition of future tax liability (asset) for enacted changes in tax laws and rates	-	8,208
Change in ownership of Partnership	(316)	-
Change in tax rates	293	-
Change in tax basis	(2,212)	-
Future tax expense (recovery)	\$ (2,235)	\$ 8,208

Significant components of future income tax liabilities (assets) are as follows:

	2008	2007
Rights and Marks	\$ 6,026	\$ 8,260
Financing fees	(53)	(52)
	\$ 5,973	\$ 8,208

8. Unitholders' Equity

a. Authorized

The Declaration of the Fund provides that an unlimited number of Fund units may be issued. Each unit is transferable and represents an equal undivided beneficial interest in any distributions of the Fund and in the net assets of the Fund. All units have equal rights and privileges. Each Fund unit entitles the holder thereof to participate equally in the allocations and distribution and to one vote at all meetings of Fund unitholders for each whole Fund unit held. The Fund units issued are not subject to future calls or assessments.

Pursuant to the Declaration of Trust, the holders, other than the Fund or its subsidiaries, of the Class B and Class D Partnership units of the Partnership will be entitled to vote in all votes of Fund unitholders as if they were holders of the number of Fund units they would receive if Class B and Class D Partnership units were exchanged into Fund units as the record date of such votes, and will be treated in all respects as Fund unitholders for the purpose of any such votes.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

8. Unitholders' Equity, continued

Fund units are redeemable at any time at the option of the holder in a price based on market value as defined in the trust agreement, subject to a maximum of \$50 cash redemptions by the Fund in any one month. The limitation may be waived at the discretion of the Trustees of the Fund. Redemption in excess of these amounts, assuming no waiving of the limitation, shall be paid by way of distribution in specie of a pro rata number of securities of the Trust held by the Fund.

b. Issued

On July 6, 2007, the Fund issued 2,600,000 subscription rights at \$9.15 per unit pursuant to a public underwriting for gross proceeds of \$23,790. On July 24, 2007, the 2,600,000 subscription rights were automatically exchanged for Fund units, and thereafter the former holders of the subscription receipts were entitled, as unitholders, to receive distributions from the Fund. On July 24, 2007, the Fund issued 766,392 units at \$9.15 per unit through a private placement with the ultimate shareholder of Pizza Pizza and the vendors of Pizza 73 for gross proceeds of approximately \$7,013. The Fund's share of the expenses of the offering was \$595 and was charged to unitholders' equity.

On September 27, 2007, the Fund issued 500,000 units at \$9.85 per unit, totaling \$4,925, through a private placement by Pizza Pizza Limited as part of the conversion of 414,872 Class B Partnership units, equivalent to 500,000 Class B Partnership units when applied against the multiplier. The Fund units were not issued for cash consideration, but for a greater entitlement to the income of the Partnership. Unitholders' equity was increased by \$4,925, Investment in Pizza Pizza Partnership was increased by \$4,375 (note 6) and contributed surplus was decreased by \$550.

	2008		2007	
	Units	Value	Units	Value
Balance - beginning of year	21,818,392	\$ 212,928	17,952,000	\$ 177,795
Public offering on July 24, 2007	-	-	2,600,000	23,790
Private offering on July 24, 2007	-	-	766,392	7,013
Private offering on September 27, 2007	-	-	500,000	4,925
Expense of offering on July 24, 2007	-	-	-	(595)
	-	-	3,866,392	35,133
Balance - end of year	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.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

8. Unitholders' Equity, continued

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.

c. Earnings per Unit

Basic net earnings per unit is calculated by dividing net earnings by the weighted average number of units outstanding during the year. 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:

	2008	2007
Basic net earnings	\$ 24,114	\$ 10,291
Equity adjustment allocated to Class B and Class D Exchangeable Partnership units	5,511	4,362
Adjusted net earnings	\$ 29,625	\$ 14,653

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

Weighted average number of:		
Fund Units	21,818,392	19,568,409
Pizza Pizza Class B and Class D Partnership units	5,989,449	5,277,408
Weighted average number of units outstanding - diluted	27,807,841	24,845,817
Diluted earnings per Fund unit	\$ 1.07	\$ 0.53

For the year ended December 31, 2007, the Class B Partnership units are anti-dilutive. Accordingly, for the year ended December 31, 2007, the diluted earnings per Fund unit equals the basic earnings per Fund unit.

d. Exchangeable units of the Partnership:

