# Holloway Lodging Corporation

Consolidated Financial Statements
**December 31, 2013 and 2012**

March 3, 2014

## Management’s Responsibility for Financial Reporting

The accompanying consolidated financial statements of **Holloway Lodging Corporation** (the “Company”) have been prepared by the Company’s management. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and contain estimates based on management’s judgment. Internal control systems are maintained by management to provide reasonable assurances that assets are safeguarded and financial information is reliable.

The Board of Directors of the Company is responsible for ensuring that management fulfils its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the consolidated financial statements and the accompanying management discussion and analysis. The Board of Directors carries out this responsibility principally through its Audit Committee.

The Audit Committee is appointed by the Board of Directors and all of its members are independent. It meets with the Company’s management and auditors and reviews internal control and financial reporting matters to ensure that management is properly discharging its responsibilities before submitting the consolidated financial statements to the Board of Directors for approval.

(signed) *“Felix Seiler”*
Acting Chief Executive Officer

(signed) *“Jane Rafuse”*
Chief Financial Officer

March 3, 2014

# Independent Auditor's Report

**To the Shareholders of**
**Holloway Lodging Corporation**

We have audited the accompanying consolidated financial statements of **Holloway Lodging Corporation** and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2013 and 2012 and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the years ended December 31, 2013 and 2012 and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

## Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

## Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Holloway Lodging Corporation and its subsidiaries, as at December 31, 2013 and 2012 and their financial performance and their cash flows for the years ended December 31, 2013 and 2012 in accordance with International Financial Reporting Standards.

(signed) *"PricewaterhouseCoopers LLP"*

**Chartered Accountants**

*PricewaterhouseCoopers LLP*
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"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

# Holloway Lodging Corporation

Consolidated Statements of Financial Position

**As at December 31, 2013 and 2012**

(in thousands of Canadian dollars)

| | 2013<br>$ | 2012<br>$ |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash (note 22) | 852 | 1,312 |
| Restricted cash | 278 | 253 |
| Capital reserve – internally restricted | 108 | 318 |
| Trade and other receivables (note 5) | 2,394 | 2,597 |
| Inventories | 225 | 203 |
| Prepaid expenses and deposits | 1,820 | 1,843 |
| | 5,677 | 6,526 |
| **Non-current assets** | | |
| Property and equipment (note 7) | 179,937 | 180,964 |
| Minority interest investments in hotel properties (note 8) | 846 | 861 |
| Loan receivable (note 9) | 4,828 | 4,879 |
| Capital reserve – restricted | 2,517 | 3,976 |
| Other assets (note 10) | 308 | 333 |
| Deferred income tax assets (note 20) | 5,295 | 7,082 |
| | 193,731 | 198,095 |
| **Total assets** | 199,408 | 204,621 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Line of credit (note 11) | 1,004 | 1,523 |
| Trade payables and accrued liabilities (note 12) | 5,091 | 5,571 |
| Current portion of mortgages payable (note 13) | 4,261 | 10,070 |
| Current portion of obligations under finance leases | – | 10 |
| | 10,356 | 17,174 |
| **Non-current liabilities** | | |
| Mortgages payable (note 13) | 103,338 | 101,613 |
| Loan due to a related party (note 15) | 307 | 291 |
| Derivative liability | – | 32 |
| | 103,645 | 101,936 |
| **Total liabilities** | 114,001 | 119,110 |
| **Equity attributable to shareholders of the Company** | 85,385 | 85,470 |
| Non-controlling interest | 22 | 41 |
| **Total equity** | 85,407 | 85,511 |
| **Total liabilities and equity** | 199,408 | 204,621 |

