

It's About...  
Building On  
Our Success

BOSTON PIZZA  
ROYALTIES INCOME FUND  
2006 ANNUAL REPORT



# 2006 Highlights

Founded in Alberta in 1964, Boston Pizza has grown to become Canada's #1 casual dining brand by continually improving our restaurant design, our menu offering and our customer experience. Boston Pizza's success has allowed the concept to grow and prosper in new markets across Canada.

In each and every Boston Pizza location, customers enjoy a friendly atmosphere, professional service and an appealing and diverse menu. It is this combination of key ingredients that has enabled Boston Pizza to serve more customers in more locations than any other full service restaurant in Canada.

There are now more than 265 Boston Pizza locations in Canada, stretching from Victoria to St. John's, with all but three of the restaurants owned and operated by independent franchisees. Whether it's a business lunch, a family dinner or watching the game with friends, Boston Pizza provides our customers the opportunity to enjoy good food in a relaxed, comfortable atmosphere.

Record system-wide gross sales of \$647 million

Industry leading same stores sales growth of 8.4%

Three more increases to monthly distributions totalling 7.8%

Over 35 million guests served nationwide

Record 41 new locations opened, bringing the total at year end to 266

Record 25 restaurants renovated to the latest design standards and one store moved to a superior location

Added approximately 2,000 new restaurant employees bringing the total to over 15,000

Boston Pizza International Inc. named to the Platinum Club for Canada's Best Managed Private Companies

We are  
Canada's #1  
Casual Dining  
Brand

The primary driver for yield growth of the Fund is SSSG. In the last 10 years Boston Pizza restaurants nationwide have averaged over 6.5% SSSG and have not experienced a negative SSSG year.

In 2006 SSSG was **8.4%**



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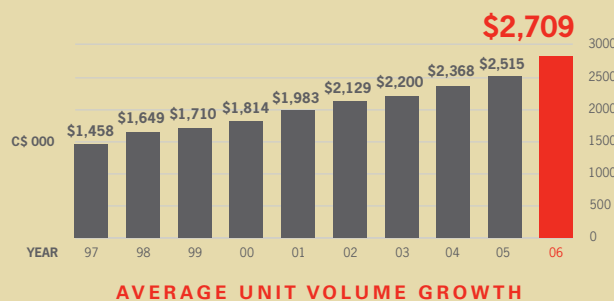


## 2006 was a Record Setting Year for Boston Pizza



AUV growth is the cumulative effect of SSSG. As AUV increases so does the financial strength of Boston Pizza franchisees.

In 2006 AUV was **\$2,709**



Store Openings in 2006 **41**

Store Closures in 2006 **1**

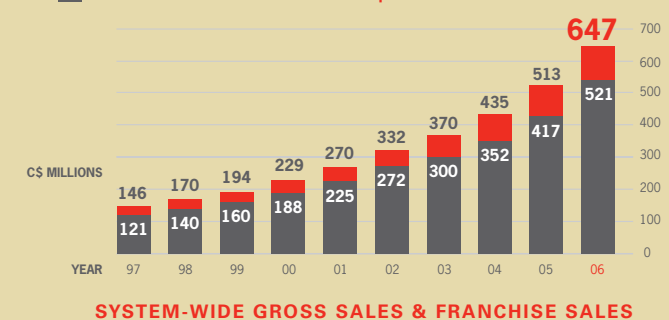


Compound annual growth of system-wide gross sales over the last 10 years

**18.1%**

System-Wide Gross Sales 2006 **\$647 million**

Franchise Sales 2006 **\$521 million**



# Stability

## It's About Stability and Long Term Thinking

"The structure of Boston Pizza aligns the interests of restaurant franchisees, the franchisor and the Fund Unitholders. All stakeholders benefit from increasing sales, expanding the operations and strengthening our position as Canada's #1 casual dining brand."

### JIM TRELIVING

Chairman & Owner  
Boston Pizza International Inc.



### AN EXPERIENCED FRANCHISOR

**"Three Pillars" Strategy** – the backdrop of all decision making that has underpinned the development and success of the Boston Pizza system.

#### A COMMITMENT TO FRANCHISEE PROFITABILITY

The best way to ensure the success of the Fund, the Company, and the Brand is to ensure the success of the franchisees.

#### A COMMITMENT TO BUILDING THE BOSTON PIZZA BRAND

Having a strong and recognizable brand that consumers trust and want to do business with creates value for all stakeholders.

#### A COMMITMENT TO CONTINUALLY IMPROVING THE CUSTOMER EXPERIENCE

40 years of focus and effort towards improving the Boston Pizza experience. A vibrant, colourful design in a casual and comfortable dining atmosphere, combined with a menu that features old favourites and new taste sensations, keeps guests coming back for more.

### A PROVEN RESTAURANT CONCEPT

**Broad Customer Appeal** – Full-service restaurant and sports bar under one roof appeals to both families and young adults

**Multiple Day Parts** – Lunch, Dinner, Late Nights and Take Out & Delivery

**Attractive Locations** – real estate selection is critical and restaurant designs are updated regularly



It Starts with  
a Solid Structure  
Firmly in Place



#### A SUCCESSFUL INCOME FUND

On July 9th, 2002 Boston Pizza International Inc. sold the BP Rights to the Fund. The BP Rights include trademarks used in connection with the operation of Boston Pizza Restaurants in Canada. BPI then entered into an agreement with the Fund which gives BPI the exclusive license to use the BP Rights for a period of 99 years in exchange for a monthly royalty payment of 4% of the franchise sales of Boston Pizza Restaurants in the royalty pool. BPI remains a private company which continues to operate as the franchisor for Boston Pizza restaurants including providing marketing, purchasing, and administrative support to existing franchisees. In addition, BPI seeks out new restaurant locations and potential franchisees in order to expand the chain and enter new markets. Any new stores opened during a calendar year are added to the royalty pool on January 1<sup>st</sup> of the following year. Since 2002, the royalty pool has expanded from 154 to 266 restaurants.

**A Top Line Fund** - The structure of the Fund provides Unitholders with top line royalty from Boston Pizza restaurants. All operating costs for Boston Pizza restaurants and capital investments for new locations are funded by franchisees. The Fund has no capital expenditures and only minor administrative expenses and, therefore, can maintain a high payout ratio to Unitholders.

**Demonstrated Consistency** - The Fund has provided monthly cash distributions to Unitholders in each month since the IPO in July 2002.

**Demonstrated Growth** - Monthly cash distributions have been increased eleven times since the IPO for a total increase of over 33%.



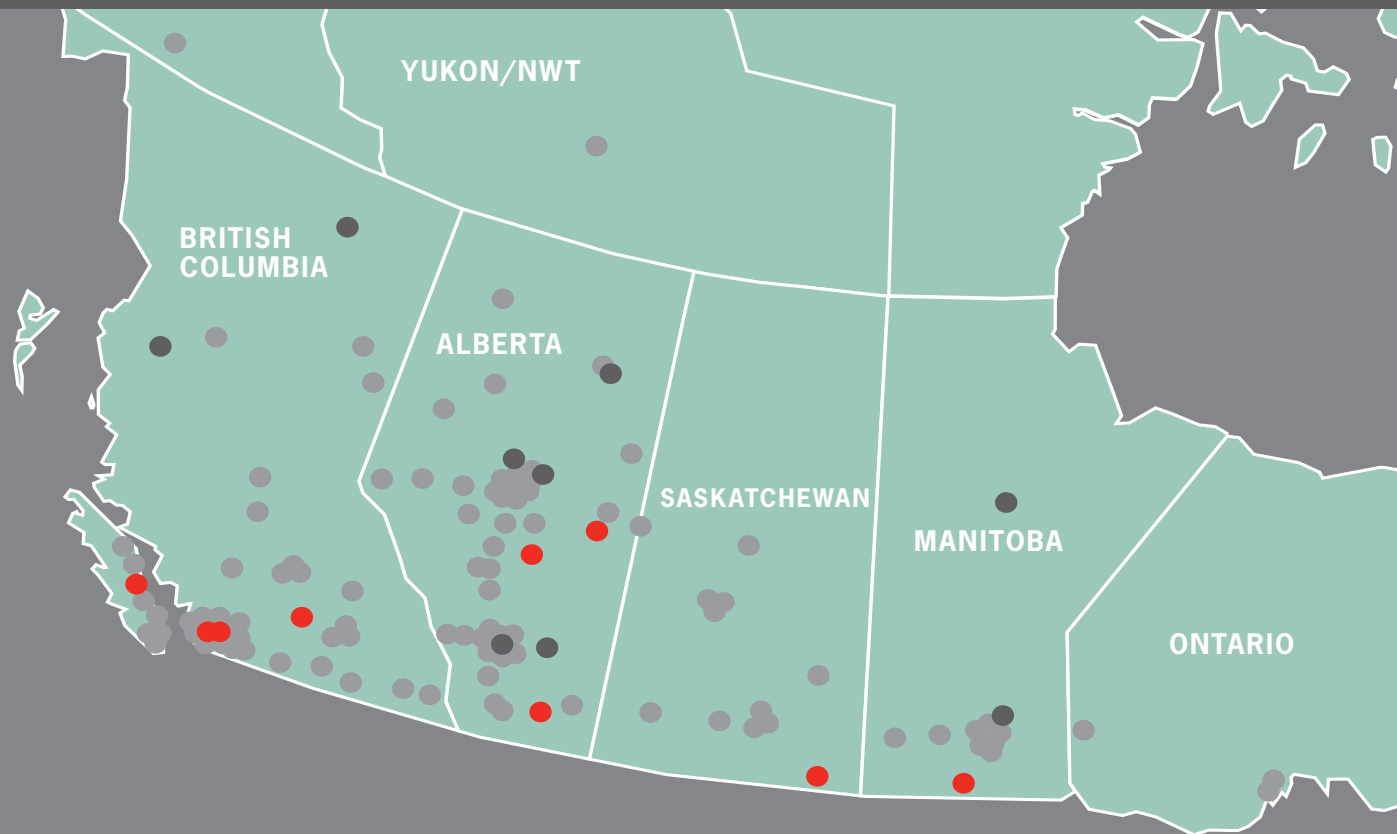
## It's About Having a Proven Model to Sustain Growth

- Currently 266 restaurants open in Canada
- Opened 31 new restaurants in 2005
- Opened 41 new restaurants in 2006

Plan approximately 130 new locations  
over next 5 years

2	Yukon/Northwest Territories
58	British Columbia
84	Alberta
12	Saskatchewan
14	Manitoba
65	Ontario
15	Québec
16	Atlantic

### 266 Restaurants Across Canada



FIRST BOSTON PIZZA  
OPENS IN ALBERTA

JIM TRELIVING OPENS  
THE FIRST BOSTON PIZZA  
FRANCHISE IN VANCOUVER

JIM TRELIVING AND GEORGE  
MELVILLE FORM PARTNERSHIP

JIM AND GEORGE  
PURCHASE BOSTON PIZZA  
INTERNATIONAL INC.

NATIONAL POST NAMES  
BOSTON PIZZA AS ONE OF  
CANADA'S BEST MANAGED  
PRIVATE COMPANIES



1964

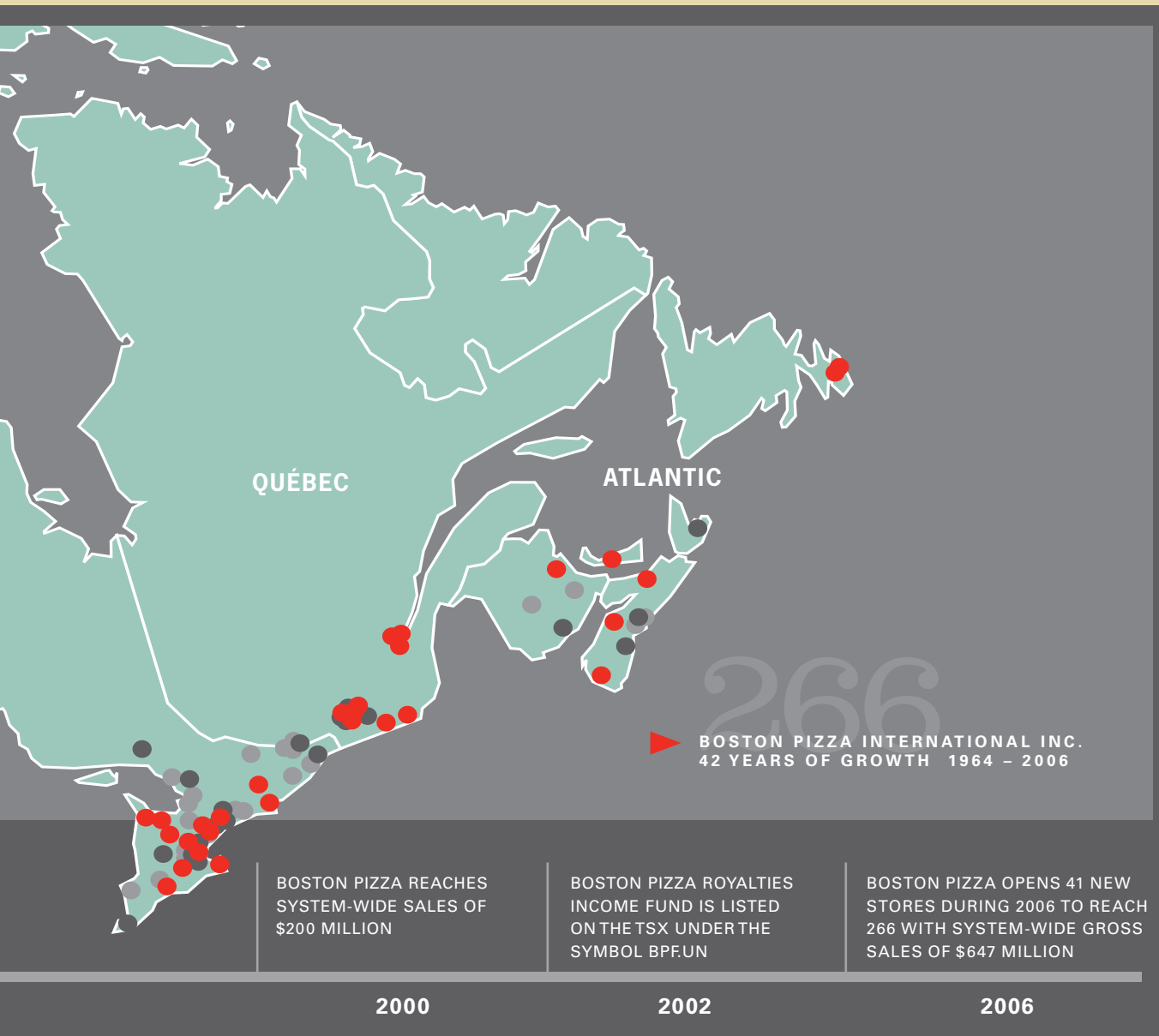
1968

1973

1983

1994

# Growth



## You Have to Know How Well Your Core Business is Doing

"We've opened over 100 new Boston Pizza restaurants since the inception of the Fund in 2002. We couldn't achieve this level of growth without a consistent focus on the factors that make each location successful: selecting great franchisees, choosing solid locations and ensuring sound unit economics."

### GEORGE MELVILLE

Chairman & Owner  
Boston Pizza International Inc.



# Letter from the Chairman Boston Pizza Royalties Income Fund



On behalf of the Trustees, I am pleased to report that the Boston Pizza Royalties Income Fund (the “Fund”) enjoyed a very successful year in 2006. This report covers the fiscal period from January 1, 2006 to December 31, 2006 (the “Year”) and the fourth quarter period from October 1, 2006 to December 31, 2006 (the “Period”). These results are also available on the Fund’s website at [www.bpincomefund.com](http://www.bpincomefund.com) and we encourage you to visit our website to follow new developments on the activities of the Fund.

## HIGHLIGHTS

The Fund continued its outstanding performance in 2006 with record franchise sales, strong same stores sales growth (“SSSG”) and three distribution increases to Unitholders.

Franchise sales reported by the 226 restaurants in the royalty pool were \$484.7 million, an increase of \$91.5 million or 23.3% versus the prior year. On a same store basis, sales increased by 6.9% for the Period and 8.4% for the Year. These SSSG figures are compared to the very strong fourth quarter and full year sales growth reported in 2005 of 10.5% and 8.0% respectively. The positive SSSG reflects Boston Pizza’s continued focus on operational excellence, successful marketing and promotional campaigns, and the impact of continuing positive economic conditions in Western Canada. Also contributing to the SSSG was Boston Pizza’s store renovation program, which requires all restaurants to be updated every seven years to the most recent design standards. During the Year, twenty-five restaurants completed a major renovation, which included ten renovations during the Period. Historically SSSG for renovated locations has been between 10 – 15% in the year following the renovation. SSSG is the key metric for yield growth in the Fund and we are pleased that Boston Pizza restaurants across Canada have achieved positive SSSG each and every period since the Fund’s initial public offering (“IPO”) in July 2002.

Based on the strong SSSG, combined with the 31 new stores added to the royalty pool on January 1, 2006, the Fund’s royalty income increased by 23.3% over 2005 to \$19.4 million. The Fund’s net earnings per unit for the Year increased 8.3% versus 2005, growing from \$1.20 per unit in 2005 to \$1.30 per unit in 2006. During the Period, net earnings per unit were \$0.32.

The Trustees continue to be pleased with the overall performance of the Fund and the underlying Boston Pizza restaurant business. In particular, we were delighted to be able to increase monthly cash distributions to Unitholders three times in 2006. The monthly distributions at the beginning of 2006 were \$0.101 per month (\$1.212 annualized) and by the end of 2006 Unitholders were receiving distributions of \$0.109 per month (\$1.308 annualized) an increase of 7.9%. Beginning with the January 2007 distribution to Unitholders, the monthly amount was increased to \$0.111 per month (\$1.332 annualized). Since the inception of the Fund in 2002, monthly distributions have been increased a total of eleven times, rising 33.2% over that time.

## OUTLOOK

With 266 restaurants stretching from Victoria to St. John’s, all of which are in the royalty pool, Boston Pizza has more locations and serves more customers annually than any other casual dining concept in Canada. BPI management plans to successfully develop the Boston Pizza brand in new markets and strengthen Boston Pizza’s position as Canada’s number one casual dining brand. In 2007, BPI estimates that it will open approximately 40 new locations across Canada while renovating approximately 24 existing restaurants.

The Board of Trustees will periodically review distribution levels and our criteria will continue to be to distribute all available cash in order to maximize returns to Unitholders. Any changes to distributions will be implemented, to the extent possible, in a manner that will allow the Fund to maintain the uniformity of distributions.

The Fund’s Trustees are committed to maintaining good corporate governance practices. As a measure of this commitment, we have documented and adopted rigorous protocols to assist in our governance responsibilities. Additionally, the Governance Committee as well as the Fund’s Audit Committee are each comprised of three trustees, all of whom are independent and unrelated. We regularly review and update these corporate governance guidelines to reflect the most current best-practices.

