

Pizza Pizza Royalty Income Fund

**Consolidated Financial Statements
December 31, 2009 and December 31, 2008**

RSM Richter LLP
Chartered Accountants

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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, 2009 and 2008 and the consolidated statements of earnings, deficit, comprehensive income, accumulated other comprehensive loss and cash flows for the years ended December 31, 2009 and 2008. 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, 2009 and 2008 and the results of its operations and its cash flows for the years ended December 31, 2009 and 2008 in accordance with Canadian generally accepted accounting principles.

RSM Richter LLP
Chartered Accountants
Licensed Public Accountants

Toronto, Ontario
March 22, 2010

Pizza Pizza Royalty Income Fund

CONSOLIDATED BALANCE SHEETS

December 31, 2009 and 2008

(Expressed in Thousands of Dollars)

	2009	2008
Assets		
Current assets:		
Receivable from Pizza Pizza Limited	\$ 150	\$ 150
Receivable from Pizza Pizza Royalty Limited Partnership	1,541	1,541
Total current assets	1,691	1,691
Loan receivable from Pizza Pizza Limited (note 5)	30,000	30,000
Investment in Pizza Pizza Royalty Limited Partnership (note 6)	195,047	188,635
	\$ 226,738	\$ 220,326
Liabilities and Unitholders' Equity		
Current liabilities:		
Distribution payable to Fund unitholders	1,691	1,691
Future income tax liability (note 7)	5,680	5,973
Unitholders' Equity:		
Fund units (note 8(b))	212,928	212,928
Contributed surplus	19,863	14,103
	232,791	227,031
Accumulated other comprehensive loss (note 10)	(1,906)	(3,166)
Deficit	(11,518)	(11,203)
	(13,424)	(14,369)
Total unitholders' equity	219,367	212,662
	\$ 226,738	\$ 220,326

See accompanying notes to consolidated financial statements

Approved by the Trustees:

(Signed) ROBERT NOBES
Trustee

(Signed) ARNOLD CADER
Trustee

(Signed) TERENCE REID
Trustee

Pizza Pizza Royalty Income Fund

CONSOLIDATED STATEMENTS OF EARNINGS

For the Years Ended December 31, 2009 and 2008

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

	2009	2008
System Sales included in the Royalty Pool (note 4(a))	\$ 451,412	\$ 470,623
Equity income in the Partnership (note 4(a))	17,883	20,079
Interest income	1,800	1,800
Earnings before income taxes	19,683	21,879
Recovery of future income taxes (note 7)	(293)	(2,235)
Net earnings	\$ 19,976	\$ 24,114
Weighted average Fund units (note 8(c))	21,818,392	21,818,392
Basic earnings per Fund unit	\$ 0.92	\$ 1.11
Weighted average diluted Fund units (note 8(c))	29,022,678	27,807,841
Diluted earnings per Fund unit (note 8(c))	\$ 0.91	\$ 1.07

CONSOLIDATED STATEMENTS OF DEFICIT

For the Years Ended December 31, 2009 and 2008

(Expressed in Thousands of Dollars Except Per Unit Amounts)

	2009	2008
Balance, beginning of period	\$ (11,203)	\$ (15,190)
Net earnings	19,976	24,114
Distributions declared (2009 – \$0.9300/unit; 2008 – \$0.9225/unit)	(20,291)	(20,127)
Balance, end of period	\$ (11,518)	\$ (11,203)

See accompanying notes to consolidated financial statements

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

	2009	2008
Net earnings	\$ 19,976	\$ 24,114
Other comprehensive income (loss)		
Share of other comprehensive income (loss) of the Partnership (notes 5 and 10)	1,260	(2,804)
Comprehensive income	\$ 21,236	\$ 21,310

CONSOLIDATED STATEMENTS OF ACCUMULATED OTHER COMPREHENSIVE LOSS
For the Years Ended December 31, 2009 and 2008
(Expressed in Thousands of Dollars)