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

**Approved on behalf of the Board of Directors:**

(signed) *"Michael Rapps"*
Chairman of the Board

(signed) *"David Wood"*
Chairman of the Audit Committee

# Holloway Lodging Corporation

Consolidated Statements of Income

**For the years ended December 31, 2013 and 2012**

(in thousands of Canadian dollars)

| | 2013<br>$ | 2012<br>$ |
|---|---|---|
| **Hotel revenues** | | |
| Rooms | 54,648 | 51,970 |
| Food and beverage | 3,809 | 4,475 |
| Other | 1,500 | 1,928 |
| | 59,957 | 58,373 |
| **Hotel expenses** | | |
| Departmental and operating expenses | 34,224 | 34,244 |
| Property taxes and insurance | 2,901 | 2,795 |
| Management fees | 1,322 | 1,289 |
| Depreciation and amortization | 8,993 | 7,845 |
| | 47,440 | 46,173 |
| **Income before the following** | 12,517 | 12,200 |
| **Other (income) and expenses** | | |
| Interest on line of credit, mortgages payable and loans due to related parties | 7,339 | 7,678 |
| Interest on convertible debentures | – | 195 |
| Accretion on convertible debentures, loans due to related parties, mortgages and deferred financing fees | 207 | 739 |
| Corporate and administrative | 2,217 | 2,523 |
| Share-based compensation | 378 | 503 |
| Depreciation and amortization – corporate assets | 43 | 5 |
| Investment income | (360) | (287) |
| Gain on acquisition of subsidiary (note 6) | – | (433) |
| Reversal of impairment of hotel properties, net (note 7) | (3,450) | (12,993) |
| (Gain) loss on disposal of minority interest investments in hotel properties (note 8) | (129) | 101 |
| Loss (gain) on disposal of hotel properties and equipment (note 6) | 15 | (5,588) |
| Fair value adjustment of Class B LP units and derivative liability | – | 21 |
| | 6,260 | (7,536) |
| **Income before income taxes** | 6,257 | 19,736 |
| **Provision for income taxes** (note 20) | 1,787 | – |
| **Net income for the year** | 4,470 | 19,736 |
| **Attributable to:** | | |
| Shareholders of the Company | 4,489 | 19,723 |
| Non-controlling interest | (19) | 13 |
| | 4,470 | 19,736 |
| Basic and diluted earnings per share (note 17) | 0.25 | 1.11 |

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

# Holloway Lodging Corporation

Consolidated Statements of Comprehensive Income

**For the years ended December 31, 2013 and 2012**

(in thousands of Canadian dollars)

| | 2013<br>$ | 2012<br>$ |
|---|---|---|
| **Net income for the year** | 4,470 | 19,736 |
| **Other comprehensive income** | | |
| **Items that may be subsequently reclassified to profit or loss** | | |
| Cumulative translation adjustments | 123 | (96) |
| Fair value adjustments or adjustment on disposal of minority interest investments in hotel properties | – | 307 |
| | 123 | 211 |
| **Comprehensive income for the year** | 4,593 | 19,947 |
| **Comprehensive income attributable to:** | | |
| Shareholders of the Company | 4,612 | 19,934 |
| Non-controlling interest | (19) | 13 |
| | 4,593 | 19,947 |

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

# Holloway Lodging Corporation

## Consolidated Statements of Changes in Equity

**For the years ended December 31, 2013 and 2012**

(in thousands of Canadian dollars)

| | Common shares (note 16) $ | Units (note 16) $ | Contributed surplus $ | Deficit $ | Accumulated other comprehensive income (loss) $ | Total attributed to shareholders $ | Non-controlling interest $ | Total shareholders' equity $ |
|---|---|---|---|---|---|---|---|---|
| **Balance, January 1, 2012** | – | 180,317 | 1,414 | (161,143) | (306) | 20,282 | – | 20,282 |
| Non-controlling interest on acquisition of subsidiary | – | – | – | – | – | – | 28 | 28 |
| Net income for the year | – | – | – | 19,723 | – | 19,723 | 13 | 19,736 |
| Other comprehensive income for the year | – | – | – | – | 211 | 211 | – | 211 |
| Comprehensive income for the year | – | – | – | 19,723 | 211 | 19,934 | 13 | 19,947 |
| Distributions paid to unitholders | – | – | – | (1,217) | – | (1,217) | – | (1,217) |
| Unit-based compensation related to options | – | – | 503 | – | – | 503 | – | 503 |
| Redemption of convertible debentures for units | – | 46,660 | – | – | – | 46,660 | – | 46,660 |
| Repurchase of units | – | (699) | – | – | – | (699) | – | (699) |
| Exchange of units | – | 7 | – | – | – | 7 | – | 7 |
| Exchange of units for common shares pursuant to corporate conversion | 226,285 | (226,285) | – | – | – | – | – | – |
| **Balance, December 31, 2012** | 226,285 | – | 1,917 | (142,637) | (95) | 85,470 | 41 | 85,511 |
| **Balance, January 1, 2013** | 226,285 | – | 1,917 | (142,637) | (95) | 85,470 | 41 | 85,511 |
| Net income for the year | – | – | – | 4,489 | – | 4,489 | (19) | 4,470 |
| Other comprehensive income for the year | – | – | – | – | 123 | 123 | – | 123 |
| Comprehensive income for the year | – | – | – | 4,489 | 123 | 4,612 | (19) | 4,593 |
| Dividends paid to shareholders | – | – | – | (2,535) | – | (2,535) | – | (2,535) |
| Share-based compensation related to options | – | – | 378 | – | – | 378 | – | 378 |
| Repurchase of common shares | (2,572) | – | – | – | – | (2,572) | – | (2,572) |
| Value of warrants recognized in equity | – | – | 32 | – | – | 32 | – | 32 |
| **Balance, December 31, 2013** | 223,713 | – | 2,327 | (140,683) | 28 | 85,385 | 22 | 85,407 |