On October 31, 2006, Canada’s Minister of Finance made an announcement concerning the imposition of a tax on distributions from existing publicly traded income trusts, starting in fiscal 2011. Subsequently, the Department of Finance provided guidelines regarding the amount of new equity that existing trusts could issue over the next four years without being considered “undue expansion”, which would result in an earlier imposition of the proposed tax. Our analysis of these guidelines has concluded that the annual process for adding newly opened Boston Pizza restaurants to the Fund’s royalty pool would be considered “normal growth” under the guidelines through 2010. The government’s proposal, which must still pass legislation to become law, has had a negative affect on our unit price. Additional information on the tax announcement is contained in the Fund’s current Management Discussion and Analysis. We will closely monitor any development with regards to the potential tax legislation change and assess the strategic and economic issues arising from this proposal.

In closing, I would like to thank each Unitholder for your continued support and for the confidence you have demonstrated by investing in the Fund.

On behalf of the Board of Trustees,

A handwritten signature in dark ink, appearing to read 'John Cowperthwaite', written over a horizontal line.

John Cowperthwaite, FCA  
Chairman, Boston Pizza Royalties Income Fund



## Letter from the Chief Executive Officer Boston Pizza International Inc.



On behalf of Boston Pizza International Inc. ("BPI"), its board of directors, management team and employees, I am pleased to present our 2006 Annual Report. This report covers the fiscal period of January 1, 2006 to December 31, 2006 (the "Year").

### HIGHLIGHTS

2006 was another great year for Boston Pizza as BPI posted excellent results and positioned the brand for continued success in the years ahead. We established new records for system-wide sales, restaurant openings, store renovations and customers served. With 41 new restaurants opened during the Year, there are now 266 locations in Canada and Boston Pizza is represented in ten provinces and two territories. We also relocated one restaurant to an improved site and renovated 25 restaurants to the latest design standards. This resulted in an impressive overall restaurant system franchise sales growth of 24.9%. Overall sales growth is achieved through the contribution of newly opened restaurants and same store sales growth ("SSSG"). SSSG, a key performance indicator of the ongoing growth of our brand, was 8.4% for the Year – our strongest annual SSSG result since the inception of the Boston Pizza Royalties Income Fund in 2002.

### BUSINESS STRATEGY

Boston Pizza continues to refine and enhance our business model by focusing on the three strategic priorities that have been the foundation for all strategic decision-making for many years. They are what we refer to as our "Three Pillars" strategy.

- The commitment to franchisee profitability
- The commitment to continually enhance the Boston Pizza brand
- The commitment to continually improve the customer experience

### OUTLOOK

We anticipate that 2007 will be another strong year for our organization. We will continue our aggressive expansion into Ontario and Québec, while continuing to seek opportunities in western Canada and the Atlantic provinces. Approximately 40 new Boston Pizza restaurants will open across Canada in 2007. Boston Pizza will also continue its successful renovation program that requires each location to renovate every seven years. In 2007, approximately 24 renovations are planned.

In 2007, we believe that the organization can continue to deliver on the most important metric to Unitholders of the Fund, namely SSSG. Through strong television and radio advertising, national and local promotions, and superior customer service, it is management's objective to deliver industry-leading SSSG.

Our management further believes that they will continue to successfully develop the Boston Pizza brand in new markets and strengthen Boston Pizza's position as Canada's number one casual dining brand. With 266 restaurants stretching from Victoria to St. John's, Boston Pizza has more locations and serves more customers annually than any other casual dining brand in Canada.

On behalf of Boston Pizza International Inc.,

A handwritten signature in black ink.

Michael Cordoba,  
Chief Executive Officer, Boston Pizza International Inc.

# Results

## It's About Same Store Sales Growth Year After Year

"Same store sales growth is the key figure for Unitholders of the Fund. The 8.4% SSSG that Boston Pizza achieved in 2006 translated into three increases to monthly cash distributions totalling 7.8%. We are very pleased that the Fund has been able to raise distributions a total of eleven times since the IPO for a total increase of over 33%."

### MARK POWELL

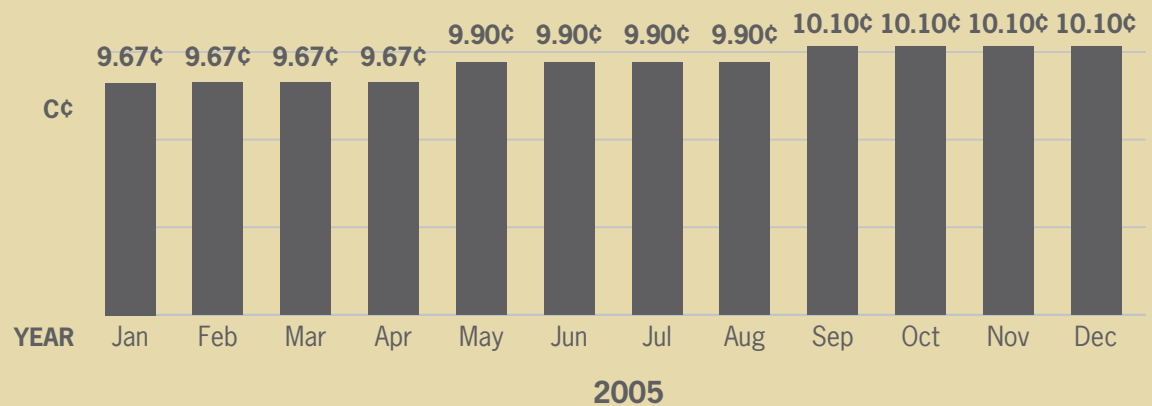
Chief Financial Officer  
Boston Pizza International Inc.



### GROWING DISTRIBUTIONS

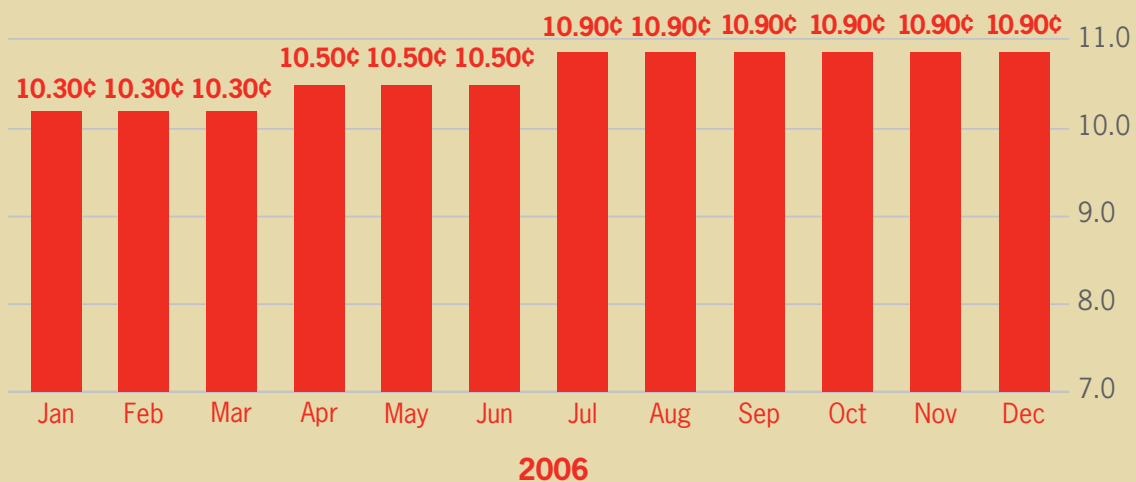
In 2006 the Fund delivered three increases in distributions to Unitholders.

Distributions have grown by **33.2%** since the IPO.





Our Stability  
and Growth are  
Reflected by the  
Distributions to  
Unitholders





We Are Active in  
Giving Back to  
the Communities  
Where We Do  
Business



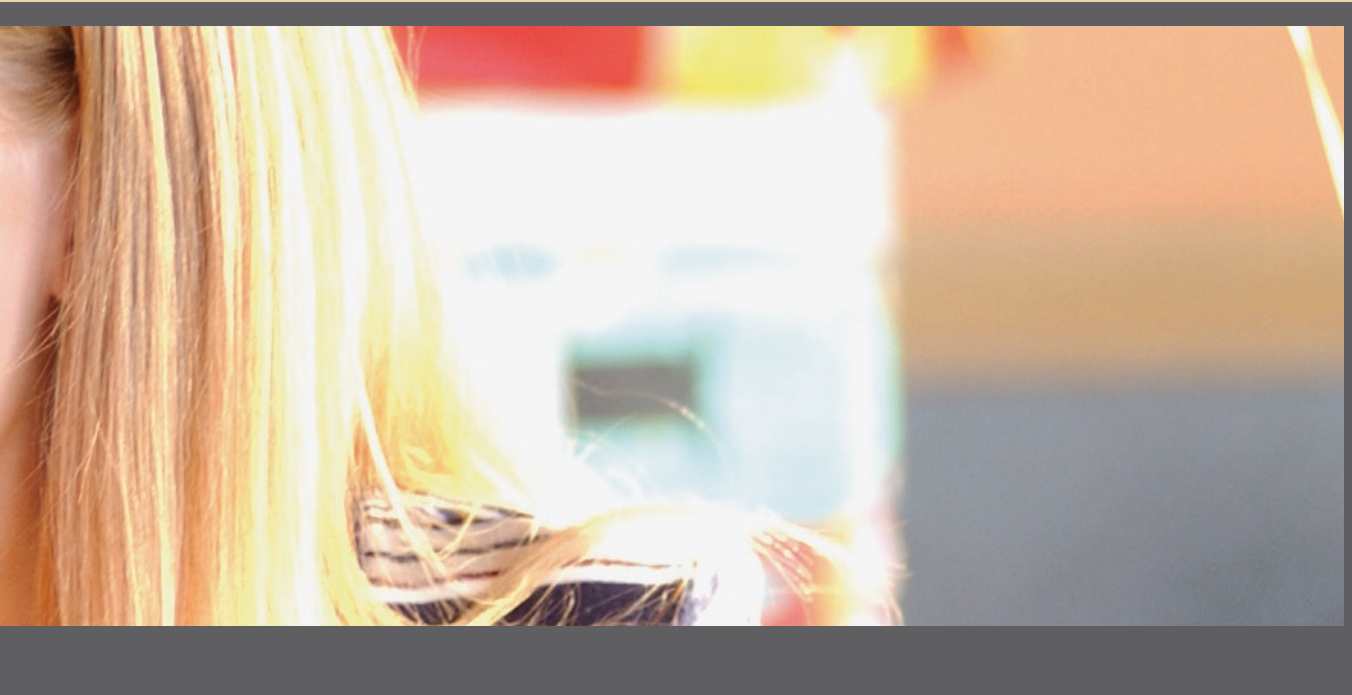
#### THE BOSTON PIZZA FOUNDATION

We are strong believers in making a return to the communities in which we do business. Boston Pizza set up the **Boston Pizza Foundation** in 1990 with the goal of raising funds for people of all ages living in and with difficult circumstances throughout Canada. As part of our commitment to the BP Foundation, we support three charities on a national level – **Heart & Stroke Foundation of Canada, Kids Help Phone and the Juvenile Diabetes Research Foundation** through various activities throughout the year.

**The Heart and Stroke Foundation** is a community-based organization dedicated to the prevention and reduction of heart disease and stroke in BC and Yukon. Funds raised support research and innovative health promotion programs that encourage lifestyle changes. Over the past two years, Boston Pizza has raised approximately \$1.5 million for the **Heart and Stroke Foundation**. For the latest information on heart health topics, call toll free: 1-800-HSF-INFO (473-4636) or visit their website at: [www.heartandstroke.ca](http://www.heartandstroke.ca).

**Kids Help Phone** (1-800-668-6868 [www.kidshelpphone.ca](http://www.kidshelpphone.ca)) and **Parent Help Line** (1-888-603-9100 [www.parenthelpline.ca](http://www.parenthelpline.ca)) are Canada's only national, bilingual, toll-free, 24-hour, anonymous and confidential phone and web counselling, referral and information services for children, youth, parents and caregivers. Each and every day, the professional counsellors at Kids Help Phone and Parent Help Line help about 1,000 kids by providing the immediate, caring support and information Canadians need – all day and every day of the year. Over the past nine years, Boston Pizza has raised over \$1 million for Kids Help Phone.

# Community



**Juvenile Diabetes Research Foundation (JDRF)** is the leading charitable founder and advocate of Type 1 diabetes research worldwide. The mission of JDRF is to find a cure for diabetes and its complications through the support of research. Boston Pizza is a national sponsor for the JDRF and CEO Mike Cordoba is the Corporate Chair for the 2007 Walk to Cure Diabetes event. For more information, please visit their website at [www.jdrf.ca](http://www.jdrf.ca).

Since its inception, the **Boston Pizza Foundation** has raised more than \$6.2 million for our national charities, as well as **Canuck Place** (a Vancouver Children's Hospice), the **Canadian Red Cross Society**, **CIBC Wood Gundy Caring for Kids** (which feeds inner-city school children), **Zajac Ranch** (which helps children who are hearing impaired) and a host of other local charities.



**"We are very proud of Boston Pizza's long history of being involved with charity activities across Canada. The Boston Pizza Foundation supports many activities involving health, children and sports that are closely aligned with elements in our restaurant operations. It is our opportunity to give back to the communities that have made Boston Pizza successful."**

## **MIKE CORDOBA**

Chief Executive Officer  
Boston Pizza International Inc.



## BOSTON PIZZA ROYALTIES INCOME FUND

### MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED DECEMBER 31, 2006

### FINANCIAL HIGHLIGHTS

The tables below set out selected historical information and other data from the financial statements of the Boston Pizza Royalties Income Fund (the "Fund"<sup>1</sup>) and the Boston Pizza Royalties Limited Partnership (the "Partnership"), which should be read in conjunction with the attached consolidated financial statements of the Fund.

Equity and interest income earned by the Fund through its interest in the Partnership have been derived as shown in the tables below.

	Jan. 1, 2006 to Dec. 31, 2006	Jan. 1, 2005 to Dec. 31, 2005	Jan. 1, 2004 to Dec. 31, 2004
(in thousands of dollars – except restaurants and per unit items)			
Number of restaurants in Royalty Pool	226	195	177
Franchise Sales <sup>2</sup> reported by restaurants in Royalty Pool	\$ 484,684	\$ 393,212	\$ 329,893
Royalty Income – 4% of Franchise Sales <sup>2</sup> of Royalty Pool Restaurants	\$ 19,387	\$ 15,728	\$ 13,196
Partnership administrative and interest expenses	\$ 1,062	\$ 891	\$ 733
Partnership earnings for the period before undernoted	\$ 18,325	\$ 14,837	\$ 12,463
BPI's interest	\$ 6,095	\$ 5,171	\$ 4,587
Equity income related to BPI royalties earned by the Fund	\$ 12,230	\$ 9,666	\$ 7,876
Interest income	\$ 1,800	\$ 1,800	\$ 1,800
Net earnings	\$ 14,030	\$ 11,466	\$ 9,676
Earnings per Fund unit	\$ 1.30	\$ 1.20	\$ 1.13
Diluted earnings per Fund unit	\$ 1.30	\$ 1.20	\$ 1.13
Distributions declared per Fund unit	\$ 1.28	\$ 1.19	\$ 1.11
Same store sales growth	8.4%	8.0%	6.8%
Number of restaurants opened during period	41	31	17
Number of restaurants closed during period	1	0	0
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2004
Total assets	\$ 124,054	\$ 102,080	\$ 87,644
Total liabilities	\$ 1,199	\$ 978	\$ 844

<sup>1</sup> Any further references to the Fund refer to the Fund and its subsidiaries, as the financial results presented in this Management Discussion and Analysis are presented on a consolidated basis.

<sup>2</sup> Franchise Sales is the basis on which the royalty is payable; it means the gross revenues of Boston Pizza restaurants in respect of which the royalty is payable. The term "gross revenue" refers to the gross revenue of: (i) the corporate Boston Pizza restaurants in Canada owned by BPI; and (ii) the amount of gross revenue reported to BPI by franchised Boston Pizza restaurants in Canada, without audit or other form of independent assurance, in the case of both (i) and (ii), after deducting revenue from the sale of liquor, beer, wine and tobacco and revenue from BPI approved national promotions and discounts and excluding applicable sales and similar taxes.



**BOSTON PIZZA  
ROYALTIES INCOME FUND**

**MANAGEMENT DISCUSSION  
AND ANALYSIS**

FOR THE YEAR ENDED DECEMBER 31, 2006

	Q4 2006	Q3 2006	Q2 2006	Q1 2006
	(in thousands of dollars – except restaurants and per unit items)			
Restaurants in the Royalty Pool	226	226	226	226
Franchise Sales <sup>2</sup> reported by restaurants in the Royalty Pool	\$ 122,551	\$ 128,280	\$ 120,115	\$ 113,738
Royalty income – 4% of Franchise Sales <sup>2</sup> of Royalty Pool Restaurants	\$ 4,901	\$ 5,131	\$ 4,805	\$ 4,550
Partnership administrative and interest expenses	\$ (297)	\$ (255)	\$ (279)	\$ (231)
Partnership earnings for the period before undernoted BPI's interest	\$ 4,604 \$ (1,470)	\$ 4,876 \$ (1,530)	\$ 4,526 \$ (1,453)	\$ 4,319 \$ (1,642)
Equity income related to BPI royalties earned by Fund	\$ 3,134	\$ 3,346	\$ 3,073	\$ 2,677
Interest income	\$ 450	\$ 450	\$ 450	\$ 450
Net earnings	\$ 3,584	\$ 3,796	\$ 3,523	\$ 3,127
Basic earnings per Fund unit	\$ 0.32	\$ 0.35	\$ 0.32	\$ 0.31
Diluted earnings per Fund unit	\$ 0.32	\$ 0.35	\$ 0.32	\$ 0.31
Distributions declared per Fund unit	\$ 0.44	\$ 0.32	\$ 0.31	\$ 0.21

	Q4 2005	Q3 2005	Q2 2005	Q1 2005
	(in thousands of dollars – except restaurants and per unit items)			
Restaurants in the Royalty Pool	195	195	195	195
Franchise Sales <sup>2</sup> reported by restaurants in the Royalty Pool	\$ 102,205	\$ 104,544	\$ 97,683	\$ 88,780
Royalty income – 4% of Franchise Sales <sup>2</sup> of Royalty Pool Restaurants	\$ 4,088	\$ 4,182	\$ 3,907	\$ 3,551
Partnership administrative and interest expenses	\$ (204)	\$ (199)	\$ (292)	\$ (196)
Partnership earnings for the period before undernoted BPI's interest	\$ 3,884 \$ (1,295)	\$ 3,983 \$ (1,312)	\$ 3,615 \$ (1,232)	\$ 3,355 \$ (1,332)
Equity income related to BPI royalties earned by Fund	\$ 2,589	\$ 2,671	\$ 2,383	\$ 2,023
Interest income	\$ 450	\$ 450	\$ 450	\$ 450
Net earnings	\$ 3,039	\$ 3,121	\$ 2,833	\$ 2,473
Basic earnings per Fund unit	\$ 0.32	\$ 0.32	\$ 0.29	\$ 0.27
Diluted earnings per Fund unit	\$ 0.32	\$ 0.32	\$ 0.29	\$ 0.27
Distributions declared per Fund unit	\$ 0.40	\$ 0.30	\$ 0.29	\$ 0.19

## BOSTON PIZZA ROYALTIES INCOME FUND

### MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED DECEMBER 31, 2006

#### OVERVIEW

This Management Discussion and Analysis covers the fiscal period from January 1, 2006 to December 31, 2006 (the “Year”) and the fourth quarter period from October 1, 2006 to December 31, 2006 (the “Period”) and is dated February 1, 2007.