	2009	2008
Balance, beginning of period	\$ (3,166)	\$ (362)
Other comprehensive income (loss) (notes 5 and 10)	1,260	(2,804)
Balance, end of period, being the Fund's share of the fair value of a cash flow hedge	\$ (1,906)	\$ (3,166)

See accompanying notes to consolidated financial statements

Pizza Pizza Royalty Income Fund

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2009 and 2008

(Expressed in Thousands of Dollars)

	2009	2008
Cash provided by (used in):		
Operating activities		
Net earnings	\$ 19,976	\$ 24,114
Equity income, an item not affecting cash (note 4(a))	(17,883)	(20,079)
Distributions received	18,491	18,295
Future income tax recovery	(293)	(2,235)
	20,291	20,095
Financing activity		
Distributions paid to unitholders	(20,291)	(20,095)
Increase (decrease) in cash	-	-
Cash, beginning of year	-	-
Cash, end of year	\$ -	\$ -

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, 2009 and 2008

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

1. Organization and Nature of Operations

Pizza Pizza Royalty Income Fund (the "Fund") 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 Pizza Pizza Licence and Royalty Agreement.

On July 24, 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, 2009, there were 568 Pizza Pizza restaurants (2008 – 559) and 69 Pizza 73 restaurants (2008 – 50) 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. Pizza Pizza 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.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2009 and 2008

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

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 (GAAP). All significant intercompany transactions have been eliminated.

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 75.2% interest in the Partnership on an equity basis whereby the Fund's investment in the Partnership is increased by its 75.2% 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 75.2% 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.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2009 and 2008

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

2. Significant Accounting Policies, continued

f. Use of Estimates

The preparation of financial statements in conformity with Canadian GAAP 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. 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.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2009 and 2008

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

3. Changes in Accounting Policies

- a) Effective January 1, 2009, the Fund has adopted the amendments to the CICA Handbook Section 3862, Financial Instruments – Disclosures, which has been amended to include additional disclosure requirements about fair value measurements of financial instruments and to enhance liquidity risk disclosure. The Fund has determined that these amendments have no material impact on its financial statements, however, the disclosures required by these changes are in note 11.
- b) Effective January 1, 2009, CICA Handbook Section 3855, Financial Instruments – Recognition and measurement has been amended to change: (1) the categories into which a debt instrument is required or permitted to be classified; (2) the impairment model for held-to-maturity financial assets to the incurred credit loss model in section 3025; and (3) require reversal of the previously recognized impairment losses on available-for-sale financial assets in specified circumstances. The Fund has determined that these amendments have no material effect on its financial statements.

Also, effective July 1, 2009, the Fund has adopted the amendments to CICA Handbook Section 3855, concerning the assessment of embedded derivatives upon reclassification of a financial asset out of the held-for-trading category. The Fund has determined that this amendment has no material effect on its financial statements

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

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:

	2009	2008
(in thousands of dollars, except number of restaurants in the Royalty Pool)		
Restaurants in Royalty Pool	637	609
System sales reported by Pizza Pizza restaurants in the Royalty Pool	\$ 370,115	\$ 389,518
System sales reported by Pizza 73 restaurants in the Royalty Pool	81,297	81,105
	451,412	470,623
Royalty – 6% on Pizza Pizza system sales	\$ 22,207	\$ 23,371
Royalty – 9% on Pizza 73 system sales	7,317	7,299
Total royalty on system sales	29,524	30,670
Partnership administrative and interest expenses	(3,343)	(3,280)
Partnership earnings for the period before undernoted Pizza Pizza Limited interest	26,181	27,390
Pizza Pizza Limited’s interest	(8,298)	(7,311)
Equity income in the Partnership	\$ 17,883	\$ 20,079

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2009 and 2008

(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.

- c. 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 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 was 1.33330 as of January 1, 2008.

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 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 was 5.58750 as of January 1, 2008.