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

# Holloway Lodging Corporation

Consolidated Statements of Cash Flows

**For the years ended December 31, 2013 and 2012**

(in thousands of Canadian dollars)

| | 2013<br>$ | 2012<br>$ |
|---|---|---|
| **Cash provided by (used in)** | | |
| **Operating activities** | | |
| Net income for the year | 4,470 | 19,736 |
| Adjustments for non-cash items (note 22) | 7,844 | (9,800) |
| | 12,314 | 9,936 |
| Changes in items of working capital (note 22) | (406) | (2,999) |
| **Net cash generated from operating activities** | 11,908 | 6,937 |
| **Investing activities** | | |
| Increase in restricted cash | (25) | (3) |
| Decrease (increase) in capital reserves | 1,669 | (317) |
| Proceeds from sale of hotel properties and equipment, net of costs | 4 | 51,177 |
| Additional investment in minority interest investments in hotel properties | – | (41) |
| Proceeds from sale of minority interest investments in hotel properties | 144 | 236 |
| Additions to property and equipment | (3,948) | (2,706) |
| Additions to other assets | (65) | – |
| Acquisition of subsidiary, net of cash acquired | – | (2,076) |
| **Net cash generated from (used in) investing activities** | (2,221) | 46,270 |
| **Financing activities** | | |
| Decrease in line of credit | (519) | (3,299) |
| Repayment of obligations under finance leases | (10) | (80) |
| Proceeds from mortgages, net of deferred financing fees | 3,296 | – |
| Repayment of mortgages payable | (7,807) | (34,255) |
| Repayment of loan due to a related party | – | (14,800) |
| Repurchase of shares | (2,572) | (699) |
| Dividends paid to shareholders | (2,535) | (1,217) |
| **Net cash used in financing activities** | (10,147) | (54,350) |
| **Decrease in cash** | (460) | (1,143) |
| **Cash – Beginning of year** | 1,312 | 2,455 |
| **Cash – End of year** | 852 | 1,312 |
| **Supplemental cash flow information** | | |
| Interest paid | 7,331 | 9,605 |
| Cash for all periods is comprised of cash on hand and balances with banks | | |

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

(in thousands of Canadian dollars)

## 1 General information

Holloway Lodging Corporation and its subsidiaries together ("Holloway" or the "Company") is a hospitality company that owns and operates hotels. As at December 31, 2013, the Company owned 16 hotels in Canada, one hotel in the United States and a 90% interest in another hotel, with 1,798 guest rooms and suites and held minority ownership interests in three other hotels. The address of its registered office is 6009 Quinpool Road, 10th Floor, Halifax, Nova Scotia.

The Company is the successor entity to Holloway Lodging Real Estate Investment Trust (the "REIT") following the completion of the conversion from an income trust to a corporation pursuant to a court-approved plan of arrangement (the "Arrangement") under the Ontario Business Corporations Act ("OBCA") effective December 31, 2012. The Arrangement involved the exchange of units of the REIT for common shares of the Company on a one-for-one basis and the dissolution of Holloway Lodging REIT and HL Trust in accordance with their respective Declarations of Trust. Effective December 31, 2012, the common shares of the Company began trading on the Toronto Stock Exchange (the "TSX") under the symbol HLC.