The Fund is a limited purpose open-ended trust established in July 2002, which trades on the Toronto Stock Exchange under the symbol BPF.UN. The Fund was created to acquire, indirectly through the Partnership and Boston Pizza Holdings Trust (the “Trust”), the Canadian trade marks owned by Boston Pizza International Inc. (“BPI”) and used in connection with the operation of the Boston Pizza restaurants in Canada (collectively the “BP Rights”<sup>3</sup>). The Partnership licenses the BP Rights to BPI in return for a 4% royalty of Franchise Sales of those restaurants included in the specific royalty pool (the “Royalty Pool”). As of January 1, 2007 there were 266 restaurants in the Royalty Pool.

A key attribute of the Fund structure is that it is a “top-line” fund. Royalty income of the Fund is based on Franchise Sales of Royalty Pool restaurants and is not determined by the profitability of either BPI or the Boston Pizza restaurants in the Royalty Pool. In addition, the Fund is not subject to the variability of earnings or expenses associated with an operating business. The Fund’s only expenses are relatively minor administrative expenses and interest on debt. Given this structure, the success of the Fund depends primarily on the ability of BPI to maintain and increase Franchise Sales of the restaurants in the Royalty Pool.

Increases in Franchise Sales are derived from both new Boston Pizza restaurants and same store sales growth (“SSSG”). SSSG, the key metric for yield growth of the Fund, is the increase in annual gross revenues of Boston Pizza restaurants as compared to gross revenues for the same period in the previous year, where restaurants were open for a full 12 months in each year. SSSG from existing restaurants is dependent on maintaining operational excellence within each Boston Pizza restaurant, general market conditions, pricing, and marketing programs undertaken by BPI. One of BPI’s competitive strengths in increasing Franchise Sales of existing locations is that BPI’s Franchise Agreement requires that each Boston Pizza restaurant undergo a complete store renovation every seven years and complete any equipment upgrades as required by BPI. Following

a complete store renovation, Franchise Sales for renovated locations have historically increased by an average of 10–15% in the year following the renovation.

Franchise Sales are also affected by the permanent closures of Boston Pizza restaurants. A Boston Pizza restaurant is closed when it ceases to be viable or when BPI has agreed with the franchisee to terminate the Franchise Agreement. BPI has a very low restaurant closure rate. In the event that a location closes, the Fund has a make-whole agreement with BPI whereby BPI will replenish the royalties that would have been paid to the Fund. BPI will not be obligated to pay the Make-whole Payment or maintain a 20% minimum retained interest in the Fund after the date on which 275 Boston Pizza restaurants are first included in the Royalty Pool.

On January 1 of each year (“Adjustment Date”), an adjustment is made to add to the Royalty Pool new Boston Pizza restaurants that opened since the last Adjustment Date. In return for adding this additional royalty revenue, BPI receives the right to indirectly acquire additional Fund units (the “Additional Entitlements”). The adjustment for new Franchise Sales added to the Royalty Pool is designed to be accretive for Fund Unitholders. The Additional Entitlements are calculated at 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund, divided by the Weighted Average Unit Price. BPI receives 80% of the Additional Entitlements initially, with the balance received when the actual full year performance of the new restaurants is known with certainty. BPI receives 100% of distributions from the Additional Entitlements throughout the year. Once these new restaurants have been part of the Royalty Pool for a full year, an audit of the royalty revenues of these restaurants received from BPI will be performed. At such time an adjustment is made to reconcile distributions paid to BPI and the Additional Entitlements received by BPI. In 2006, BPI opened 41 new Boston Pizza restaurants across Canada and closed one full-service restaurant. On January 1, 2007, 40 net new restaurants were added to the Royalty Pool, bringing the total to 266, and BPI received the right to acquire an additional 1,726,782 units of the Fund, representing 80% of the Additional Entitlements.

<sup>3</sup> BP Rights are the trademarks that as at July 17, 2002 were registered or the subject of pending applications for registration under the Trade-Marks Act (Canada), and other trademarks and the trade names which are confusing with the registered or pending trademarks. The BP Rights purchased do not include the rights outside of Canada to any trademarks or trade names used by BPI or any affiliated entities in its business, and in particular do not include the rights outside of Canada to the trademarks registered or pending registration under the Trade-Marks Act (Canada).

## BOSTON PIZZA ROYALTIES INCOME FUND

### MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED DECEMBER 31, 2006

The following information provides additional analysis of the operations and financial position of the Fund and should be read in conjunction with the consolidated financial statements and accompanying notes. The consolidated financial statements are in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles. *Readers should note that the 2006 results are not directly comparable with the 2005 results due to the fact that there were 226 restaurants in the Royalty Pool for the Year and 195 restaurants in the Royalty Pool for the same period in 2005.*

#### OPERATING RESULTS

Boston Pizza continued to post positive growth in 2006. Franchise Sales growth of royalty pool restaurants was 19.9% for the Period and 23.3% for the Year compared to the same periods in 2005. This was achieved through SSSG and the addition of 31 new restaurants to the Royalty Pool on January 1, 2006.

#### Same Store Sales Growth

SSSG, the key driver of yield growth for Unitholders of the Fund, was 6.9% for the Period and 8.4% for the Year. These SSSG figures are compared to the fourth quarter and full year sales growth reported in 2005 of 10.5% and 8.0% respectively.

Boston Pizza restaurants across Canada have achieved positive SSSG each and every period since the Fund's initial public offering ("IPO") in July 2002. Over the past decade, SSSG has averaged 6.6% annually – a figure that compares quite favourably against the Canadian restaurant industry as a whole. This consistent sales growth is the reason that the Trustees have been able to increase monthly cash distributions to Unitholders ten times since the Fund's inception, including three times during 2006.

#### New Store Openings, Renovations and Relocations

During the Period, 18 new Boston Pizza restaurants were opened, bringing the total to 41 new restaurant openings for the Year. Also during the Period, one restaurant closed when the franchise agreement was not renewed on its expiry date because the franchisee decided it would not meet the renewal conditions set by BPI. As a result of the make-whole payment provisions outlined in the License and Royalty Agreement dated July 17, 2002, as amended (the "Make-whole Payment"), BPI was obligated to make the Make-whole Payment during the period from the date of closure to December 31, 2006

(the "Royalty Payment Period") when new restaurants were added to the Royalty Pool. The Make-whole Payment is calculated on the following formula:

$$4\% \times \left[ \frac{\text{\#days closed during Royalty Payment Period}}{365} \right] \times \left[ \text{lost franchise revenues (defined below)} \right]$$

Lost franchise revenues are calculated based upon the amount of Franchise Revenues of the closed restaurant for the first 12 months after it was included in the Royalty Pool. The Make-whole Payment required for this one restaurant was \$11,115.

As well, during the Period, ten Boston Pizza restaurants were renovated. A total of 25 Boston Pizza restaurants have completed major renovations and one restaurant was relocated during the Year. Typically, locations are closed for two to three weeks for renovation. Newly renovated locations typically experience a sales increase of 10 – 15% in the year following the renovation.

#### Revenues

For the Period royalty income received by the Partnership was \$4,902,003 compared to \$4,088,183 for the same period in 2005. For the Year, royalty income received by the Partnership was \$19,387,344 compared to \$15,728,498 in 2005. Interest income earned by the Fund for the Period was \$450,019 and by the Partnership was \$9,919. For the same period in 2005, interest income earned by the Fund was \$450,019 and by the Partnership was \$3,191. For the Year, interest income earned by the Fund was \$1,800,059 and by the Partnership was \$29,718. In 2005, interest income earned by the Fund was \$1,800,059 and by the Partnership was \$7,678. Royalty income was based on the Royalty Pool of 226 Boston Pizza restaurants in Canada reporting Franchise Sales of \$122,550,070 for the Period and \$484,683,589 for the Year. In 2005, Royalty income was based on the Royalty Pool of 195 Boston Pizza restaurants in Canada reporting Franchise Sales of \$102,204,575 in the fourth quarter and \$393,212,490 for the full year. Interest income to the Fund is derived from the \$24 million loan from the Fund to BPI. The interest on this loan is paid monthly by BPI at a rate of 7.5% per annum.



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**Expenses**

Partnership expenses for the Period were \$306,413: consisting of \$85,069 of interest expense on its \$5 million term loan, (the "Term Loan"), \$2,100 for amortization of deferred financing charges on its credit facilities, and \$219,244 for general and administrative expenses. The general and administrative expenses are comprised mainly of professional fees, insurance premiums, transfer agent costs and trustee fees. For the same period in 2005, Partnership expenses were \$212,160: \$69,555 of interest expense on its Term Loan, \$1,050 for amortization of deferred financing charges on its credit facilities, and \$141,555 for general and administrative expenses. For the Year, Partnership expenses were \$1,091,333: \$325,548 of interest expense on its Term Loan, \$6,300 for amortization of deferred financing charges on its credit facilities, and \$759,485 for general and administrative expenses. For the same period in 2005, Partnership expenses were \$898,624: consisting of \$257,329 of interest expense on its Term Loan, \$21,700 for amortization of deferred financing charges on its credit facilities, and \$619,595 for general and administrative expenses.

**Distributions**

The Fund's net earnings during the Period were \$3,585,069 or \$0.32 per unit with the Fund declaring distributions of \$4,794,560 or \$0.44 per unit. During the same period in 2005, net earnings were \$3,038,523 or \$0.32 per unit with the Fund declaring distributions of \$3,912,676 or \$0.40 per unit. For the Year, the Fund's earnings were \$14,030,115 or \$1.30 per unit with the Fund declaring distributions of \$14,053,781 or \$1.28 per unit. In 2005, net earnings were \$11,465,930 or \$1.20 per unit with the Fund declaring distributions of \$11,401,508 or \$1.19 per unit. Since the IPO, Unitholders have received ten distribution increases. At the time of the IPO the monthly distributions were set at \$0.0833 per unit and by the end of the Period, distributions were \$0.1090 per unit, an increase of 31%.

Distributions for the Year were as follows:

PERIOD	PAYMENT DATE	AMOUNT/UNIT
January 1 – 31, 2006	February 28, 2006	10.30¢
February 1 – 28, 2006	March 31, 2006	10.30¢
March 1 – 31, 2006	April 28, 2006	10.30¢
April 1 – 30, 2006	May 31, 2006	10.50¢
May 1 – 31, 2006	June 30, 2006	10.50¢
June 1 – 30, 2006	July 31, 2006	10.50¢
July 1 – 31, 2006	August 31, 2006	10.90¢
August 1 – 31, 2006	September 29, 2006	10.90¢
September 1 – 30, 2006	October 31, 2006	10.90¢
October 1 – 31, 2006	November 30, 2006	10.90¢
November 1 – 30, 2006	December 29, 2006	10.90¢
December 1 – 31, 2006	January 31, 2007	10.90¢

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

**Units Outstanding**

At December 31, 2006 there were 10,996,700 public Fund units issued, 13,745,875 on a fully diluted basis, and BPI held securities exchangeable for 2,749,175 units of the Fund, representing a 20% indirect interest in the Fund.

**Tax Treatment of Distributions**

Of the \$1.28 in distributions declared per unit during the Year, 16.4% or \$0.21 per unit represents a tax deferred return of capital and 83.6% or \$1.07 per unit is taxable as income from property.

**SUBSEQUENT EVENTS**

On January 1, 2007, 41 new Boston Pizza restaurants that opened across Canada between January 1, 2006 and December 31, 2006 were added to the Royalty Pool. One restaurant that closed during the Year was removed from the Royalty Pool. The estimated annual gross franchise revenue for the 40 net new restaurants in 2007 is \$74,555,000. This amount is based on the addition of \$75,777,000 in estimated annual gross franchise revenue for the 41 new restaurants less \$1,222,000 in annual gross franchise revenue from the one closed restaurant. The estimated 4% royalty revenue the Fund will receive in 2007 from these additional 40 net new restaurants is \$2,982,200. The royalty revenue for the purposes of calculating the Additional Entitlements, therefore, is \$2,758,535 or 92.5% of \$2,982,200. In return for adding the royalty revenue from these 40 net new restaurants to the Royalty Pool, BPI received the right to acquire an additional 1,726,782 units, representing 80% of the Additional Entitlements with the balance received when the actual full year performance of the new restaurants is known with certainty. The 1,726,782 Additional Entitlements represents 11.2% of the total outstanding units on a fully diluted basis. BPI also receives an increase in monthly distributions based on 100% of the Additional Entitlements. The calculation for the number of Additional Entitlements received by BPI is designed to be accretive to existing Unitholders as the additional royalty revenues from the new restaurants are licensed to the Fund at a 7.5% discount. Once the actual performance of these new Royalty Pool restaurants for 2007 is known, the number of Additional Entitlements will be adjusted in 2008 to reflect the actual royalty revenue received by the Fund in 2007.

In January 2007 an audit of the royalty revenues of the 31 locations that were added to the Royalty Pool on January 1, 2006 was completed. The purpose of this audit was to compare actual royalty revenue from these 31 locations to the estimated amount of royalty revenue the Fund expected to receive. The original royalty revenue the Fund expected to receive was \$2,443,920 and the actual royalty revenue that the Fund received was \$2,553,020. As a result of this adjustment and distributions that were paid on the excess units, the Partnership will make a further cash payment to BPI of \$108,672 to reconcile distributions received by BPI for the difference between estimated and actual royalty revenue for the 31 locations. BPI received the right to acquire 80% of the Additional Entitlements at the Adjustment Date in 2006. Following the audit, BPI received the right to acquire 465,995 Additional Entitlements.

**LIQUIDITY & CAPITAL RESOURCES**

The Fund's distribution policy is to distribute all available cash in order to maximize returns to Unitholders. In light of small seasonal variations that are inherent to the restaurant industry, the Fund's policy is to make equal distribution payments to Unitholders on a monthly basis in order to smooth out these fluctuations. Any further increase in distributions will be implemented in such a manner so that the continuity of uniform monthly distributions is maintained, while making provisions for working capital due to seasonal variations of Boston Pizza restaurant sales. It is expected that future distributions will continue to be funded entirely by cash flow from operations.

As of December 31, 2006, working capital of the Fund taken together with working capital of the Partnership totaled \$1,019,748. The Partnership has a \$1 million operating line of credit available to finance their operations. At year-end, no amount was drawn from the line of credit.

**CONTROLS AND PROCEDURES**

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

In accordance with Multilateral Instrument 52-109 issued by the Canadian Securities Administrators with respect to certification of disclosure in issuers' annual filings, the CEO and CFO have evaluated the effectiveness of internal disclosure controls as of the year ended December 31, 2006. Based on that evaluation, the CEO and CFO have concluded that the control procedures provide reasonable assurance that: (a) information required to be disclosed by the Fund in its annual filings or other reports filed and submitted under applicable securities legislation is recorded, processed, summarized and reported within the prescribed time periods, and (b) material information regarding the Company is accumulated and communicated to management, including its CEO and CFO in a timely manner.

In addition, the CEO and CFO have designed or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial

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reporting and the preparation of financial statements for external purposes. There have been no material changes to the internal controls during the year that have had a material effect on the internal controls.

#### CRITICAL ACCOUNTING ESTIMATES

The preparation of consolidated Fund's and Partnership's financial statements in conformity with GAAP requires estimates and judgments to be made that affect the reported amounts of assets and liabilities, net earnings and expenses, and related disclosures. The estimates are based on historical experience and knowledge of economics, market factors and the restaurant industry along with various other assumptions that are believed to be reasonable under the circumstances.

The Partnership annually reviews the book value of the intangible assets for impairment. The intangible assets are comprised primarily of the BP Rights and at year-end were reported at \$160,035,037. The review is based on the unit price throughout the fiscal year compared to the IPO unit price, distributable cash throughout the fiscal year compared to the level set out in the prospectus, and any legal issues that may have a significant impact on the Partnership. The Partnership reviewed the intangible assets as at December 31, 2006 and concluded there was no impairment.

#### OUTLOOK

The information contained in "Outlook" is forward looking information. Please see "Note Regarding Forward Looking Statements" below for a discussion of the risks and uncertainties in connection with forward-looking information.

The management of BPI has advised the Trustees that Boston Pizza is well positioned for future growth and should continue to strengthen its position as the number one casual dining brand in Canada. In 2007 BPI management anticipates that approximately 40 new locations will open across Canada. Management will continue to pursue further development in Western Canada and the Atlantic provinces, while the majority of new locations are expected to be in Ontario and Québec. BPI estimates that its 275<sup>th</sup> restaurant will open in 2007 and will be added to the Royalty Pool on January 1, 2008. At that point, BPI will no longer be obligated for Make-whole Payments or minimum interest obligation as described in the Fund's prospectus.

Boston Pizza's operating strategy and execution have consistently delivered annual SSSG above industry averages and the management of BPI has advised the Trustees that it expects this performance to continue in 2007. SSSG in the year ahead will be supported by a new television advertising campaign, a larger national marketing budget and an updated menu roll-out. In addition, BPI expects that approximately 24 locations will conduct major renovations which will facilitate the ongoing effort to deliver industry-leading SSSG. Boston Pizza restaurants achieved outstanding SSSG in the first quarter of 2006, of 12.7% and BPI management recognizes that SSSG in the first quarter of 2007 will be compared against this very strong result.

#### RISKS & UNCERTAINTIES

##### *The Restaurant Industry*

The performance of the Fund is directly dependent upon the royalty and interest payments received from BPI. The amount of Royalty received from BPI is dependent on various factors that may affect the casual dining sector of the restaurant industry. The restaurant industry generally, and in particular the casual dining sector, is intensely competitive with respect to price, service, location and food quality. Competitors include national and regional chains, as well as independently owned restaurants. If BPI and the Boston Pizza franchisees are unable to successfully compete in the casual dining sector, Franchise Sales may be adversely affected; the amount of royalty reduced and the ability of BPI to pay the royalty or interest on the BP Loan may be impaired. The restaurant industry is also affected by changes in demographic trends, traffic patterns, and the type, number, and location of competing restaurants. In addition, factors such as government regulations, smoking bylaws, inflation, publicity from any food borne illnesses, increased food, labour and benefits costs, and the availability of experienced management and hourly employees may adversely affect the restaurant industry in general and therefore potentially Boston Pizza Franchise Sales. BPI's success also depends on numerous factors affecting discretionary consumer spending, including economic conditions, disposable consumer income and consumer confidence. Adverse changes in these factors could reduce guest traffic or impose practical limits on pricing, either of which could reduce revenue and operating income, which could adversely affect revenue, the royalty and the ability of BPI to pay the royalty to the Fund or interest on the BP Loan.