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

In early January 2009, adjustments to royalty payments and Pizza Pizza's Class D Exchange Multiplier were made based on the actual performance of the nine Pizza 73 restaurants added to the Royalty Pool on January 1, 2008. As a result of the adjustments, the new Class D Exchange Multiplier was 7.9961 and Pizza Pizza's exchangeable units can be exchanged into 799,610 Fund units which is an increase of 240,860 Fund units, effective January 1, 2008.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2009 and 2008

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

4. Partnership Operations, continued

- e. 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 increased to 568. The yield of the Fund units was determined to be 15.3% calculated using \$6.04 as a weighted average unit price calculated based on the market price of the units traded on the TSX during the 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.

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

As a result of the Adjusted Class B and Class D Exchange Multiplier, as of December 31, 2009, Pizza Pizza currently holds Class B and Class D Partnership units exchangeable into 7,204,286 (2008 – 5,989,449) Fund units. As at December 31, 2009, the Fund reported an increase in its investment in the Partnership and a contributed surplus of \$5,760 (2008 – \$8,702) to reflect the increase in value as a result of the vend-in of the new royalty stream.

5. Loan Receivable from Pizza Pizza Limited

	2009	2008
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 Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2009 and 2008

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

5. Loan Receivable from Pizza Pizza Limited, continued

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% (2008 – 6%).

6. Investment in Pizza Pizza Royalty Limited Partnership

	2009	2008
Balance – beginning of year	\$ 188,635	\$ 180,984
Equity income of the Partnership	17,883	20,079
Accretion of value on change in Royalty Pool (note 4(e))	5,760	8,702
Share of other comprehensive income (loss) of the Partnership	1,260	(2,804)
Distributions declared from the Partnership	(18,491)	(18,326)
Balance - end of year	\$ 195,047	\$ 188,635

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

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, gave 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 imposed a rate of 31.5%, which was subsequently lowered to 28.25% for 2011, 26.25% for 2012, 25.5% for 2013 and 25% for 2014 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.

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 (recovery) is a non-cash item, which does not affect cash flow.

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

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2009 and 2008

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

7. Future Income Taxes, continued

The reconciliation to the statutory tax rate is as follows:

	2009		2008
Earnings before income taxes	\$ 19,683	\$	21,879
Combined Canadian federal and provincial rate	33%		33.5%
Computed expected income tax expense	6,495		7,329
Earnings not taxable	(6,495)		(7,329)
Change in ownership of Partnership	(253)		(316)
Change in tax rates	(827)		293
Change in tax basis	787		(2,212)
Future tax recovery	\$ (293)	\$	(2,235)

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

	2009		2008
Rights and Marks	\$ 5,729	\$	6,026
Financing fees	(49)		(53)
	\$ 5,680	\$	5,973

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.

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.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2009 and 2008

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

8. Unitholders' Equity, continued

b. Issued

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

The Fund's objective when managing capital is to:

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

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

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

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:

	2009	2008
Basic net earnings	\$ 19,976	\$ 24,114
Equity adjustment allocated to Class B and Class D Exchangeable Partnership units	6,498	5,511
Adjusted net earnings	\$ 26,474	\$ 29,625

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2009 and 2008

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

8. Unitholders' Equity, continued

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

	2009	2008
Weighted average number of:		
Fund units	21,818,392	21,818,392
Pizza Pizza Class B and Class D Partnership units (note 4(e))	7,204,286	5,989,449
Weighted average number of units outstanding – diluted	29,022,678	27,807,841
Diluted earnings per Fund unit	\$ 0.91	\$ 1.07

d. Exchangeable Units of the Partnership

As of December 31, 2009, Pizza Pizza indirectly holds an effective 24.8% 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.

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

	2009	2008
Exchangeable Class B Partnership units	5,743,931	5,430,699
Exchangeable Class D Partnership units	1,460,355	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.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

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10. Cash Flow Hedges

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

	Notional Amount	December 31, 2009 Fair Value	December 31, 2008 Fair Value	Contract Expires
Interest rate swap	\$ 20,000	\$ (157)	\$ (513)	January 6, 2010
Interest rate swap	10,000	(880)	(1,303)	July 23, 2012
Interest rate swap	17,000	(1,497)	(2,217)	July 23, 2012

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

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 the \$47,000 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 Bankers' Acceptance rate.