As of December 31, 2008, Pizza Pizza indirectly holds an effective 21.5% interest in the Fund by holding all Class B and Class D Partnership units. Subject to the Subordination Agreement, Pizza Pizza has the right to exchange one Class B or Class D Partnership unit indirectly for that number of units 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". Class B and Class D Partnership units held by Pizza Pizza carry voting rights in the Fund equivalent to the number of units into which they are exchangeable at that time. Subject to the prior rights of the holders of Class C Partnership units and to the Subordination Agreement, the holders of Class B and Class D Partnership units are entitled to receive monthly distributions of remaining available cash of the Partnership, if any, on a pro rata basis with Class A Partnership units held by the Trust.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

8. Unitholders' Equity, continued

The equivalent number of exchangeable Class B and Class D Partnership units outstanding are as follows:

	2008	2007
Exchangeable Class B Partnership units	5,430,699	4,908,915
Exchangeable Class D Partnership units	558,750	-

9. 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.

10. Cash Flow Hedges

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

	Notional Amount	December 31, 2008 Fair Value	December 31, 2007 Fair Value	Contract Expires
Interest rate swap	\$ 20,000	\$ (513)	\$ 299	January 6, 2010
Interest rate swap	10,000	(1,303)	(273)	July 23, 2012
Interest rate swap	17,000	(2,217)	(469)	July 23, 2012

The Fund uses equity accounting for its interest in the Partnership's earnings and has recorded its share, effectively 78.5%, of the comprehensive income (loss) generated by the Partnership.

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 which total to the \$47,000 of the outstanding principal bank loan balance. 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 an amount based upon 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 (loss).

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

11. 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	32,350
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 78.5%. Furthermore, the Fund has reduced its credit risk with Pizza Pizza by obtaining security for its loan.

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.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

11. Financial Instruments, continued

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 \$407.

12. Supplementary Cash Flow Information

	2008	2007
Supplementary information:		
Interest received	\$ 1,800	\$ 1,849

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

13. 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 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.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

14. Subsequent Events

a. 2008 Royalty Pool Adjustment

In early January 2009, adjustments to royalty payments and Pizza Pizza's Class B Exchange Multiplier were made based on the actual performance of the 36 restaurants added to the Royalty Pool on January 1, 2008. As a result of the adjustments, the new Class B Exchange Multiplier is 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 restaurants added to the Royalty Pool on January 1, 2008. As a result of the adjustments, the new Class D Exchange Multiplier is 7.9961 and 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.

b. 2009 Royalty Pool Adjustment – Class B Exchange Multiplier

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. Weighted average unit price is calculated based on the market price of the units traded on the TSX during the period of twenty 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.

c. 2009 Royalty Pool Adjustment – Class D Exchange Multiplier

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 territory adjusted a previously existing restaurant, 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 and the weighted average unit 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 15.3% and \$6.04, respectively. 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.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

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

14. Subsequent Events, continued

d. Pizza Pizza Royalty Income Fund Outstanding Units

As of January 1, 2009, in exchange for adding the 28 net, new Pizza Pizza and Pizza 73 restaurants to the Royalty Pool, Pizza Pizza has received 148,690 additional Class B equivalent units and 660,745 Class D equivalent units. These units represent 80% of the full Class B and Class D entitlements

(185,863 and 825,932 units, respectively), with the balance to be received when the 2009 sales performance is known with certainty.

Including the 809,435 exchangeable units described above, Pizza Pizza owns equivalent, exchangeable units equal to 24.8% of the Fund's fully diluted units.

The chart below shows the Fund units that would be outstanding if all of the Class B and D units were converted to Fund units after accounting for their respective multipliers.

<u>Units outstanding & issuable on January 1, 2009</u>		
Public float		21,818,392
Class B units held by Pizza Pizza	5,430,699	
Pizza Pizza additional Class B units - Holdback as of December 31, 2008	164,542	
Additional Pizza Pizza Class B equivalent units – as of January 1, 2009	<u>148,690</u>	5,743,931
Class D units held by Pizza Pizza	558,750	
Pizza Pizza additional Class D units - Holdback as of December 31, 2008	240,860	
Additional Pizza Pizza Class D equivalent units – as of January 1, 2009	<u>660,745</u>	1,460,355
Number of fully diluted units		<u>29,022,678</u>
<u>Proportion of all units outstanding available for exchange by Pizza Pizza</u>		<u>24.8%</u>