### ***Boston Chicken / Boston Market Litigation***

Since 1995, BPI has been challenging Boston Chicken Inc.'s and Global Restaurant Operations of Ireland Limited's registration of the "Boston Chicken" trademark in Canada. In March 2003, the Federal Court of Appeal unanimously ordered the expungement of "Boston Chicken" from the trademark registry. The expungement of the "Boston Chicken" trademark was a significant victory because there is now only one owner, the Partnership, of registered trademarks using "Boston" in connection with restaurant foodservices in Canada. Additionally, since 1995, BPI has opposed the registration of the "Boston Market" trademark. As a result, "Boston Market" is not yet a registered trademark. In 2002, BPI and the Partnership commenced legal action against Global Restaurant Operations of Ireland Limited, Boston Market Canada Company, Boston Market Corporation and McDonald's Restaurants of Canada Limited (collectively, the "McDonald's Group") for trademark infringement over the McDonald's Group's use of "Boston Market". In the fall of 2002, the McDonald's Group commenced legal actions challenging the validity of the Boston Pizza trademarks owned by the Partnership, some of which have been registered, and in use for over 30 years. BPI management believes that this is a tactical maneuver by the McDonald's Group and is unlikely to succeed. However in the unlikely event that the challenge to the Boston Pizza trademarks is successful, the Partnership would lose the benefits of registration of its trademarks under the Trade-Marks Act (Canada), which may mean losing the ability to prevent others from using the registered trademarks for the goods and services for which they are registered and to prevent others from using similar or confusing trademarks or names. However the loss of the registration under the Trade-Marks Act (Canada) would not prevent the Partnership from continuing to license and use the "Boston Pizza" and related trademarks in the existing operations and geographic territories where they are presently used and from taking other measures to protect their rights in respect of, and their ability to use, the "Boston Pizza" and related trademarks in new areas where BPI and its sub-licensees do not presently operate Boston Pizza restaurants. The parties are waiting for trial dates, none of which have been set. BPI management does not expect the infringement trial to commence before 2008. BPI management believes that ultimately, BPI and the Partnership will succeed in its litigation with the McDonald's Group. However, there are no assurances or certainty as to the eventual outcome of these legal proceedings.

### **RISKS RELATED TO THE STRUCTURE OF THE FUND**

#### ***Income Tax Matters***

On October 31, 2006, the federal Minister of Finance (the "Minister") announced new proposals (the "2006 Proposals") that, if enacted, would change the manner in which certain flow-through entities, referred to as "specified investment flow-through" entities or "SIFTs", and the distributions from such entities are taxed. In their current form, the 2006 Proposals will not apply to SIFTs that were publicly traded on October 31, 2006 ("Grandfathered SIFTs") until January 1, 2011. However, the 2006 Proposals indicate that any "undue expansion" of a Grandfathered SIFT between October 31, 2006 and January 1, 2011 (the "Interim Period"), would be viewed as abusive tax avoidance and may cause the deferred application of the 2006 Proposals to be rescinded.

Following the October 31, 2006 announcement, the Department of Finance ("Finance") issued a press release on December 15, 2006 wherein it provided guidelines (the "Normal Growth Guidelines") as to what would be considered "normal growth" as opposed to "undue expansion".

On December 21, 2006 Finance released draft legislation to implement the 2006 Proposals (the "Draft Legislation") and invited commentary on the technical aspects of the Draft Legislation prior to January 31, 2007. The Minister has indicated that, following this consultation period, legislation will be introduced to implement the 2006 Proposals.

Provided that the Fund is not considered to have undergone an "undue expansion" during the Interim Period, the Draft Legislation, if enacted in its current form, will change the manner in which the Fund and its distributions are taxed beginning January 1, 2011. More specifically, the Fund will be subject to entity level taxation, which will reduce the amount of cash available for distribution to the Unitholders. Based on the proposed rate of entity level taxation, the tax on income (other than taxable dividends) distributed by the Fund to its Unitholders would approximate the tax rate applicable to income earned by Canadian public corporations. Based on information released by Finance in conjunction with the 2006 Proposals, the applicable rate in 2011 would be 31.5% but this is subject to change between now and 2011.

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Distributions received by Unitholders beginning January 1, 2011 would be characterized as eligible dividends received from a Canadian public corporation. Generally, individual Unitholders resident in Canada would be subject to tax based on the enhanced gross-up and dividend tax credit applicable to eligible dividends. Unitholders subject to the highest marginal rate of tax would receive an after-tax return from their now reduced distribution of income approximately equal to the after-tax return if the pre-tax income of the SIFT had been distributed directly to and taxed in the hands of the Unitholders. However, reduced distributions will be an absolute cost to other types of Unitholders including pension funds, Registered Retirement Savings Plans and non-residents who would not benefit from characterization of the distribution as dividends.

If the Fund is considered to have undergone an “undue expansion” during the Interim Period, the 2006 Proposals may become applicable to the Fund prior to January 1, 2011. No assurance can be given that the Fund will be able to maintain its status as a Grandfathered SIFT until January 1, 2011. Loss of this status may result in material adverse tax consequences for the Fund and its Unitholders.

No assurance can be given as to the provisions of any final legislation that may be enacted to implement the 2006 Proposals, the Normal Growth Guidelines or the Draft Legislation. The provisions of such legislation, if enacted, may be materially different than the provisions of the Draft Legislation and/or the Normal Growth Guidelines.

Although the Fund and the Partnership are of the view that all expenses to be claimed by them in the determination of their respective incomes under the Tax Act will be reasonable and deductible in accordance with the applicable provisions of the Tax Act and that the allocation of income for purposes of the Tax Act between BPI and the Trust is reasonable, there can be no assurance that the Tax Act or the interpretation of the Tax Act will not change, or that Canada Revenue Agency (the “CRA”) will agree with the expenses claimed. If the CRA successfully challenges the deductibility of such expenses or the allocation of such income, the Partnership’s allocation of taxable income to the Trust, and indirectly the Fund and the Unitholders, will increase or change.

There can be no assurance that Canadian federal income tax laws respecting the treatment of mutual fund trusts will not be changed in a manner which adversely affects the holders of Units. If the Fund ceases to qualify as a “mutual fund trust” under the Tax Act, the income tax considerations would be materially and adversely different in certain respects.

Interest on the BP Loan accrues at the Fund level for income tax purposes whether or not actually paid. Similarly, the Royalty may accrue at the Partnership level for income tax purposes whether or not actually paid. As a result, the income of the Partnership allocated to the Fund (through the Trust), in respect of a particular fiscal year may exceed the cash distributed by the Partnership to the Fund (through the Trust) in such year. The Declaration of Trust provides that an amount equal to the taxable income of the Fund will be distributed each year to Unitholders in order to reduce the Fund’s taxable income to zero. Where, in a particular year, the Fund does not have sufficient available cash to distribute such an amount to Unitholders (for instance, where interest payments on the BP Loan or payments of the Royalty are due but not paid in whole or in part), the Declaration of Trust provides that additional Units must be distributed to Unitholders in lieu of cash distributions. Unitholders will generally be required to include an amount equal to the fair market value of those Units into their taxable income, in circumstances when they do not directly receive a cash distribution.

In addition, pursuant to the Acquisition Agreement under which BPI transferred the BP Rights to the Partnership, BPI and the Partnership made elections under the Tax Act to transfer the BP Rights on a partially tax-deferred basis. The cost to the Partnership of the BP Rights subject to those elections is less than fair market value of the BP Rights at the time of the transfer, such that the Partnership may realize taxable income on the future disposition of these marks.

#### **Investment Eligibility**

There can be no assurance that the Units will continue to be qualified investments for Deferred Income Plans and registered education savings plans under the Tax Act. The Tax Act imposes penalties for the acquisition or holding of non-qualified or ineligible investments.

***Dependence of the Fund on the Boston Pizza Holdings Trust (the “Trust”) and BPI***

The cash distributions to the Unitholders are entirely dependent on the ability of the Trust to pay its interest obligations under the Trust Notes, and to make distributions on the Trust Units and upon the ability of BPI to pay the interest on the BP Loan and the ability of the Trust to meet its obligations to assume payment of the BP Loan as consideration for the purchase of Class C Units.

The sole source of revenue of the Partnership and the Fund is the Royalty payable to the Partnership and the interest on the BP Loan payable to the Fund, by BPI. BPI collects franchise fees and other amounts from Boston Pizza franchisees and generates revenues from its corporate restaurants. In the conduct of the business, BPI pays expenses and incurs debt and obligations to third parties. These expenses, debts and obligations could impact the ability of BPI to pay the Royalty to the Partnership and interest on the BP Loan to the Fund.

The Partnership and the Fund are each entirely dependent upon the operations and assets of BPI to pay the Royalty to the Partnership and interest on the BP Loan to the Fund, and each is subject to the risks encountered by BPI in the operation of its business, including the risks relating to the casual dining restaurant industry referred to above and the results of operations and financial condition of BPI.

***Leverage: Restrictive Covenants***

The Partnership has third-party debt service obligations under the Operating Loan and the Term Loan. The degree to which the Partnership is leveraged could have important consequences to the holders of the Units, including: (i) a portion of the Partnership's cash flow from operations could be dedicated to the payment of the principal of and interest on its indebtedness, thereby reducing funds available for distribution to the Fund; and (ii) certain of the Partnership's borrowings will be at variable rates of interest, which exposes the Partnership to the risk of increased interest rates.

The Term Loan and Operating Loan contain numerous restrictive covenants that limit the discretion of the Partnership's management with respect to certain business matters. These covenants place restrictions on, among other things, the ability of the Partnership to incur additional indebtedness, to create liens or other encumbrances,

to pay distributions or make certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity. A failure to comply with the obligations in the Term and Operating Loans could result in an event of default which, if not cured or waived, could permit acceleration of the relevant indebtedness and acceleration. If the indebtedness under the Term Loan and Operating Loan were to be accelerated, there can be no assurance that the Trust's assets would be sufficient to repay in full that indebtedness.

Borrowings by BPI could adversely affect BPI's ability to pay the royalty, the Make-whole Payments and interest on the BP Loan.

***Cash Distributions are Not Guaranteed and Will Fluctuate with the Partnership's Performance***

Although the Fund intends to distribute the income earned by the Fund less expenses of the Fund and amounts, if any, paid by the Fund in connection with the redemption of Units, there can be no assurance regarding the amounts of income to be generated by the Fund or the Partnership. The actual amount distributed in respect of the Units will depend upon numerous factors, including payment of the Royalty and interest on the BP Loan by BPI.

***Nature of Units***

Securities such as the units are hybrids in that they share certain attributes common to both equity securities and debt instruments. The Units do not represent a direct investment in the Trust or the Partnership and should not be viewed by investors as units in the Trust or the Partnership. As holders of Units, Unitholders will not have the statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring “oppression” or “derivative” actions. The Units represent a fractional interest in the Fund. The Fund's only assets will be Series 1 Trust Notes and Trust Units, the BP Loan and Common Shares of Boston Pizza GP Inc. The price per Unit is a function of anticipated distributable cash.



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#### ***Possible Unitholder Liability***

The Declaration of Trust of the Fund provides that no Unitholder will be subject to any liability whatsoever to any person in connection with a holding of Units. However, there remains a risk, which is considered by the Fund to be remote in the circumstances, that a Unitholder could be personally liable despite such statement in the Declaration of Trust for the obligations of the Fund to the extent that claims are not satisfied out of the assets of the Fund. It is intended that the affairs of the Fund will be conducted to seek to minimize such risk wherever possible. There is legislation under the laws of British Columbia (discussed below) and other provinces which is intended to provide protection for beneficial owners of trusts.

On March 30, 2006, the Income Trust Liability Act (British Columbia) came into force. This legislation creates a statutory limitation on the liability of beneficiaries of British Columbia income Trusts such as the Fund. The legislation provides that a Unitholder will not be, as a beneficiary, liable for any act, default, obligation or liability of the trustees.

#### ***Distribution of Securities on Redemption or Termination of the Fund***

Upon a redemption of Units or termination of the Fund, the Trustees may distribute Series 2 Trust Notes and Series 3 Trust Notes directly to the Unitholders, subject to obtaining all required regulatory approvals. There is currently no market for the Series 2 Trust Notes and Series 3 Trust Notes. In addition, the Series 2 Trust Notes and Series 3 Trust Notes are not freely tradable and are not currently listed on any stock exchange. Securities of the Trust so distributed may not be qualified investments for trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education savings plans, depending upon the circumstances at the time.

#### ***The Fund May Issue Additional Units Diluting Existing Unitholders' Interests***

The Declaration of Trust authorizes the Fund to issue an unlimited number of Units and Special Voting Units for such consideration and on such terms and conditions as shall be established by the Trustees without the approval of any Unitholders. Additional Units will be issued by the Fund upon the exchange of the Class B Units.

#### **ADDITIONAL INFORMATION**

Copies of the following documents, containing additional information relating to the Fund, may be obtained upon request from the administrative office of the Fund at:

5500 Parkwood Way  
Richmond, British Columbia V6V 2M4

or may be found at [www.bpincomefund.com](http://www.bpincomefund.com) or [www.sedar.com](http://www.sedar.com):

- The Fund's Annual Information Form, together with one copy of any document, or the pertinent pages of any document, incorporated by reference in the Annual Information Form;
- The Fund's audited financial statements and management discussion and analysis for its most recently completed financial year for which financial statements have been filed, together with the accompanying auditors' report and a copy of the most recent interim financial statements and management discussion and analysis of the Fund that have been filed, if any, for any period after the end of its most recently completed financial year;
- The Fund's information circular in respect of its most recent annual meeting of Unitholders that involved the appointment of Trustees;
- A copy of the prospectus dated July 9<sup>th</sup>, 2002; and
- A copy of the audited financial statements and management discussion and analysis of Boston Pizza International Inc. for its most recently completed financial year and a copy of the most recent interim unaudited financial statements and management discussion and analysis of Boston Pizza International Inc.

A person who is not a Unitholder of the Fund may be required to pay a reasonable charge for such copies. Additional information, including Trustees' remuneration and indebtedness, principal holders of the Fund's securities and interests of insiders in material transactions, where applicable, is contained in the Fund's information circular for its most recent annual meeting of Unitholders that involved the appointment of Trustees. Additional financial information is provided in the Fund's audited financial statements for its most recently completed financial year.

**NOTE REGARDING FORWARD LOOKING STATEMENTS**

Certain statements in this management discussion and analysis may constitute “forward looking” statements that involve known and unknown risks, uncertainties, future expectations and other factors which may cause the actual results, performance or achievements of the Fund, the Boston Pizza Holdings Trust, the Partnership, BPI, BostonPizza restaurants, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward looking statements. When used in this management discussion and analysis, such statements use such words as “anticipate”, “estimate”, “may”, “will”, “expect”, “believe”, “plan” and other similar terminology. These statements reflect current expectations regarding future events and operating performance and speak only as of the date of this management discussion and analysis. These forward looking statements involve a number of risks, uncertainties and future expectations including, but not limited to the risks and uncertainties set out above in “Risks & Uncertainties”. This management discussion and analysis discusses some of the factors that could cause actual results to differ materially from those expressed in or underlying such forward looking statements. Forward looking statements are made as of the date hereof and we assume no obligation to update or revise them to reflect new events or circumstances.



**AUDITORS' REPORT  
TO THE UNITHOLDERS OF  
BOSTON PIZZA ROYALTIES  
INCOME FUND**

FOR THE YEAR ENDED DECEMBER 31, 2006

We have audited the consolidated balance sheets of Boston Pizza Royalties Income Fund as at December 31, 2006 and 2005 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. 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, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*KPMG LLP*

Chartered Accountants

Vancouver, Canada

January 24, 2007

(except as to note 11(c), which is as of February 19, 2007)



**BOSTON PIZZA  
ROYALTIES INCOME FUND**

**CONSOLIDATED  
BALANCE SHEETS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
<b>Assets</b>		
Current assets:		
Cash	\$ 275	\$ 1,415
Interest receivable on note receivable from Boston Pizza International Inc. (note 4)	\$ 150,000	\$ 150,000
Distributions receivable from Boston Pizza Royalties Limited Partnership	\$ 1,048,645	\$ 828,173
	\$ 1,198,920	\$ 979,588
Note receivable from Boston Pizza International Inc. (note 4)	\$ 24,000,000	\$ 24,000,000
Investment in Boston Pizza Royalties Limited Partnership (note 5)	\$ 98,854,840	\$ 77,100,557
	\$ 124,053,760	\$ 102,080,145
<b>Liabilities and Unitholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ –	\$ 50
Distributions payable to fund unitholders	\$ 1,198,640	\$ 978,169
	\$ 1,198,640	\$ 978,219
Unitholders' equity:		
Fund units (note 6(a))	\$ 122,606,237	\$ 100,829,377
Retained earnings	\$ 248,883	\$ 272,549
	\$ 122,855,120	\$ 101,101,926
Organization and nature of operations (note 1)		
Contingency (note 8)		
Subsequent events (note 11)		
	\$ 124,053,760	\$ 102,080,145

See accompanying notes to consolidated financial statements.

Approved by the Trustees:



John Cowperthwaite



William Brown



Robert Phillips

**BOSTON PIZZA  
ROYALTIES INCOME FUND**

**CONSOLIDATED STATEMENTS  
OF EARNINGS AND  
RETAINED EARNINGS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**Consolidated Statements of Earnings**

	2006	2005
Revenue (note 3(a)):		
Equity income related to BPI royalties	\$ 12,230,056	\$ 9,665,871
Interest income	\$ 1,800,059	\$ 1,800,059
Net earnings	\$ 14,030,115	\$ 11,465,930
Weighted average units outstanding (note 6(b))	\$ 10,806,211	\$ 9,540,761
Basic and diluted earnings per Fund unit	\$ 1.30	\$ 1.20

**Consolidated Statements of Retained Earnings**

	2006	2005
Retained earnings, beginning of year	\$ 272,549	\$ 208,127
Net earnings	\$ 14,030,115	\$ 11,465,930
Distributions declared to Fund unitholders	\$ (14,053,781)	\$ (11,401,508)
Retained earnings, end of year	\$ 248,883	\$ 272,549

See accompanying notes to consolidated financial statements.

**BOSTON PIZZA  
ROYALTIES INCOME FUND**

**CONSOLIDATED STATEMENTS  
OF CASH FLOWS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Cash provided by (used in):		
Operations:		
Net earnings	\$ 14,030,115	\$ 11,465,930
Equity income, an item not affecting cash	\$ (12,230,056)	\$ (9,665,871)
Distributions received from Boston Pizza Royalties Limited Partnership	\$ 12,032,161	\$ 9,601,508
Accounts payable and accrued liabilities	\$ (50)	\$ –
	\$ 13,832,170	\$ 11,401,567
Financing:		
Distributions paid to Fund unitholders	\$ (13,833,310)	\$ (11,401,508)
Increase (decrease) in cash	\$ (1,140)	\$ 59
Cash, beginning of year	\$ 1,415	\$ 1,356
Cash, end of year	\$ 275	\$ 1,415

Supplemental cash flow information (note 9)

See accompanying notes to consolidated financial statements.

**BOSTON PIZZA  
ROYALTIES INCOME FUND**

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**1. ORGANIZATION AND NATURE OF OPERATIONS:**

**(a) Organization:**

Boston Pizza Royalties Income Fund (the “Fund”) is an unincorporated open-ended limited purpose trust established under the laws of the Province of British Columbia. Pursuant to the Declaration of Trust signed June 10, 2002, as amended on July 17, 2002, an amount equal to all of the income of the Fund together with the non-taxable portion of any net capital gain realized by the Fund will be distributed by the Fund to its unitholders each month. As a result, the Fund will not be liable for income taxes. Income tax obligations related to the distributions by the Fund are obligations of the unitholders.