During the year ended December 31, 2009, the Partnership has also entered into a new Interest Rate Swap Agreement to mitigate the risk associated with the fact that the existing swap on the \$20,000 bank loan expires in January 2010. This swap agreement is a forward swap which will replace the January 6, 2010 swap of \$20,000 and became effective on January 6, 2010, and obligates the Partnership to pay the Swap Counterparty an amount based upon a fixed interest rate of 2.68% 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. As of December 31, 2009, the Partnership is obligated to pay \$393 if the forward swap agreement is terminated prior to the expiry date.

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

Fair value measurements recognized in the balance sheet must be classified in accordance with the fair value hierarchy established by CICA Handbook Section 3862, which reflects the significance of the inputs used in determining the measurements. The inputs can be either observable or unobservable. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon its own market assumptions.

Pizza Pizza Royalty Income Fund

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11. Financial Instruments, continued

The fair value hierarchy consists of the following three levels:

Level 1: Inputs are quoted, unadjusted prices in active markets for identical assets or liabilities;

Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly;

Level 3: Inputs for the asset or liability that are not based on observable market data.

The carrying amounts of the 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 cash flow hedge is recorded in the financial statements at fair value using observable inputs available for similar assets and liabilities in the active markets at the measurement date, as provided by sources independent from the Company (Level 2).

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	36,830
Distribution payable to Fund unitholders	1,691	1,691

Credit Risk

The Fund is exposed to credit risk in the event of non-payment by Pizza Pizza and the Partnership and that Pizza Pizza's operations are within the same segment, commercial food services. The Fund is of the opinion that this credit risk is mitigated since the Partnership receives monthly royalty payments from Pizza Pizza based on sales generated by a large number of Pizza Pizza and Pizza 73 restaurants in diverse geographical regions. These royalty payments are used to fund the first priority distribution from the Partnership to Pizza Pizza, which is used to fund the interest owing to the Fund on its loan receivable from Pizza Pizza. The remaining royalty payments are used to fund the monthly distribution to the unitholders of the Partnership of which the Fund owns 75.2%. Furthermore, the Fund has reduced its credit risk with Pizza Pizza by obtaining security for its loan.

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.

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11. Financial Instruments, continued

Cash Flow Risk

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

Interest Rate Risk

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

If the interest rate was to change by plus/minus 10% of the existing rate, the other comprehensive income (loss) would change by approximately plus/minus \$258 (2008 – \$407).

12. Supplementary Cash Flow Information

	2009	2008
Supplementary information:		
Interest received	\$ 1,800	\$ 1,800

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.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2009 and 2008

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13. Recent Accounting Pronouncements, continued

Comprehensive Revaluation of Assets and Liabilities

CICA Handbook Section 1625, Comprehensive Revaluation of Assets and Liabilities, has been amended as a result of issuing Sections 1582, 1601 and 1602. The amendments are effective for the Fund for its 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.

Equity

CICA Handbook Section 3251, Equity, has been amended as a result of issuing Section 1602 to require disclosure of non-controlling interests in equity. This amendment is effective for the Fund for its 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.

International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed its plan to converge with International Financial Reporting Standards ("IFRS"). The Fund must prepare its interim and annual consolidated financial statements in accordance with IFRS for the periods beginning on or after January 1, 2011. The Fund has formally established an IFRS project team consisting of members of its finance group and is led by the Chief Financial Officer. The team has performed a review of the impact of IFRS on the Fund's accounting policies, information systems, internal controls over financial reporting, and contractual arrangements and covenants. While the effects of IFRS have not fully been determined, the team has identified that the key areas expected to be impacted, include the accounting for the Fund's interest in the Pizza Pizza Royalty Limited Partnership and the method of calculation of future income taxes.