The results of operations for the year ended December 31, 2013 represent the operations of 17 hotels and a 90% interest in the Holiday Inn Express in Stellarton, NS for the full year. The results of operations for the year ended December 31, 2012 represent the operations of 17 hotels for the full year and 4 hotels for part of the year. The leasehold interest on the 5 Calgary Downtown Suites Hotel in Calgary, AB was sold on January 12, 2012, the Radisson Hotel and Suites in Fort McMurray, AB was sold on February 1, 2012 and the Super 8 hotel in Three Hills, AB was sold on June 29, 2012. The Company acquired a 90% interest in the Holiday Inn Express in Stellarton, NS on November 30, 2012.

## 2 Basis of preparation

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada ("GAAP") as set out in the CPA Canada Handbook – Accounting – Part 1 ("CPA Canada Handbook") which incorporates International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These consolidated financial statements were approved for issue by the Board of Directors on March 3, 2014.

(in thousands of Canadian dollars)

## 3 Summary of significant accounting policies

The significant accounting policies used in the preparation of these consolidated financial statements are as follows:

### Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for the minority interest investments in hotel properties, which are recognized at fair value through other comprehensive income.

The preparation of financial statements conforming to IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in applying certain accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

### Consolidation

These financial statements consolidate the accounts of the Company and its subsidiaries. Subsidiaries are all entities over which the Company has control. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. Intercompany balances, income and expense amounts are eliminated.

The Company applies the acquisition method to account for business combinations. Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. If the total of consideration transferred, non-controlling interest recognized and any previously held interest is less than the fair value of the net assets of the subsidiary acquired the difference is recognized as a gain in the income statement. The Company recognizes any non-controlling interest in the subsidiary at the non-controlling interest's proportionate share of the recognized amounts of the acquiree's identifiable net assets. Any acquisition related costs are expensed as they are incurred.

### Foreign currency translation

i. Functional and presentation currency

Items included in the financial statements of each consolidated entity in the group are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The functional currency and presentation currency of the Company is the Canadian dollar.

The financial statements of entities that have a functional currency different from that of the Company ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities - at the closing rate at the date of the statement of financial position and income and expenses - at the average rate of the period (as this is considered a reasonable approximation of the actual rates prevailing at the transaction dates). All resulting changes are recognized in other comprehensive income as cumulative translation adjustments.

(in thousands of Canadian dollars)

## 3 Summary of significant accounting policies (continued)

**Foreign currency translation** (continued)

ii. Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the transaction dates. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at exchange rates of monetary assets and liabilities denominated in currencies other than an entities' functional currency are recognized in the consolidated statement of income in departmental and operating expenses.

**Cash**

Cash includes cash on hand and balances held with banks.

**Financial instruments**

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

At initial recognition, the Company classifies its financial instruments in the following categories:

i) Financial assets and liabilities at fair value through profit and loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term.

Financial instruments in this category are recognized initially and subsequently at fair value. Derivatives are also included in this category unless they are designated as hedges. The Company has issued warrants which qualified as a derivative liability until they were reclassified to equity following the conversion to a corporation. Gains and losses on remeasurement to fair value of the warrants were included in fair value adjustment of derivative liability in the consolidated statement of income.

ii) Available-for-sale investments: Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within twelve months of the end of the reporting period. The Company's available-for-sale assets comprise its minority interest investments in hotel properties.

(in thousands of Canadian dollars)

## 3 Summary of significant accounting policies (continued)

**Financial instruments** (continued)

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains and losses arising from remeasurement are recognized in other comprehensive income. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the consolidated statement of income and are included in gain or loss on disposal of minority interest investments in hotel properties.