The Fund was established to indirectly, through the Boston Pizza Royalties Limited Partnership (the “Partnership”), acquire the trademarks and trade names owned by Boston Pizza International Inc. (“BPI”) and used in connection with the operation of Boston Pizza restaurants in Canada (collectively, the “BP Rights”). The BP Rights do not include the rights outside of Canada to any trademarks or trade names used by BPI or any affiliated entities in its business, and in particular do not include the rights outside of Canada to the trademarks registered or pending registration under the Trade-Marks Act (Canada). The BP Rights also exclude certain restaurant locations in Canada, primarily those locations that were opened subsequent to the formation of the Fund and have not been rolled into the Royalty Pool of the Fund (note 11(b)).

The Fund was also established to acquire, directly from a bank, the BPI loan (the “BP Loan”) in the principal amount of \$24 million.

**(b) Nature of operations:**

BPI carries on business as a franchisor of casual dining pizza and pasta restaurants and operates only in Canada. The rights to operations outside of Canada, which are owned by an affiliated company, and certain restaurants in Canada, as noted above, are not included in the Royalty Pool of the Fund.

Substantially all of the Fund’s revenues are earned from certain operations of BPI and, accordingly, the revenues of the Fund and its ability to pay distributions to unitholders is dependent on the ongoing ability of BPI 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 Boston Pizza Holdings Trust (the “Trust”), and its 80%-owned subsidiary Boston Pizza GP Inc. (“BPGP”) (collectively the “Companies” or “Fund”). BPGP is the managing general partner and BPI is a general partner of the Partnership. All residual ownership of BPGP is either directly or indirectly controlled by BPI.

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

All significant intercompany transactions have been eliminated.

The Partnership is considered to be a Variable Interest Entity and BPI is a primary beneficiary of the Partnership; accordingly, BPI is required to consolidate the Partnership. Prior to 2005, the Partnership was consolidated with the Fund based on its voting rights. The Partnership was established to acquire and hold the BP Rights, which were previously owned by BPI. The Partnership and BPI also entered into a License and Royalty agreement to allow BPI the use of the BP Rights for a term of 99 years, for which BPI pays 4% of the Franchise Revenues (as defined) of certain restaurants located in Canada (the “Royalty Pool”).

**(b) Revenue recognition:**

Interest revenue is recognized and accrued when earned.

**(c) Investment in Boston Pizza Royalties Limited Partnership:**

The investment in the Partnership is accounted for using the equity method. Under the equity method, the original cost of the investment is adjusted for the Fund’s share of post-acquisition earnings or losses and is reduced for distributions or advances received. The statement of earnings includes the Fund’s share of the Partnership’s earnings or losses for the year. 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 BPI.



**BOSTON PIZZA  
ROYALTIES INCOME FUND**

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**(d) Distributions:**

The amount of cash to be distributed to Fund unitholders is determined with reference to net earnings adjusted for amortization, other non-cash charges and interest on the term loan. Distributions to Fund unitholders are recorded when declared, made monthly and are subject to the Fund 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 period.

**(f) Use of estimates:**

The preparation of financial statements requires 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 and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination of impairment in the value of investments and provisions for contingencies. Actual results could differ from those estimates.

**(g) Financial instruments:**

The Fund's financial instruments consist of cash, interest receivable on note receivable from BPI, distributions receivable from the Partnership, note receivable from BPI, accounts payable and accrued liabilities, and distributions payable to fund unitholders. Management estimates that the fair values of these financial instruments, other than the note receivable from BPI, which is discussed below, approximate their carrying values. It is management's opinion that the Fund is not exposed to significant interest rate or credit risk from these financial instruments. Due to the interrelationship between the note receivable from BPI and the Class C Partnership units held by BPI (described in note 4), the fair value of the note cannot be reasonably estimated.

**3. OPERATIONS:**

**(a)** Franchise sales reported by Boston Pizza Restaurants in the Royalty Pool for the year ended December 31, 2006 were \$484,683,589 (2005 – \$393,212,490).

Equity and interest income earned by the Fund has been derived as follows:

	2006	2005
(in thousands of dollars, except number of restaurants in the Royalty Pool)		
Restaurants in the Royalty Pool	226	195
Franchise sales reported by restaurants in the Royalty Pool	\$ 484,684	\$ 393,212
Royalty income – 4% of Franchise sales	\$ 19,387	\$ 15,728
Administrative and interest expenses	\$ 1,062	\$ 891
Partnership earnings for the period before undernoted	\$ 18,325	\$ 14,837
BPI's interest	\$ (6,095)	\$ (5,171)
Equity income related to BPI royalties earned by Fund	\$ 12,230	\$ 9,666
Interest income	\$ 1,800	\$ 1,800
Net earnings	\$ 14,030	\$ 11,466
Basic and diluted earnings per Fund unit	\$ 1.30	\$ 1.20

## BOSTON PIZZA ROYALTIES INCOME FUND

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

(b) On January 1 of each year, the number of restaurants in the Royalty Pool on which BPI pays a royalty to the Fund is adjusted to include franchise sales from new Boston Pizza restaurants opened less franchise sales from any Boston Pizza restaurants that have permanently closed during the year. Effective January 1, 2006, restaurants opened on or before December 31 of the prior year are added to the Royalty Pool. The 2007 additions include all restaurants opened between January 1, 2006 and December 31, 2006 (2006 – November 2, 2004 and December 31, 2005) (note 11(b)). In return for adding this net franchise revenue to the Royalty Pool, BPI receives the right to indirectly acquire additional Fund units (the “Additional Entitlement”). The Additional Entitlement is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund Units. BPI initially receives 80% of the Additional Entitlement with the balance received when the actual full year performance of the new restaurants is known with certainty.

On January 1, 2006, 31 (2005 – 18) new Boston Pizza restaurants opened during the period from November 2, 2004 to December 31, 2005, were added to the Royalty Pool. The Franchise sales of these 31 new restaurants were initially estimated at \$61.1 million. The total number of restaurants in the Royalty Pool was increased to 226. The yield of the Fund units was determined to be 7.61% calculated using a weighted average unit price of \$15.59. Weighted average unit price is calculated based on the market price of the units traded on the TSX Stock Exchange during the period of twenty consecutive days ending on the fifth trading day before January 1, 2006. As a result of the contribution of the additional net sales to the Royalty Pool, and assuming 100% of the Additional Entitlement, BPI's Additional Entitlement is equivalent to 1,904,808 (2005 – 1,292,182) Fund units. BPI also receives a proportionate increase in monthly distributions from the Partnership. Of the Additional Entitlement, 20% (2006 – 380,962 units; 2005 – 258,436 units), remain unissued and are not eligible for conversion to Fund units until January 1, 2007 (2005 units – January 1, 2006) based on the actual performance of the new stores (see note 11(a)).

(c) On January 1, 2006, adjustments to royalty payments and Additional Entitlement were made based on the actual performance of eighteen restaurants added to the Royalty Pool on January 1, 2005. Based on these adjustments, BPI received its pro rata portion of the remaining Additional Entitlement, being 115,977 Fund units.

(d) On February 17, 2006, BPI exchanged Class B Partnership units for 1,311,859 Fund units. BPI then sold these Fund units to the public. As of December 31, 2006, there were 10,996,700 (2005 – 9,684,841) Fund units issued and BPI had a 20% indirect interest in the Fund.

BPI has agreed to maintain a minimum 20% indirect interest in the Fund until there are 275 restaurants in the Royalty Pool.

#### 4. NOTE RECEIVABLE FROM BOSTON PIZZA INTERNATIONAL INC.:

	2006	2005
Note receivable with interest payable monthly at 7.5% per annum, due July 17, 2042	\$ 24,000,000	\$ 24,000,000

The note arose at the time of the acquisition of the trademarks and trade names from BPI in July 2002 and is secured by a general security agreement. The note may not be assigned without the prior consent of BPI.

BPI, as the holder of 2,400,000 Class C Partnership units, has the right to transfer such Class C Partnership units to the Trust in consideration for the assumption by the Trust of, and the concurrent release of BPI of its obligations with respect to, an amount of the indebtedness under the BP loan equal to \$10.00 for each Class C Partnership unit transferred.

**BOSTON PIZZA  
ROYALTIES INCOME FUND**

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**5. INVESTMENT IN BOSTON PIZZA ROYALTIES LIMITED  
PARTNERSHIP:**

Balance as at December 31, 2004	\$ 62,798,866
Acquisition of additional Partnership units by issuing Fund units	\$ 14,237,327
Equity income	\$ 9,665,871
Distributions from the Partnership	\$ (9,601,507)
Balance as at December 31, 2005	\$ 77,100,557
Acquisition of additional Partnership units by issuing Fund units	\$ 21,776,860
Equity income	\$ 12,230,056
Distributions from the Partnership	\$ (12,252,633)
Balance as at December 31, 2006	\$ 98,854,840

Summarized balance sheet of the Partnership is as follows:

	2006	2005
Current assets	\$ 8,175,440	\$ 6,741,761
Long-term assets, consisting of the BP Rights	\$ 160,047,787	\$ 138,145,095
Total assets	\$ 168,223,227	\$ 144,886,856
Current liabilities	\$ 7,155,972	\$ 5,880,053
Long-term liabilities	\$ 5,000,000	\$ 5,000,000
Partners' surplus	\$ 156,067,255	\$ 134,006,803
Total liabilities and surplus	\$ 168,223,227	\$ 144,886,856

**6. FUND UNITS:**

(a) The Declaration of Trust of the Fund provides that an unlimited number of Fund units may be issued. Each Fund 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 distributions 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 A Partnership units and Class B Partnership units are 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 A Partnership units and Class B Partnership units were exchanged into Fund units as at 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 at a price based on market value as defined in the trust agreement, subject to a maximum of \$50,000 in 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.

**BOSTON PIZZA  
ROYALTIES INCOME FUND**

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**(b) Fund units outstanding:**

	2006	2005
December 31	10,996,700	9,684,841
Weighted average	10,806,211	9,540,761

**(c) Exchangeable units of the Partnership:**

	2006	2005
Units (underlying the Class B Partnership units)	3,130,137	2,679,647

BPI has the right to exchange each Class B Partnership unit it holds for a number of Fund Units based, at any time, on a defined calculation which is based in part on the net franchise revenues from restaurants opened subsequent to July 17, 2002. Class B Partnership units held by BPI carry voting rights equivalent to the number of units into which such Class B Partnership units are exchangeable at that time. Subject to the prior rights of the holders of Class C Partnership units, the holders of the Class B Partnership units are entitled to receive a cumulative preferential cash distribution equal to the distribution on Class C Partnership units multiplied by the number of Class B Partnership units issued, multiplied by a defined ratio which is based in part on the net franchise revenues from restaurants opened subsequent to July 17, 2002, and divided by the number of issued LP units. Class B Partnership units are also entitled to a pro rata share of residual distributions of the Partnership.

As described in note 3(b), on January 1, 2006, Class B Partnership units received Additional Entitlement equivalent to 1,904,808 units (2005 – 1,292,182 units), upon adding new stores to the Royalty Pool.

**7. RELATED PARTY TRANSACTIONS:**

The Fund has engaged BPI to provide certain administrative services on behalf of the Fund. These services were provided by BPI for no charge.

BPI is a related party by virtue of holding certain Partnership units.

**8. CONTINGENCY:**

BPI and the Fund are involved in trademark litigation with entities affiliated with McDonald's Restaurants of Canada (the "McDonald's Group"), opposing the registration by the McDonald's Group in Canada of the Boston Market trademark. Additionally, BPI and the Fund have commenced an action against the McDonald's Group to prevent them from infringing BPI's and the Fund's respective interests in the Boston Pizza trademarks by operating Boston Market in Canada. The McDonald's Group has filed a counterclaim and a separate action challenging the validity of the registered trademark "Boston Pizza" and related trademarks under the Trade-Marks Act (Canada). Management does not believe that this action will succeed. However, in the event that the challenge to the Boston Pizza trademarks is successful, the Fund would lose the benefits of registration of its trademarks under the Trade-Marks Act (Canada), which may mean losing the ability to prevent others from using the registered trademarks for the goods and services for which they are registered and to prevent others from using similar or confusing trademarks or names. However, the loss of the registration under the Trade-Marks Act (Canada), would not prevent the Fund from continuing to license and use the "Boston Pizza" and related trademarks in the existing operations and geographic territories where they are presently used and from taking other measures to protect their rights in respect of, and their ability to use, the "Boston Pizza" and related trademarks, in new areas where BPI and its sub-licensees do not presently operate Boston Pizza restaurants.



**BOSTON PIZZA  
ROYALTIES INCOME FUND**

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**9. SUPPLEMENTAL CASH FLOW INFORMATION:**

	2006	2005
Supplemental cash flow information:		
Interest received	\$ 1,800,059	\$ 1,800,059
Non-cash financing and investing activities:		
Acquisition of additional Partnership units by issuing Fund units	\$ 21,776,860	\$ 14,237,327

**10. INCOME TAXES:**

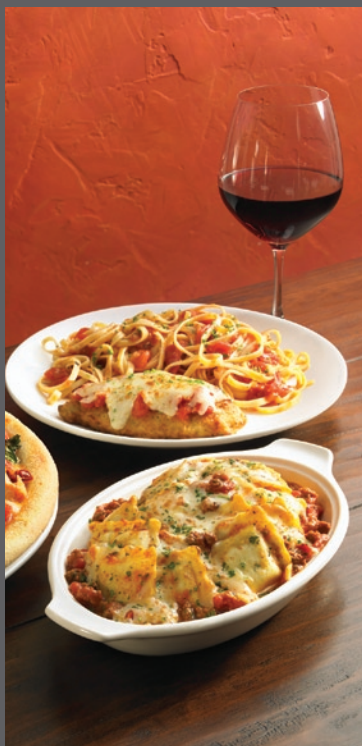
On October 31, 2006, proposed legislation was announced that would affect the non-taxable status of the Fund. The proposed taxation changes, if substantively enacted, would trigger recognition of future income tax assets and liabilities with a corresponding impact on future tax expense, based on the temporary differences expected to reverse after the date that the taxation changes take effect.

At December 31, 2006, the accounting bases of the Fund's consolidated assets and liabilities exceed the tax bases by approximately \$10.5 million (2005 – \$8.2 million).

**11. SUBSEQUENT EVENTS:**

- (a) On January 1, 2007, adjustments to royalty payments and Additional Entitlement were made based on the actual performance of 31 restaurants added to the Royalty Pool on January 1, 2006. Based on these adjustments, BPI will receive its pro rata portion of the remaining Additional Entitlement, 465,995 Fund units.
- (b) On January 1, 2007, 41 new Boston Pizza restaurants that opened during the period from January 1, 2006 to December 31, 2006 were added to the Royalty Pool. One restaurant that closed during the period was removed from the Royalty Pool. The Franchise sales of these 40 net new restaurants has been estimated at \$74.6 million. The total number of restaurants in the Royalty Pool has increased to 266. The yield of the Fund units was determined to be 8.64% calculated using a weighted average unit price of \$14.79. Weighted average unit price is calculated based on the market price of the unit traded on the TSX Stock Exchange 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, and assuming 100% of the Additional Entitlement, BPI's Additional Entitlement is equivalent to 2,158,478 (2005 – 1,904,808) Fund units. BPI will also receive a proportionate increase in monthly distributions from the Partnership. Of the Additional Entitlement, 20% (2007 – 431,696 units; 2006 – 380,962 units), remain unissued and are not eligible for conversion to Fund units until January 1, 2008 (2006 units – January 1, 2007) based on the actual performance of the new stores.
- (c) On February 19, 2007, BPI exchanged Class B Partnership units for 1,754,222 Fund units, resulting in an increase in the Fund's investment in the Partnership and unitholders' equity of approximately \$26,575,000. BPI then sold these Fund units to the public. Subsequent to the exchange and sale, BPI holds exchangeable Partnership units equivalent to 3,187,730 Fund units, or 20% of the issued and outstanding units on a fully diluted basis.

You're Among  
Friends at  
Boston Pizza



**BOSTON PIZZA  
INTERNATIONAL INC.**

**MANAGEMENT DISCUSSION  
AND ANALYSIS**

FOR THE YEAR ENDED DECEMBER 31, 2006

**FINANCIAL HIGHLIGHTS**

The tables below set out selected historical information and other data from the consolidated financial statements of Boston Pizza International Inc. ("BPI" or the "Company"), which should be read in conjunction with the attached consolidated financial statements of BPI.

	January 1, 2006 to December 31, 2006	January 1, 2005 to December 31, 2005	January 1, 2004 to December 31, 2004
	(in thousands of dollars)		
Restaurant System Franchise Sales <sup>1</sup>	\$ 521,202	\$ 417,385	\$ 352,015
<u>Income Statement Data</u>			
Total Revenue	\$ 56,650	\$ 45,397	\$ 36,164
Non-controlling interest related to royalty expense	\$ 12,230	\$ 9,666	\$ 7,876
Net Income (Loss) Before Taxes	\$ 8,819	\$ 5,707	\$ 3,020
	December 31, 2006	December 31, 2005	December 31, 2004
	(in thousands of dollars)		
Total Assets	\$ 63,011	\$ 64,831	\$ 50,767
Total Long-term Liabilities	\$ 45,008	\$ 45,449	\$ 34,976
Deferred Gain and Other	\$ 67,065	\$ 55,130	\$ 50,598
	Q4 2006	Q3 2006	Q2 2006
	(in thousands of dollars)		
Restaurant System Franchise Sales <sup>1</sup>	\$ 138,062	\$ 139,895	\$ 127,456
<u>Income Statement Data</u>			
Total Revenue	\$ 15,512	\$ 14,530	\$ 14,163
Non-controlling interest related to royalty expense	\$ 3,134	\$ 3,346	\$ 3,073
Net Income Before Taxes	\$ 884	\$ 1,614	\$ 1,774
	Q4 2005	Q3 2005	Q2 2005
	(in thousands of dollars)		
Restaurant System Franchise Sales <sup>1</sup>	\$ 115,695	\$ 111,585	\$ 101,073
<u>Income Statement Data</u>			
Total Revenue	\$ 13,254	\$ 12,340	\$ 10,178
Non-controlling interest related to royalty expense	\$ 2,589	\$ 2,671	\$ 2,383
Net Income Before Taxes	\$ 542	\$ 1,021	\$ (336)

1 Represents the Franchise Sales of the three restaurants owned by BPI and the Franchise Sales reported to BPI by franchised Boston Pizza restaurants without audit. Franchise Sales are gross revenue after deducting revenue from the sale of liquor, beer, wine and tobacco and revenue from BPI approved national promotions & discounts.

## OVERVIEW

This Management Discussion and Analysis covers the fiscal period from January 1, 2006 to December 31, 2006 (the “Year”) and the fourth quarter period from October 1, 2006 to December 31, 2006 (the “Period”) and is dated February 1, 2007. A copy of this report and additional information about BPI and the Boston Pizza Royalties Income Fund (the “Fund”) is available at [www.sedar.com](http://www.sedar.com) or [www.bpincomefund.com](http://www.bpincomefund.com).

BPI is a privately controlled company and is the franchisor of the Boston Pizza concept in Canada. The Company competes in the casual dining sector of the restaurant industry and is the number one casual dining brand in Canada. With 266 restaurants stretching from Victoria to St. John’s, all of which are in the royalty pool (the “Royalty Pool”), Boston Pizza has more locations and serves more customers annually than any other casual dining restaurant chain in Canada.