14. Subsequent Events

a. 2009 Royalty Pool Adjustment

In early January 2010, adjustments to royalty payments and Pizza Pizza's Class B Exchange Multiplier were made based on the actual performance of the 18 restaurants added to the Royalty Pool on January 1, 2009. As a result of the adjustments, the new Class B Exchange Multiplier is 1.4240 and Pizza Pizza's exchangeable units can be exchanged into 5,800,072 Fund units which is an increase of 56,141 Fund units, effective January 1, 2009.

In early January 2010, adjustments to royalty payments and Pizza Pizza's Class D Exchange Multiplier were made based on the actual performance of the 19 restaurants added to the Royalty Pool on January 1, 2009. As a result of the adjustments, the new Class D Exchange Multiplier is 15.4543 and Pizza Pizza's exchangeable units can be exchanged into 1,545,432 Fund units which is an increase of 85,077 Fund units, effective January 1, 2009.

b. 2010 Royalty Pool Adjustment – Class B Exchange Multiplier

On January 1, 2010, 22 net, new Pizza Pizza restaurants were added to the Royalty Pool as a result of 31 new restaurants opening and nine closing from January 1, 2009 to December 31, 2009. The additional system sales from the 31 new restaurants are estimated at \$9,985 annually less sales of \$3,075 from nine permanently closed Pizza Pizza restaurants resulting in net, estimated Pizza Pizza sales of \$6,910 added to the Royalty Pool. The total number of Pizza Pizza restaurants in the Royalty Pool has increased to 590. The yield of the Fund units was determined to be 14.2% calculated using \$6.54 as a weighted average unit price. Weighted average unit price is calculated based on the market price of the units

Pizza Pizza Royalty Income Fund

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14. Subsequent Events, continued

traded on the TSX during the period of twenty consecutive days ending on the fifth trading day before January 1, 2010. 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 0.0810; the new Class B Multiplier is 1.5050. 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, 2010, once the actual performance of the new restaurants is determined in early 2011.

c. 2010 Royalty Pool Adjustment – Class D Exchange Multiplier

On January 1, 2010, 12 new Pizza 73 restaurants were added to the Royalty Pool as a result of new restaurants opening between September 2, 2008 and September 1, 2009. The additional system sales from the 12 new restaurants are estimated at \$8,230 annually, which was reduced by \$6,807 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 \$1,423 added to the Royalty Pool. The total number of Pizza 73 restaurants in the Royalty Pool has increased to 81. 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 14.2% and \$6.54, 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 1.0191; the new Class D Multiplier is 16.4734. 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, 2010, once the actual performance of the new restaurants is determined in early 2011.

d. Pizza Pizza Royalty Income Fund Outstanding Units

As of January 1, 2010, in exchange for adding the 34 net, new Pizza Pizza and Pizza 73 restaurants to the Royalty Pool, Pizza Pizza has received 329,910 additional Class B equivalent units and 101,912 Class D equivalent units. These units represent 80% of the full Class B and Class D entitlements (412,387 and 127,390 units, respectively), with the balance to be received when the 2010 sales performance is known with certainty.

Including the 431,822 exchangeable units described above, Pizza Pizza owns equivalent, exchangeable units equal to 26.3% of the Fund's fully diluted units.

Pizza Pizza Royalty Income Fund

Notes to Consolidated Financial Statements

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

14. Subsequent Events, continued

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, 2010</u>		
Public float		21,818,392
Class B units held by Pizza Pizza	5,743,931	
Pizza Pizza additional Class B units - Holdback as of December 31, 2009	56,141	
Additional Pizza Pizza Class B equivalent units – as of January 1, 2010	<u>329,910</u>	6,129,982
Class D units held by Pizza Pizza	1,460,355	
Pizza Pizza additional Class D units - Holdback as of December 31, 2009	85,077	
Additional Pizza Pizza Class D equivalent units – as of January 1, 2010	<u>101,912</u>	1,647,344
Number of fully diluted units		<u>29,595,718</u>
Proportion of all units outstanding available for exchange by Pizza Pizza		26.3%