The Company charges a 7% royalty fee on Franchise Sales for all full-service Boston Pizza restaurants open in Canada and a 5% royalty fee on Franchise Sales for the four Boston Pizza Quick Express restaurants that are open in Canada. BPI pays the Fund a 4% royalty fee based on Franchise Sales of the specific royalty pool for the use of the Boston Pizza trademarks (the “BP Rights”<sup>2</sup>). There were 226 restaurants in the Royalty Pool for the Year.

On January 1 of each year (“Adjustment Date”), an adjustment is made to add to the Royalty Pool new Boston Pizza restaurants that opened prior to that Adjustment Date. In return for adding this additional royalty revenue, BPI receives the right to indirectly acquire additional Fund units (the “Additional Entitlements”). The adjustment for new Franchise Sales added to the Royalty Pool is designed to be accretive for Fund Unitholders. The Additional Entitlements are calculated at 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund, divided by the weighted average unit price. BPI receives 80% of the Additional Entitlements initially, with the balance received when the actual full year performance of the new restaurants is known with certainty.

<sup>2</sup> BP Rights are the trademarks that as at July 17, 2002 were registered or the subject of pending applications for registration under the *Trade-Marks Act* (Canada), and other trademarks and the trade names which are confusing with the registered or pending trademarks. The BP Rights purchased do not include the rights outside of Canada to any trademarks or trade names used by BPI or any affiliated entities in its business, and in particular do not include the rights outside of Canada to the trademarks registered or pending registration under the *Trade-Marks Act* (Canada).

BPI receives 100% of distributions from the Additional Entitlements throughout the year. Once these new restaurants have been part of the Royalty Pool for a full year, an audit of the royalty revenues of these restaurants received from BPI will be performed. At such time an adjustment will be made to reconcile distributions paid to BPI and the Additional Entitlements received by BPI.

## BUSINESS STRATEGY

The success of Boston Pizza can be attributed to three simple underlying principles that are the foundation for all of our strategic decision-making – the “Three Pillars” strategy.

- The commitment to franchisee profitability
- The commitment to continually enhance the Boston Pizza brand
- The commitment to continually improve the customer experience

The Company realizes that its franchisees have to be profitable to succeed. To enhance profitability and to facilitate the growth of Boston Pizza, BPI aggressively enhances and promotes the Boston Pizza brand through national television and radio advertising, and national and local promotions. The costs associated with national marketing of Boston Pizza are paid for by Boston Pizza Co-op Advertising (the “Co-op”). Franchisees pay 2.5% of Franchise Sales into the Co-op, 76% of these funds are used to purchase television and radio media advertising, and the remaining 24% is used for production of materials and administration. Both Boston Pizza franchisees and the corporate support staff continuously find new ways to improve the customer’s experience so that they will return to Boston Pizza again and again. Management is confident that this “Three Pillars” strategy will continue to focus BPI’s efforts and develop new markets and continue to strengthen Boston Pizza’s position as Canada’s number one casual dining brand.

The following information provides additional analysis of the operations and financial position of the Company and should be read in conjunction with the consolidated financial statements and accompanying notes. The financial statements are in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles.



## OPERATING RESULTS

Boston Pizza continued to post positive growth in 2006. System-wide Franchise Sales growth was 19.3% for the Period and 24.9% for the Year. Overall sales growth is achieved through new store openings and same store sales growth.

### Same store sales growth

Same store sales growth ("SSSG"), the key driver of yield growth for individual Unitholders of the Fund, is the increase in gross revenues of Boston Pizza restaurants as compared to gross revenues for the same period in the previous year, where restaurants were open for the full period in each year. SSSG was 6.9% for the Period and 8.4% for the Year. These SSSG figures are compared to the fourth quarter and fiscal year SSSG reported in 2005 of 10.5% and 8.0% respectively.

### New Store Openings and Renovations

During the Period, 18 new Boston Pizza restaurants were opened, bringing the total to 41 new restaurant openings for the Year. Also during the Period, one restaurant closed when the franchise agreement was not renewed on its expiry date because the franchisee decided it would not meet the renewal conditions set by BPI. As a result of the make-whole payment provisions outlined in the License and Royalty Agreement dated July 17, 2002, as amended (the "Make-whole Payment"), BPI was obligated to make the Make-whole Payment during the period from the date of closure to December 31, 2006 (the "Royalty Payment Period") when new restaurants were added to the Royalty Pool. The Make-whole Payment is calculated on the following formula:

$$4\% \times \left[ \frac{\text{\#days closed during}}{\text{Royalty Payment Period}} \right] \times \left[ \frac{\text{lost franchise revenues}}{\text{(defined below)}} \right]$$

365

Lost franchise revenues are calculated based upon the amount of Franchise Revenues of the closed restaurant for the first 12 months after it was included in the Royalty Pool. The Make-whole Payment required for this one restaurant is \$11,115.

As well, during the Period, ten Boston Pizza restaurants were renovated. A total of 25 Boston Pizza restaurants have completed major renovations and one restaurant was relocated during the Year. Typically, locations are closed for two to three weeks for renovation.

Newly renovated locations typically experience a sales increase of 10 – 15% in the year following the renovation.

### Revenues

BPI's revenues during the Period were \$15,512,046 and \$13,254,091 for the same period in 2005. For the Year, BPI's revenues were \$56,650,061 compared to \$45,397,408 in 2005. The increase in revenues is primarily attributed to royalties from new store openings and positive SSSG. BPI's revenue is mainly derived from royalty income from franchised Boston Pizza restaurants, sales in corporately owned restaurants, initial franchise fees, and franchise renewal fees.

### Expenses

During the Period, non-controlling interest related to royalty expense was \$3,134,050 compared to \$2,588,505 for the same period in 2005. For the Year, this expense was \$12,230,056 compared to \$9,665,872 in 2005. This represents the royalty expense for the use of the BP Rights net of amounts due to BPI with respect to its interest in the Boston Pizza Royalties Limited Partnership (the "Partnership").

Administrative expenses and restaurant operating costs during the Period were \$9,559,151 and \$8,605,242 for the same period in 2005. For the Year, administrative expenses and restaurant operating costs were \$32,743,700 compared to \$28,696,863 for the same period in 2005. These expenses include salary and administrative costs associated with the services provided to franchised Boston Pizza restaurants, the operation of the three corporately owned restaurants, and development activities in established territories. Operating expenses increased during the Period primarily due to the hiring of additional employees to support continued expansion. Expenses were lower in 2005 compared to 2006 due to the opening of a third corporate restaurant in Laval, Québec during the third quarter of 2005 and hiring of additional employees to support the continued expansion.

BPI presents the costs of developing territories separately until the operational break-even is achieved. BPI's entry into the Québec market is currently presented as a developing territory. The development and administrative expenses for Québec totaled \$901,480 during the Period and \$449,475 for the same period in 2005. For the Year these expenses totaled \$2,733,184 compared to \$1,591,679 for the same period in 2005.

### **Other Income and Expenses**

Before taking into account depreciation and amortization, management fee, amortization of deferred gain associated with the sale of the BP Rights, interest on the loan from the Fund, interest on long-term debt, and gain on the sale of Partnership units and income tax, earnings were \$1,916,365 during the Period and \$1,611,869 for the same period in 2005. For the Year these earnings were \$8,943,121 compared to \$5,442,994 for the same period in 2005.

Depreciation and amortization was \$424,911 for the Period and \$330,774 for the same period in 2005. For the Year, depreciation and amortization was \$1,490,111 compared to \$874,190 for the same period in 2005.

Management fees were \$217,590 during the Period and \$358,683 for the same period in 2005. For the Year, management fees were \$857,668 and \$1,153,416 for the same period in 2005.

Interest expense on the \$24 million loan acquired by the Fund at the time of initial public offering ("IPO") was \$450,000 during the Period and \$450,000 for the same period in 2005. For the Year, this interest expense was \$1,800,000 compared to \$1,800,000 for the same period in 2005.

Interest on long-term debt was \$138,048 during the Period and \$87,108 for the same period in 2005. Interest expense on the \$5 million term loan held by the Partnership of \$85,068 (2005 – \$69,555) is included in this amount. For the Year, interest on long-term debt was \$495,898 compared to \$296,657 for the same period in 2005. Interest expense on the \$5 million term loan held by the Partnership of \$325,547 (2005 – \$257,329) is included in this amount.

The amortization of the deferred gain from the IPO was \$198,139 during the Period and \$156,474 for the same period in 2005. For the Year, amortization of the deferred gain from the IPO was \$769,968 and \$648,405 for the same period in 2005. The deferred gain arose from the sale of BP Rights to the Fund and is amortized over 99 years, the term of the License and Royalty Agreement. The net deferred gain as at December 31, 2006 was \$67,064,806.

Given the combined effects of the above-noted factors, BPI produced earnings before income taxes of \$883,955 for the Period and an

after tax loss of \$465,550. Earnings before tax were \$541,778 for the same period in 2005 and after tax earnings were \$58,308. For the Year, BPI produced earnings before income taxes of \$8,819,153 and after tax earnings of \$5,261,764. Earnings before tax were \$5,706,915 for 2005 and after tax earnings were \$3,812,545.

### **NEW RESTAURANTS ADDED TO THE ROYALTY POOL**

As of December 31, 2006 there were 10,996,700 Fund units issued – 13,745,875 on a fully diluted basis – and BPI had a 20% indirect interest in the Fund. BPI has committed to maintain a minimum 20% indirect interest in the Fund until there are 275 restaurants in the Royalty Pool.

On January 1, 2007, the number of Boston Pizza restaurants included in the Fund's Royalty Pool was increased to include the 41 new restaurants opened across Canada during the period January 1, 2006 to December 31, 2006. One restaurant which closed during the Year was removed from the Royalty Pool. In return for adding the royalty revenue from these 40 net new restaurants to the Royalty Pool, BPI received the right to acquire an additional 1,726,782 Units, representing 80% of the Additional Entitlements with the balance received when the actual full year performance of the new restaurants is known with certainty. The 1,726,782 Additional Entitlements represented 11.2% of the Units on a fully diluted basis. BPI also receives an increase in monthly distributions based on 100% of the Additional Entitlements. The calculation for the number of Additional Entitlements received by BPI is designed to be accretive to existing Unitholders as the additional royalty revenues from the new restaurants are licensed to the Fund at a 7.5% discount. The estimated annual gross franchise revenue for the 40 net new restaurants in 2007 is \$74,555,000, due to the addition of \$75,777,000 in estimated annual gross franchise revenue for the 41 new restaurants less \$1,222,000 in annual gross franchise revenue from the one closed restaurant. The estimated 4% royalty revenue the Fund will receive in 2007 from these additional 40 net new restaurants is \$2,982,200. The royalty revenue for the purposes of calculating the Additional Entitlements, therefore, is \$2,758,535 or 92.5% of \$2,982,200. Once the actual performance of these new Royalty Pool restaurants for 2007 is known, the number of Additional Entitlements will be adjusted in 2008 to reflect the actual royalty revenue received by the Fund in 2007. As of January 1, 2007 there were 266 restaurants in the Royalty Pool.

**BOSTON PIZZA  
INTERNATIONAL INC.**

**MANAGEMENT DISCUSSION  
AND ANALYSIS**

FOR THE YEAR ENDED DECEMBER 31, 2006

In January 2007 an audit of the royalty revenues of the 31 locations that were added to the Royalty Pool on January 1, 2006 was completed. The purpose of this audit was to compare actual royalty revenue from these 31 locations to the estimated amount of royalty revenue the Fund expected to receive. The original royalty revenue the Fund expected to receive was \$2,443,920 and the actual royalty revenue that the Fund received was \$2,553,020. As a result of this adjustment and distributions that were paid on the excess units, the Partnership made a further cash payment to BPI of \$108,672 to reconcile distributions received by BPI for the difference between estimated and actual royalty revenue for the 31 locations. As a result of this adjustment and distributions that were paid on the excess units, the Partnership made a further cash payment to BPI of \$108,672 to reconcile distributions received by BPI for the difference between estimated and actual royalty revenue for the 31 locations. Since BPI only received 80% of the Additional Entitlements at the Adjustment Date in 2006, following this audit BPI received the right to acquire 465,995 Additional Entitlements.

**LIQUIDITY & CAPITAL RESOURCES**

The Partnership has a \$1 million revolving operating line of credit with a 364-day term to allow for any seasonal variations that could result in mismatches between royalty revenue inflows and distributions to Unitholders of the Fund. Since inception in July, 2002, the line of credit has been maintained with a nil balance.

BPI is an entirely franchised business except for three corporate restaurants. For 2007, BPI has forecasted capital requirements of approximately \$3,140,000 which will consist mainly of the renovation of one corporate location and the purchase of office and computer equipment. Approximately \$1,000,000 of this amount will be provided through new bank financing.

**Long-Term Debt Obligations**

The Partnership has a \$5 million non-revolving term loan facility, with a current maturity date of July 5, 2009, that was arranged during the IPO to partially finance the purchase of the BP Rights from BPI and to provide term debt as part of the capital structure.

BPI has long-term debt obligations for equipment financing that are secured by specific assets of the Company. These term loans are secured by a general assignment of book debts and certain guarantees from the Company, shareholders and related companies.

Principal repayments on BPI's long-term debt and capital lease obligations, excluding the Partnership's \$5 million term loan, for the next five years ending December 31 are as follows:

2007	\$ 747,396
2008	\$ 1,029,263
2009	\$ 346,545
2010	\$ 339,535
2011	\$ 363,204

**Other Long-Term Commitments**

BPI is committed under operating lease contracts for office space, restaurant space and advertising contracts. The minimum annual rental payments under these leases for the next five years ending December 31 are as follows:

2007	\$ 1,998,852
2008	\$ 1,659,656
2009	\$ 1,471,412
2010	\$ 1,398,124
2011	\$ 1,029,040

**MANAGEMENT DISCUSSION  
AND ANALYSIS**

FOR THE YEAR ENDED DECEMBER 31, 2006

**Outlook**

Boston Pizza is well positioned for future growth and should continue to strengthen its position as the number one casual dining brand in Canada. In 2007 BPI management anticipates that approximately 40 new locations will open across Canada. Management will continue to pursue further development in Western Canada and the Atlantic provinces, while the majority of new locations are expected to be in Ontario and Québec. BPI estimates that its 275<sup>th</sup> restaurant will open in early 2007 and will be added to the Royalty Pool on January 1, 2008. At that point, BPI will no longer be obligated for Make-whole Payments or minimum interest obligation as described in the Fund's prospectus.

Boston Pizza's operating strategy and execution have consistently delivered annual SSSG above industry averages and, with the impact of national and local marketing programs and BPI's unique restaurant renovation program, BPI management expects this performance to continue in 2007. BPI anticipates approximately 24 locations will conduct major renovations which will facilitate the ongoing effort to deliver industry-leading SSSG. Boston Pizza restaurants achieved outstanding SSSG in the first quarter of 2006, of 12.7% and BPI management recognizes that SSSG in the first quarter of 2007 will be compared against this very strong result.

As with all forward-looking statements, due care and caution should be employed to ensure that appropriate interpretation is made.<sup>3</sup>

**RISKS & UNCERTAINTIES**

***The Restaurant Industry***

The performance of the Fund is directly dependent upon the royalty and interest payments received from BPI. The amount of royalty received from BPI is dependent on various factors that may affect the casual dining sector of the restaurant industry. The restaurant industry generally, and in particular the casual dining sector, is intensely competitive with respect to price, service, location and food quality. Competitors include national and regional chains, as well as independently owned restaurants. If BPI and the Boston Pizza franchisees are unable to successfully compete in the casual dining sector, Franchise Sales may be adversely affected; the amount of royalty reduced and the ability of BPI to pay the royalty or interest on the BP Loan may be impaired. The restaurant industry is also affected by changes in demographic trends, traffic patterns, and the type, number, and location of competing restaurants. In addition, factors such as government regulations, smoking bylaws, inflation, publicity from any food borne illnesses, increased food, labour and benefits costs, and the availability of experienced management and hourly employees may adversely affect the restaurant industry in general and therefore potentially Boston Pizza Franchise Sales. BPI's success also depends on numerous factors affecting discretionary consumer spending, including economic conditions, disposable consumer income and consumer confidence. Adverse changes in these factors could reduce guest traffic or impose practical limits on pricing, either of which could reduce revenue and operating income, which could adversely affect revenue, the royalty and the ability of BPI to pay the royalty to the Fund or interest on the BP Loan.

***Boston Chicken / Boston Market Litigation***

Since 1995, BPI has been challenging Boston Chicken Inc.'s and Global Restaurant Operations of Ireland Limited's registration of the "Boston Chicken" trademark in Canada. In March 2003, the Federal Court of Appeal unanimously ordered the expungement of "Boston Chicken" from the trademark registry. The expungement of the "Boston Chicken" trademark was a significant victory because there is now only one owner, the Partnership, of registered trademarks using "Boston" in connection with restaurant foodservices in Canada. Additionally, since 1995, BPI has opposed the registration of the "Boston Market" trademark. As a result, "Boston Market" is not yet a registered trademark.

<sup>3</sup> Certain statements in this Management Discussion and Analysis may constitute "forward-looking" statements which involve known and unknown risks, uncertainties, future expectations and other factors which may cause the actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. When used in this annual report such statements are such words as "may", "will", "expect", "believe", "plan", "anticipate" and other similar terminology. These statements reflect management's current expectations regarding future events and operating performance and speak only as of the date of this annual report. These forward-looking statements involve a number of risks, uncertainties and future expectations. The following are some factors that could cause actual results to differ materially from those expressed in or underlying such forward-looking statements: competition; changes in demographic trends; changing consumer preferences and discretionary spending patterns; changes in national and local business and economic conditions; legislation and governmental regulation; accounting policies and practices; and the results of operations and financial condition of BPI. The foregoing list of factors is not exhaustive. Forward looking statements are made as of the date hereof and we assume no obligation to update or revise them to reflect new events or circumstances.

**BOSTON PIZZA  
INTERNATIONAL INC.**

**MANAGEMENT DISCUSSION  
AND ANALYSIS**

FOR THE YEAR ENDED DECEMBER 31, 2006

In 2002, BPI and the Partnership commenced legal action against Global Restaurant Operations of Ireland Limited, Boston Market Canada Company, Boston Market Corporation and McDonald's Restaurants of Canada Limited (collectively the "McDonald's Group") for trademark infringement over the McDonald's Group's use of "Boston Market". In the fall of 2002, the McDonald's Group commenced legal actions challenging the validity of the Boston Pizza trademarks owned by the Partnership, some of which have been registered, and in use for over 30 years. BPI management believes that this is a tactical maneuver by the McDonald's Group and is unlikely to succeed. However in the unlikely event that the challenge to the Boston Pizza trademarks is successful, the Partnership would lose the benefits of registration of its trademarks under the Trade-Marks Act (Canada), which may mean losing the ability to prevent others from using the registered trademarks for the goods and services for which they are registered and to prevent others from using similar or confusing trademarks or names. However the loss of the registration under the Trade-Marks Act (Canada) would not prevent the Partnership from continuing to license and use the "Boston Pizza" and related trademarks in the existing operations and geographic territories where they are presently used and from taking other measures to protect their rights in respect of, and their ability to use, the "Boston Pizza" and related trademarks in new areas where BPI and its sub-licensees do not presently operate Boston Pizza restaurants. The parties are waiting for trial dates, none of which have been set. BPI management does not expect the infringement trial to commence before 2008. BPI management believes that ultimately, BPI and the Partnership will succeed in its litigation with the McDonald's Group. However, there are no assurances or certainty as to the eventual outcome of these legal proceedings.

For a more detailed list of risks and uncertainties please refer to the Fund's Annual Information Form for the fiscal year ended December, 31, 2006 which is available at [www.sedar.com](http://www.sedar.com).

**ADDITIONAL INFORMATION**

Additional Information relating to BPI, the Partnership and the Fund is available on SEDAR at [www.sedar.com](http://www.sedar.com), including the Fund's Annual Information Form for the fiscal year ended December 31, 2006.



**AUDITORS' REPORT  
TO THE SHAREHOLDERS  
OF BOSTON PIZZA  
INTERNATIONAL INC.**

YEARS ENDED DECEMBER 31, 2006 AND 2005

We have audited the consolidated balance sheets of Boston Pizza International Inc. as at December 31, 2006 and 2005 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company'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 Company as at December 31, 2006 and 2005, the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*KPMG LLP*

Chartered Accountants  
Vancouver, Canada

January 29, 2007  
(except as to note 20(c), which is as of February 19, 2007  
and as to note 20(d), which is as of March 23, 2007)

**BOSTON PIZZA  
INTERNATIONAL INC.**

**CONSOLIDATED  
BALANCE SHEETS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
<b>Assets</b>		
Current assets:		
Cash	\$ 4,891,265	\$ 3,790,932
Accounts receivable (note 16)	\$ 8,051,101	\$ 7,888,819
Prepaid expenses	\$ 1,102,408	\$ 656,065
Future income taxes (note 12)	\$ 194,685	\$ 228,814
	<hr/>	<hr/>
	\$ 14,239,459	\$ 12,564,630
Long-term receivables (note 6)	\$ 24,604,232	\$ 32,478,189
Long-term investments (note 5)	\$ 74,476	\$ 74,476
Capital assets (note 7)	\$ 6,978,137	\$ 6,465,996
Deferred charges and intangible assets (note 8)	\$ 328,499	\$ 334,299
Future income taxes (note 12)	\$ 16,786,091	\$ 12,912,980
	<hr/>	<hr/>
	\$ 63,010,894	\$ 64,830,570

See accompanying notes to consolidated financial statements.

**BOSTON PIZZA  
INTERNATIONAL INC.**

**CONSOLIDATED  
BALANCE SHEETS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
<b>Liabilities and Shareholders' Deficiency</b>		
Current liabilities:		
Accounts payable and accrued liabilities (note 16)	\$ 9,384,033	\$ 8,377,497
Income taxes payable	\$ 929,465	\$ 580,354
Current portion of deferred revenue	\$ 2,340,655	\$ 2,706,061
Current portion of long-term debt (note 9)	\$ 747,396	\$ 710,554
	\$ 13,401,549	\$ 12,374,466
Long-term debt (note 9)	\$ 7,777,399	\$ 7,078,243
Income tax payable	\$ 5,166,797	\$ –
Deferred revenue	\$ 4,165,820	\$ 4,243,877
Notes payable (note 10)	\$ 24,000,000	\$ 30,300,000
Other long-term liabilities (note 11)	\$ 3,897,988	\$ 3,826,998
Deferred gain (note 4)	\$ 67,064,806	\$ 55,129,592
Shareholders' deficiency:		
Share capital (note 13)	\$ 100	\$ 100
Deficit	\$ (62,463,565)	\$ (48,122,706)
	\$ (62,463,465)	\$ (48,122,606)
Commitments (note 14)		
Contingencies (note 15)		
Subsequent events (note 20)		
	\$ 63,010,894	\$ 64,830,570

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:



George Melville, Director



James Treliving, Director

**BOSTON PIZZA  
INTERNATIONAL INC.**

**CONSOLIDATED STATEMENTS  
OF OPERATIONS AND DEFICIT**

YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Franchise, restaurant – established territories and other revenues (note 16)	\$ 56,650,061	\$ 45,397,408
Administrative expenses, expenses of established territories and restaurant operating costs (note 16)	\$ 32,743,700	\$ 28,696,863
Development and administrative expenses – Québec (note 3(e))	\$ 2,733,184	\$ 1,591,679
Non-controlling interest related to royalty expense	\$ 12,230,056	\$ 9,665,872
Earnings before undernoted	\$ 8,943,121	\$ 5,442,994
Depreciation and amortization	\$ 1,490,111	\$ 874,190
Management fee (note 16)	\$ 857,668	\$ 1,153,416
Interest on note payable to Boston Pizza Royalties Income Fund (note 16)	\$ 1,800,000	\$ 1,800,000
Interest on long-term debt	\$ 495,898	\$ 296,657
Amortization of deferred gain (note 4)	\$ (769,968)	\$ (648,405)
Gain on sale of Fund units	\$ (3,749,741)	\$ (3,739,779)
Earnings before income taxes	\$ 8,819,153	\$ 5,706,915
Income tax expense (recovery) (note 12):		
Current	\$ 7,479,605	\$ 785,500
Future	\$ (3,922,216)	\$ 1,108,870
	\$ 3,557,389	\$ 1,894,370
Net earnings	\$ 5,261,764	\$ 3,812,545
Deficit, beginning of year	\$ (48,122,706)	\$ (43,090,511)
Dividends declared	\$ (19,500,000)	\$ (10,300,000)
Refundable dividend tax	\$ (102,623)	\$ 1,455,260
Deficit, end of year	\$ (62,463,565)	\$ (48,122,706)

See accompanying notes to consolidated financial statements.

**BOSTON PIZZA  
INTERNATIONAL INC.**

**CONSOLIDATED STATEMENTS  
OF CASH FLOWS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Cash provided by (used in):		
Operations:		
Net earnings	\$ 5,261,764	\$ 3,812,545
Items not affecting cash:		
Depreciation and amortization	\$ 1,490,111	\$ 874,190
Future income taxes	\$ (3,922,216)	\$ 1,108,870
Amortization of deferred gain	\$ (769,968)	\$ (648,405)
Gain on sale of Boston Pizza Royalties Limited Partnership units	\$ (3,749,741)	\$ (3,739,779)
Non-controlling interest related to royalty expense	\$ 12,230,056	\$ 9,665,872
Distributions to non-controlling interest	\$ (11,897,041)	\$ (9,601,500)
Change in non-cash operating items (note 19(a))	\$ (106,926)	\$ (2,535,399)
	\$ (1,463,961)	\$ (1,063,606)
Investments:		
Long-term receivables	\$ (1,526,043)	\$ (6,749,705)
Sale of Fund Units, net of transaction costs	\$ 21,738,291	\$ 14,266,157
Purchase of capital assets, net	\$ (1,983,952)	\$ (4,768,563)
	\$ 18,228,296	\$ 2,747,889
Financing:		
Repayment of long-term debt	\$ (704,966)	\$ (241,930)
Proceeds from long-term debt	\$ 1,440,964	\$ 2,710,820
Payment of dividends	\$ (16,400,000)	\$ (4,000,000)
	\$ (15,664,002)	\$ (1,531,110)
Increase in cash	\$ 1,100,333	\$ 153,173
Cash, beginning of year	\$ 3,790,932	\$ 3,637,759
Cash, end of year	\$ 4,891,265	\$ 3,790,932

See supplementary cash flow information (note 19(b))

See accompanying notes to consolidated financial statements.



## BOSTON PIZZA INTERNATIONAL INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

#### 1. NATURE OF OPERATIONS:

Boston Pizza International Inc. (the "Company") was incorporated on May 26, 1982 under the laws of British Columbia and continued under the Canada Business Corporations Act on August 26, 2002. Its principal business activity is the operation and franchising of Boston Pizza restaurants in Canada. The Company initially focused on the growth of its business in Western Canada and is currently in the process of developing its Eastern Canada market.

#### 2. BASIS OF PRESENTATION:

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles, and include the accounts of the following entities, after elimination of all material intercompany balances and transactions:

Boston Pizza International Inc. and subsidiaries:	
Lansdowne Holdings Ltd.	100.00%
Winston Churchill Pizza Ltd.	100.00%
Laval Corporate Training Centre Inc.	100.00%
Boston Pizza Royalties Limited Partnership	20.00%

In June 2003, the CICA issued Accounting Guideline 15, *Consolidation of Variable Interest Entities* ("AcG-15"), requiring the consolidation of variable interest entities ("VIEs") by the primary beneficiary of the expected residual returns or losses or both of the VIE. A 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. AcG-15 became effective for the Company on January 1, 2005 with retroactive application to its comparative results for the prior year.

Boston Pizza Royalties Limited Partnership (the "Partnership") is considered to be a VIE and the Company is the primary beneficiary of the Partnership, accordingly the Company now consolidates the Partnership. Previously, the Partnership was consolidated by Boston Pizza Royalties Income Fund (the "Fund") based on its voting rights and the Company accounted for its investment in the Partnership on an equity basis. The Partnership was established to hold the trademarks and trade names used

in connection with the operation of Boston Pizza restaurants in Canada (collectively, the "BP Rights"). The Partnership and the Company also entered into a License and Royalty agreement to allow the Company the use of the BP Rights for a term of 99 years, for which the Company pays the Partnership 4% of the Franchise Revenues (as defined) of certain restaurants located in Canada (the "Royalty Pool").

#### 3. SIGNIFICANT ACCOUNTING POLICIES:

##### (a) Inventory:

Inventory of supplies is valued at the lower of cost and replacement cost.

##### (b) Capital assets:

Capital assets are recorded at cost less accumulated depreciation.

##### (c) Depreciation and amortization:

The Company provides for depreciation of capital assets over their estimated useful lives as follows:

Asset	Basis	Rate
Building	Declining balance	4%
Office furniture and equipment	Declining balance	10–50%
Office furniture and equipment under capital lease	Straight-line at various rates	up to 7 years
Leasehold improvements	Straight-line	term of the lease

##### (d) Revenue recognition and deferred revenue:

###### (i) Franchise revenues:

###### AREA FRANCHISE FEES:

Area franchise fee deposits are deferred until the agreed number of franchisee-owned restaurants is opened. The area franchise fee is expected to match costs incurred by the Company during the pre-opening period and is amortized into income as restaurants are opened. In the event that the required number of restaurants is not opened during the specified time period, the deposit becomes non-refundable and is recognized as income.

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**MONTHLY FRANCHISE FEE:**

Monthly franchise fees are recorded as they are earned, net of any allowance for doubtful accounts.

**FRANCHISE FEE DEPOSITS:**

Franchise fee deposits are deferred and presented net of expenses incurred relating to the sale of the franchise. When the franchise commences operations, the franchise deposits are recorded as franchise revenue and the related costs are included as an expense.

**(ii) Restaurant revenues:**

Revenue from corporately owned restaurant operations is recorded when services are rendered.

**(iii) Supplier contributions:**

The Company receives supplier contributions from franchisee suppliers to be used for various franchise activities. Supplier contributions are recorded as they are earned.

**(e) Established and developing territories:**

The Company develops a territorial business plan, when establishing new markets, but initially requires an infrastructure that will identify appropriate locations, attract franchise candidates and develop operating procedures applicable to the new territory.

As part of the business plan, the Company estimates the minimum number of franchise locations required to be opened that would generate sufficient franchise revenues to meet the incremental costs of operating the new territory. The costs of developing territories are separately presented in the financial statements until the minimum number of franchise locations have been opened, at which time the costs of operating the territory are included in administrative expenses – established territories.

**(f) Income taxes:**

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment.

The refundable portion of taxes on investment income is charged to retained earnings. The recovery of refundable taxes previously charged to retained earnings is credited to retained earnings in the period it becomes receivable.

**(g) Cash:**

Cash consists of cash on hand, balances with banks, and short-term investments with an initial term of three months or less.

**(h) Restaurant locations – Canada:**

	2006	2005
Corporately owned restaurants included in the Royalty Pool	3	2
Franchised restaurants included in the Royalty Pool	223	193
	226	195
Corporately owned restaurants excluded from the Royalty Pool (notes 4 and 20(b))	–	1
Closure of franchised restaurant included in Royalty Pool	1	–
Franchised restaurants excluded from the Royalty Pool (notes 4 and 20(b))	41	30
	266	226

**BOSTON PIZZA  
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During the year, one restaurant closed when the franchise agreement was not renewed on its expiry date of October 10, 2006 because the franchisee decided it would not meet the renewal conditions set by BPI. As a result of the make-whole payment provisions outlined in the License and Royalty Agreement dated July 17, 2002, as amended (the "Make-whole Payment"), BPI is obligated to make the Make-whole Payment during the period from the date of closure to December 31, 2006 (the "Royalty Payment Period") when new restaurants are to be added to the Royalty Pool. The Make-whole Payment required for this one restaurant is \$11,115.

**(i) Investment in BP International Rights Holdings Inc.:**

As part of the sale of intangible assets (note 8), the Company transferred to BP International Rights Holdings Inc. ("IP Co") (a company controlled by the ultimate shareholders of the Company) certain intellectual property ("the Operating Systems") in exchange for preferred shares of IP Co.

The Operating Systems consist of processes, procedures, and all other intellectual property inherent to the Operating Systems for use outside of Canada.

**(j) Use of estimates:**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates include the valuation of accounts receivable and long-term receivables, capital assets, future income tax benefits, deferred charges, deferred revenue and estimated income taxes payable.

**(k) Goodwill:**

Goodwill represents the excess of the purchase price over the fair value of net assets acquired. On an ongoing basis, management reviews the valuation and amortization of goodwill, taking into consideration any events and circumstances which might have impaired its carrying value.

**(l) Tenant inducements:**

Tenant inducements received either in the form of cash or rent free periods are deferred and amortized as a reduction in rent over the period of the lease term.

**(m) Deferred gain:**

The gain realized on sale of the BP Rights is being deferred and amortized over the 99 year term of the License and Royalty Agreement (note 8).

**(n) Financial instruments:**

**(i) Fair values:**

The carrying values of cash, accounts receivable, accounts payable, accrued liabilities and income taxes payable approximate their fair values due to the relatively short periods to maturity of the instruments. The interest bearing portion of the long-term receivables, long-term debt and note payable to the Boston Pizza Royalties Income Fund bear interest at rates that, in management's opinion, approximate the current interest rates and therefore carrying values approximate their fair values. Included in long-term receivables are non-interest bearing advances to related companies totaling \$997,883 (2005 – \$7,467,835), accordingly management has not determined the fair value of these advances due to their related party nature and the absence of a secondary market for such instruments.

**(ii) Credit risk:**

The distribution of the Company's franchisees and suppliers and the business risk management procedures have the effect of avoiding any significant concentration of credit risk.

**BOSTON PIZZA  
INTERNATIONAL INC.**

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**4. DEFERRED GAIN:**

	2006	2005
Balance, beginning of year	\$ 55,129,592	\$ 50,598,098
Fund units received on		
exchange of Partnership units	\$ 17,988,551	\$ 10,527,756
Long-term incentive plan (note 11)	\$ (5,283,369)	\$ (5,347,857)
Amortization of deferred gain	\$ (769,968)	\$ (648,405)
	<u>\$ 67,064,806</u>	<u>\$ 55,129,592</u>

Annually, on January 1, the Boston Pizza restaurants in the Royalty Pool on which the Company pays a royalty to the Fund are adjusted to include the adjusted franchise revenue from new Boston Pizza restaurants opened on or before December 31 of the prior year, less franchise revenue from any Boston Pizza restaurants that have permanently closed during the year. In return for adding this net franchise revenue to the Royalty Pool, Boston Pizza receives the right to indirectly acquire additional Fund units (the "Additional Entitlement"). The Additional Entitlement is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund Units.

The Company receives 80% of the Additional Entitlement initially, with the balance received when the actual full year performance of the new restaurants is known with certainty. Monthly distributions from the Fund are based on full Additional Entitlement, subject to adjustment on January 1 of the next fiscal year when full year performance of the new restaurants is known with certainty.

On January 1, 2006, 31 new Boston Pizza restaurants (2005 – 18) opened during the period from November 2, 2004 to December 31, 2005 were added to the Fund. In accordance with the terms of the Partnership agreements, the Partnership provided entitlements to the Company to receive distributions on 1,904,808 (2005 – 1,292,182) Class B Partnership units in exchange for the addition of these new restaurants to the Royalty Pool. 20% of the Additional Entitlement, 380,962 units (2005 – 258,436) remain unissued and are not entitled for conversion to Fund units until January 1, 2007 (2005 units – January 1, 2006) based on the actual performance of the new stores.

On January 1, 2006, adjustments to royalty payments and Additional Entitlement were made based on the full year performance of eighteen restaurants added to the Royalty Pool on January 1, 2005. Based on these adjustments, the Company received its pro rata portion of the remaining Additional Entitlement, 115,977 Partnership units.

On February 17, 2006, the Company initiated the exchange of Class B Partnership units for 1,311,859 Fund units. Following this exchange, the Company sold their units of the Fund at \$16.60 per unit to the public for gross proceeds of \$21,777,648 and recognized a gain on sale of \$3,749,741, net of transaction costs of \$39,356.

**5. LONG-TERM INVESTMENTS:**

	2006	2005
Investment in BP Limited Partnership Holding Inc.	\$ 74,456	\$ 74,456
Investment in BP GP	20	20
	<u>\$ 74,476</u>	<u>\$ 74,476</u>

**BOSTON PIZZA  
INTERNATIONAL INC.**

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**6. LONG-TERM RECEIVABLES:**

Long-term receivables consist of the following:		
	2006	2005
Advances to companies owned by shareholders of the Company, non-interest bearing, unsecured with no specified terms of repayment	\$ 997,883	\$ 7,467,836
Promissory notes, including accrued interest, to companies owned by the shareholders of the Company, bearing interest at 7.6%, unsecured with no specific terms of repayment	\$ 23,606,349	\$ 25,010,353
	<u>\$ 24,604,232</u>	<u>\$ 32,478,189</u>

**7. CAPITAL ASSETS:**

	Cost	Accumulated amortization	Net book value
<b>2006</b>			
Office furniture and equipment	\$ 6,489,027	\$ 3,765,155	\$ 2,723,872
Office furniture and equipment under capital lease	\$ 1,961,571	\$ 617,718	\$ 1,343,853
Leasehold improvements	\$ 3,480,498	\$ 1,780,566	\$ 1,699,932
Building	\$ 1,230,652	\$ 24,613	\$ 1,206,039
Auto	\$ 24,176	\$ 19,735	\$ 4,441
	<u>\$13,185,924</u>	<u>\$ 6,207,787</u>	<u>\$ 6,978,137</u>
<b>2005</b>	Cost	Accumulated amortization	Net book value
Office furniture and equipment	\$ 5,208,210	\$ 2,983,189	\$ 2,225,021
Office furniture and equipment under capital lease	\$ 1,814,886	\$ 347,195	\$ 1,467,691
Leasehold improvements	\$ 4,154,700	\$ 1,387,761	\$ 2,766,939
Auto	\$ 24,176	\$ 17,831	\$ 6,345
	<u>\$11,201,972</u>	<u>\$ 4,735,976</u>	<u>\$ 6,465,996</u>



**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**8. DEFERRED CHARGES AND INTANGIBLE ASSETS:**

<b>2006</b>	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net book value</b>
Deferred			
finance charges	\$ 175,000	\$ 153,250	\$ 21,750
Intangible assets			
("BP Rights")	\$ 250,001	\$ –	\$ 250,001
Goodwill and other	\$ 56,748	\$ –	\$ 56,748
	<u>\$ 481,749</u>	<u>\$ 153,250</u>	<u>\$ 328,499</u>
<b>2005</b>	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net book value</b>
Deferred			
finance charges	\$ 162,500	\$ 134,950	\$ 27,550
Intangible assets			
("BP Rights")	\$ 250,001	\$ –	\$ 250,001
Goodwill and other	\$ 056,748	\$ –	\$ 56,748
	<u>\$ 469,249</u>	<u>\$ 134,950</u>	<u>\$ 334,299</u>

On July 17, 2002, the Fund successfully completed an offering of units. A portion of the net proceeds of the offering were used by the Fund to indirectly acquire through an interest in the Partnership all rights in Canada and to certain trademarks, pending trademark applications, unregistered trademarks used in the business of the Company, trade names and in all goodwill associated with those trade names, owned by the Company (collectively, the "BP Rights"). The Partnership acquired the BP Rights from the Company in exchange for cash and by issuing partnership interests. The Partnership and the Company entered into a Licence and Royalty agreement to allow the Company the Canadian use of the BP Rights for a term of 99 years, for which the Company pays a royalty equal to 4% of the franchise revenues (as defined) of certain restaurants located in Canada (the "Royalty Pool").

As a result of the consolidation of the Partnership as required by the adoption of AcG-15 (note 2), the BP Rights are now recorded at their historical cost.

**9. LONG-TERM DEBT:**

<b>Long-term debt consists of:</b>	<b>2006</b>	<b>2005</b>
Term loans:		
The Bank of Nova Scotia term loan bearing interest at the bank prime plus 0.75% per annum, renewed with a maturity date of July 5, 2009.	\$ 5,000,000	\$ 5,000,000
GE Capital Canada Equipment Financing Inc. term loan bearing interest at 6.95% per annum, due August 4, 2013, repayable in blended monthly instalments of \$6,008, secured by restaurant equipment	\$ 384,975	\$ 139,807
GE Capital Canada Equipment Financing Inc. term loan bearing interest at 6.58% per annum, due December 18, 2013, repayable in blended monthly installments of \$13,399, secured by restaurant equipment	\$ 900,000	\$ –
GE Capital Canada Equipment Financing Inc. term loan bearing interest at the bank prime plus 2.75% per annum, repayable in blended monthly payments of \$14,672, due October 4, 2012, secured by restaurant equipment	\$ 875,769	\$ 998,094
	...cont'd	

**BOSTON PIZZA  
INTERNATIONAL INC.**

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**9. LONG-TERM DEBT (continued):**

Long-term debt consists of:

	2006	2005
Term loans (continued):		
GE Capital Canada Equipment Financing Inc. term loan bearing interest at the bank prime plus 2.75% per annum, repayable in blended monthly payments of \$1,129 due October 4, 2015, secured by restaurant equipment	\$ 130,873	\$ 137,010
Obligations under capital lease:		
The Bank of Nova Scotia lease bearing interest at the bank prime plus 2.35% per annum, repayable in blended monthly payments of \$37,403, secured by restaurant equipment with a final purchase price of \$282,300 due December 1, 2008	\$ 1,068,710	\$ 1,448,385
Other obligations under capital lease bearing interest at 2.86% per annum, secured by specific assets of the Company	\$ 164,468	\$ 65,501
	\$ 8,524,795	\$ 7,788,797
Current portion	\$ 747,396	\$ 710,554
	\$ 7,777,399	\$ 7,078,243

Term loans are secured by a general assignment of book debts and certain guarantees from the Company, shareholders and related companies.

Principal repayments on long-term debt and capital lease obligations for years ending December 31 are as follows:

2007	\$ 747,396
2008	\$ 1,029,263
2009	\$ 5,346,545
2010	\$ 339,535
2011 and thereafter	\$ 1,062,056
	\$ 8,524,795

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**10. NOTES PAYABLE:**

	2006	2005
Note payable to the Boston Pizza Royalties Income Fund with interest payable monthly at 7.5% per annum, due July 17, 2042 (a)	\$ 24,000,000	\$ 24,000,000
Note payable to the parent company, non-interest bearing and due on demand	\$ —	\$ 6,300,000
	<u>\$ 24,000,000</u>	<u>\$ 30,300,000</u>

(a) The note payable to the Fund arose at the time of the sale of the trademarks and trade names from the Company in July 2002 and is secured by a general security agreement. The note may not be assigned without the prior consent of the Company.

The Company, as the holder of 2,400,000 Class C Partnership units, has the right to transfer such Class C Partnership units to the Trust in consideration for the assumption by the Trust of, and the concurrent release of the Company of its obligations with respect to, an amount of the indebtedness under the BP loan equal to \$10.00 for each Class C Partnership unit transferred.

**11. OTHER LONG-TERM LIABILITIES:**

	2006	2005
Long-term portion of incentive plan	\$ 3,213,523	\$ 3,267,118
Tenant inducements	\$ 300,783	\$ 288,742
Minority Interest (Public's equity less distributions paid)	\$ 383,682	\$ 271,138
	<u>\$ 3,897,988</u>	<u>\$ 3,826,998</u>

During the year, the Company accrued \$5,283,369 for a long-term incentive plan ("LTIP") for its employees of which \$3,213,523 is included in other long-term liabilities. The incentive pool is determined based on the number of restaurants added to the Royalty Pool of the Fund. Adjustments are made to the incentive pool based on certain performance criteria. The awards to executive employees are paid over a three year period and awards to other employees are paid over a two-year period. These LTIP awards are recorded as a reduction of deferred gain as they are directly related to the process of earning Additional Entitlement on Class B Partnership units which are also recorded as deferred gain upon exchange (note 4).

**BOSTON PIZZA  
INTERNATIONAL INC.**

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**12. INCOME TAXES:**

Income tax expense as reported differs from the amount that would be computed by applying the combined Federal and provincial statutory income tax rates to earnings before income taxes. The reasons for the differences are as follows:

	2006	2005
Earnings before income taxes	\$ 8,819,153	\$ 5,706,915
Combined Canadian federal and provincial tax rates	34.46%	35.00%
	\$ 3,039,080	\$ 1,997,420
Increased (reduced) by:		
Permanent differences	\$ 65,947	\$ (903,485)
Refundable tax charged to retained earnings	\$ (102,623)	\$ 499,984
Change in statutory tax rates	\$ 554,985	\$ 300,451
Income tax expense	\$ 3,557,389	\$ 1,894,370

The tax effects of temporary differences that give rise to significant portions of the future tax assets and liabilities are:

	2006	2005
Future income tax assets (liabilities):		
Deferred gain	\$ 16,478,489	\$ 12,303,535
Losses carried forward	\$ –	\$ 26,784
Capital assets	\$ (109,516)	\$ (68,564)
Deferred revenue	\$ 424,423	\$ 704,024
Goodwill and other intangibles	\$ 187,380	\$ 176,015
	\$ 16,980,776	\$ 13,141,794
Current future income tax assets	\$ 194,685	\$ 228,814
	\$ 16,786,091	\$ 12,912,980

**13. SHARE CAPITAL:**

Authorized:

10,000 common shares of no par value	2006	2005
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Issued:

100 common shares	\$ 100	\$ 100
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**14. COMMITMENTS:**

The Company is committed under operating lease contracts for office space, restaurant space and advertising contracts. The minimum annual rental payments under these leases for the next five years ending December 31 are as follows:

2007	\$ 2,211,738
2008	\$ 1,731,288
2009	\$ 1,471,412
2010	\$ 1,398,124
2011	\$ 1,206,399

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

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**15. CONTINGENCIES:**

- (a) The Company guarantees lease payments totaling \$150,000 for one of its franchisees.
- (b) BPI and the Fund are involved in trademark litigation with entities affiliated with McDonald's Restaurants of Canada (the "McDonald's Group"), opposing the registration by the McDonald's Group in Canada of the Boston Market trademark. Additionally, BPI and the Fund have commenced an action against the McDonald's Group to prevent them from infringing BPI's and the Fund's respective interests in the Boston Pizza trademarks by operating Boston Market in Canada. The McDonald's Group has filed a counterclaim and a separate action challenging the validity of the registered trademark "Boston Pizza" and related trademarks under the Trade-Marks Act (Canada). Management does not believe that this action will succeed. However, in the event that the challenge to the Boston Pizza trademarks is successful, the Fund would lose the benefits of registration of its trademarks under the Trade-Marks Act (Canada), which may mean losing the ability to prevent others from using the registered trademarks for the goods and services for which they are registered and to prevent others from using similar or confusing trademarks or names. However, the loss of the registration under the Trade-Marks Act (Canada), would not prevent the Fund from continuing to license and use the "Boston Pizza" and related trademarks in the existing operations and geographic territories where they are presently used and from taking other measures to protect their rights in respect of, and their ability to use, the "Boston Pizza" and related trademarks, in new areas where BPI and its sub-licensees do not presently operate Boston Pizza restaurants.

**16. RELATED PARTY TRANSACTIONS:**

Included in accounts payable and accrued liabilities is \$19,037 (2005 – nil) payable to an associated company. Included in accounts receivable is \$281,057 (2005 – \$735,934) due from the Company's parent company. Also included in accounts receivable is \$75,000 (2005 – \$75,000) for administrative services provided to a related party.

The Company earned revenues of \$411,634 (2005 – \$353,805) from a company under common control of which \$107,000 (2005 – \$96,000) is included in accounts receivable as at December 31, 2006.

Included in administrative expenses and restaurant operating costs are amounts paid by the Company relating to rent of \$483,332 (2005 – \$468,900) and management fees of \$2,465,336 (2005 – \$2,659,584) to companies under common control. Additionally, included in management fees is \$674,668 (2005 – \$970,416) paid to the Company's parent and \$183,000 (2005 – \$183,000) paid by the Company's subsidiary, respectively for services rendered.

The Company paid interest on a note payable to the Fund of \$1,800,000 (2005 – \$1,800,000).

The Company earned \$1,451,131 (2005 – \$1,488,937) of interest and management fees from companies under common control. Interest and management fees are included in revenues.



**BOSTON PIZZA  
INTERNATIONAL INC.**

**NOTES TO CONSOLIDATED  
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YEARS ENDED DECEMBER 31, 2006 AND 2005

**17. SEGMENT REPORTING:**

Management has determined the Company operates in one segment, which involves franchise fee income, sales from company restaurants and rental income. Substantially all of the Company's assets and revenues are located or earned in Canada, the Company's U.S. territorial development expense is incurred substantially in the U.S. and these operations were transferred to a related party.

**18. COMPARATIVE FIGURES:**

Certain of the comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

**19. SUPPLEMENTARY CASH FLOW INFORMATION:**

**(a) Change in non-cash operating items:**

	2006	2005
Accounts receivable	\$ (162,282)	\$ (2,871,717)
Prepaid expenses	\$ (446,343)	\$ (120,229)
Accounts payable and accrued liabilities	\$ 1,006,536	\$ 2,859,575
Income taxes payable	\$ 5,496,520	\$ (43,897)
Deferred revenue	\$ (443,463)	\$ 931,785
Long-term liabilities	\$ (5,557,894)	\$ (3,290,916)
	\$ (106,926)	\$ (2,535,399)

**(b) Supplementary information:**

	2006	2005
Interest received	\$ 281,716	\$ 77,640
Interest paid	\$ 2,295,898	\$ 2,096,657
Income taxes paid	\$ 1,973,502	\$ 1,135,318
Non-cash transactions:		
Increase (decrease) in refundable dividend tax and future income taxes	\$ (102,623)	\$ 1,381,932
Settlement of dividends payable through issuance of notes payable	\$ 3,100,000	\$ 6,300,000
Settlement of notes payable through transfer of long-term receivables	\$ 9,400,000	\$ —

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**20. SUBSEQUENT EVENTS:**

- (a)** On January 1, 2007, adjustments to royalty payments and Additional Entitlement were made based on the actual performance of 31 restaurants added to the Royalty Pool on January 1, 2006. Based on these adjustments, BPI will receive its pro rata portion of the remaining Additional Entitlement, 465,995 Fund units.
- (b)** On January 1, 2007, 41 new Boston Pizza restaurants opened and one closed during the period from January 1, 2006 to December 31, 2006 were added to the Royalty Pool. The Franchise sales of these 40 net new restaurants have been estimated at \$74.6 million. The total number of restaurants in the Royalty Pool has increased to 266. The yield of the Fund units was determined to be 8.64% calculated using a weighted average unit price of \$14.79. Weighted average unit price is calculated based on the market price of the unit traded on the TSX Stock Exchange 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, and assuming 100% of the Additional Entitlement, BPI's Additional Entitlement is equivalent to 2,158,478 (2005 – 1,904,808) Fund units. BPI will also receive a proportionate increase in monthly distributions from the Partnership. Of the Additional Entitlement, 20% (2007 – 431,696 units; 2006 – 380,962 units), remain unissued and are not eligible for conversion to Fund units until January 1, 2008 (2006 units – January 1, 2007) based on the actual performance of the new stores.
- (c)** On February 19, 2007, the Company exchanged Class B Partnership units for 1,754,222 Fund units. Following this exchange the Company sold these Fund units to the public for gross proceeds of approximately \$26,575,000 and recognized a gain on sale of approximately \$1,405,000 net of transaction costs. Subsequent to the exchange and sale of Fund units, the Company holds exchangeable Partnership units equivalent to 3,187,730 Fund units, or 20% of the issued and outstanding units on a fully diluted basis.
- (d)** On March 23, 2007, the Company declared \$21,000,000 of dividends to its shareholders.

Our mission: To be a world class franchisor through selecting and training people to profitably manage an outstanding foodservice business.

To achieve this goal we are innovative and responsive in our approach in business. We work as a team providing attention to detail but never losing sight of the larger picture. We recognize the need to provide leadership in all areas of our operations, marketing and development.

## BOSTON PIZZA ROYALTIES INCOME FUND | GLOSSARY

BP Rights	(a) All rights in Canada to certain registered trademarks and pending applications for trademarks, including "Boston Pizza", "BP & Design", "BP's Lounge", "BP's Bistro", "Boston's The Gourmet Pizza", "Boston Pizza Quick Express", "Boston Pizza Restaurant & Sports Bar" (b) All rights in Canada in certain unregistered trademarks and trade names used in the business of BPI; and (c) Certain goodwill associated with the items referenced in (a) and (b) above.
BPI	Boston Pizza International Inc.
Casual Dining	\$10-\$20 average cheque, full table service, themed atmosphere, generally little take-out service.
CRFA	Canadian Restaurant and Foodservices Association.
Fiscal Year	January 1 to December 31 for both the Fund and BPI.
Franchise Sales	Gross revenue generated from Boston Pizza restaurants across Canada, less sales generated from alcohol, tobacco and Boston Pizza International Inc. approved national promotions and discounts.
Full Service Restaurants	Establishments that may sell alcoholic beverages, provide take-out services, operate a bar, or present live entertainment in addition to serving food and non-alcoholic beverages. This industry includes full-service establishments known as fine-dining restaurants, family restaurants and restaurant-bars. Source: Statistics Canada.
Fund	Boston Pizza Royalties Income Fund.
Gross Sales/System Sales	Gross revenue generated from Boston Pizza restaurants across Canada.
IPO	Initial Public Offering – date July 17, 2002.
Non-Controlling Interest	BPI's indirect interest in the Fund.
Partnership	Boston Pizza Royalties Limited Partnership.
Royalty Pool	In any period, those Boston Pizza restaurants on which royalty equating to 4% of franchise sales/revenue is to be paid to the Fund.
Sales Growth	The increase in gross revenue generated from Boston Pizza restaurants across Canada over a previous period.
SSSG	Same store sales growth – refers to the overall increase in gross sales of Boston Pizza restaurants that have been opened for a minimum of 24 months.
Unit	A trust unit of the Fund, each such unit representing an equal undivided interest therein.
Unitholder(s)	At the relevant time, the holder(s) of the Units.
20-day Weighted Average Unit Price	As at any date or for any period, the weighted average price at which the Units have traded on a Stock Exchange during the period of 20 consecutive trading days ending on the fifth trading day before such date or the end of the period. The weighed average price is defined as the amount obtained by dividing the aggregate sale price of all of the Units traded on the relevant Stock Exchange during such period divided by the total number of Units so traded.

**UNITHOLDER INFORMATION**  
**BOSTON PIZZA ROYALTIES INCOME FUND**

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5500 Parkwood Way  
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**TRUSTEES OF THE FUND**

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RETIRED PARTNER ERNST & YOUNG LLP

William C. Brown  
CORPORATE DIRECTOR

Robert L. Phillips  
CORPORATE DIRECTOR

**TRANSFER AGENT**

Computershare Investor Services Inc.

**STOCK EXCHANGE LISTING**

Toronto Stock Exchange: BPF.UN

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– **THE MANAGING GENERAL PARTNER OF**  
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*Retired Partner Ernst & Young LLP*

William C. Brown  
DIRECTOR\*

*Corporate Director*

Robert L. Phillips  
DIRECTOR\*  
*Corporate Director*

Mike Cordoba  
DIRECTOR  
*Chief Executive Officer*

Mark Powell  
DIRECTOR  
*Chief Financial Officer*

\*AUDIT COMMITTEE AND GOVERNANCE COMMITTEE

**SHAREHOLDER INFORMATION**  
**BOSTON PIZZA INTERNATIONAL INC.**

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**MANAGEMENT TEAM**

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CHAIRMAN & OWNER

George Melville  
CHAIRMAN & OWNER

Mike Cordoba  
CHIEF EXECUTIVE OFFICER

Mark Powell  
CHIEF FINANCIAL OFFICER

Mark Pacinda  
PRESIDENT

Al Cave  
EXECUTIVE VICE-PRESIDENT – CORPORATE SERVICES

Stephen Plunkett  
EXECUTIVE VICE-PRESIDENT – WESTERN CANADA

Ken Otto  
EXECUTIVE VICE-PRESIDENT – ONTARIO & MARITIMES

Wayne Shanahan  
EXECUTIVE VICE-PRESIDENT – QUEBEC

[www.bostonpizza.com](http://www.bostonpizza.com)

## Closing Thoughts from Our President

**“We were very pleased with the performance of our business in 2006. New records were set for sales, restaurant openings and store renovations and we continued to position the brand for growth in the years ahead. My thanks go out to all of our dedicated employees, franchisees and partners that have contributed to Boston Pizza’s success.”**

**MARK PACINDA**

President  
Boston Pizza International Inc.



Our mission: To be a world class franchisor through selecting and training people to profitably manage an outstanding foodservice business.

To achieve this goal we are innovative and responsive in our approach in business. We work as a team providing attention to detail but never losing sight of the larger picture. We recognize the need to provide leadership in all areas of the operations, marketing and restaurant development.



ROYALTIES INCOME FUND

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