Investment income on available-for-sale investments is included in the consolidated statement of income as investment income when the Company's right to receive payment is established.

iii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables, included in current assets due to their short-term nature comprise trade and other receivables, cash, restricted cash and capital reserves – internally restricted. The Company's loans and receivables, included in non-current assets comprise its loan receivable and capital reserve – restricted. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment. The carrying amount of a loan receivable classified as impaired is reduced to the present value of the estimated future cash flows discounted at the effective interest rate of the loan.

iv) Financial liabilities at amortized cost: Financial liabilities at amortized cost include the line of credit, trade payables and accrued liabilities, mortgages payable and obligations under finance leases and loan due to a related party. Trade payables and accrued liabilities are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method. Mortgages payable and the loan due to a related party is recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method. These are classified as current liabilities if payment is due within twelve months or if a waiver for a covenant breach has not been received by the period end date. Otherwise, they are presented as non-current liabilities.

(in thousands of Canadian dollars)

## 3 Summary of significant accounting policies (continued)

### Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired.

A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria used to determine if there is objective evidence of an impairment loss include:

i) significant financial difficulty of the obligor;
ii) delinquencies in interest or principal payments;
iii) it becomes probable that the borrower will enter bankruptcy or other financial reorganization; and/or
iv) a significant or prolonged decline in the fair value of the asset below its cost.

If such evidence exists, the Company recognizes an impairment loss, as follows:

i) Financial assets carried at amortized cost: The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of a provision for impairment account and the loss is recognized in the consolidated statement of income.

ii) Available-for-sale investments: The impairment loss is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the consolidated statement of income. This amount represents the loss in accumulated other comprehensive income that is reclassified to the statement of income.

   Impairment losses on available-for-sale investments, when recorded in the consolidated statement of income, are not reversed.

### Inventories

Inventories consist of linen, food, beverages and other supplies. Inventories are stated at the lower of cost and net realizable value. Cost is determined using the first in, first out ("FIFO") method. Net realizable value is the estimated replacement cost. If the carrying value exceeds the net realizable value, a write-down is recognized in the consolidated statement of income.

### Capital reserves

Capital reserves represent funds held by mortgagors (capital reserve – restricted) or funds internally restricted (capital reserve – internally restricted) for capital improvements to the hotel properties.

(in thousands of Canadian dollars)

## 3 Summary of significant accounting policies (continued)

### Minority interest investments in hotel properties

The minority interest investments in hotel properties represent equity ownership interests in three hotel partnerships or co-tenancies ranging from 6.00% to 19.06%. These investments are accounted for as available-for-sale investments and are measured at fair value at each reporting period with changes in value recognized in other comprehensive income. Significant or prolonged declines in fair value are removed from other comprehensive income and recognized in the statement of income.

### Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditures that are directly attributable to the acquisition of the item. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. Repairs and maintenance costs are charged to the statement of income during the period in which they are incurred.

Land is not depreciated. The major categories of property and equipment are depreciated on a straight-line basis as follows:

| | |
|---|---|
| Land lease | Term of the lease |
| Buildings and components | 15 to 60 years |
| Furniture, fixtures and equipment | 7 years |
| Paving | 10 years |
| Signage | 10 years |
| Landscaping | 5 years |
| Computer equipment and websites | 3 years |
| Vehicles | 3 years |

The Company allocates the amount initially recognized in respect of an item of property and equipment to its significant components and depreciates each component separately. Building components include core structure, HVAC/mechanical, roofing, elevators, windows/doors and other. The carrying amount of a replaced component is derecognized when replaced. Residual values, the method of amortization and the useful lives of the assets are reviewed annually and adjusted if appropriate.

Gains and losses on disposals of property and equipment are presented either as gain or loss on disposal in the consolidated statement of income.

(in thousands of Canadian dollars)

## 3 Summary of significant accounting policies (continued)

### Impairment of non-financial assets

Property and equipment are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units or "CGUs"). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Value in use is defined as the present value of the expected future cash flows of the relevant asset or CGU, as determined by management.

The Company evaluates impairment losses for potential reversals when events or circumstances warrant such consideration.

Impairments or reversals of previously recorded impairments on property and equipment are presented as provision for impairment of hotel properties or reversal of impairment of hotel properties in the consolidated statement of income.

### Other assets

Other assets consist of franchise fees and other intangible assets. Application and initial franchise fees are amortized on a straight-line basis over the term of the franchise agreement and the amortization is included in depreciation and amortization in the statement of income. Other intangible assets are amortized on a straight-line basis over their estimated useful life.

### Leases

Leases entered into by the Company in which substantially all of the benefits and risks of ownership are transferred to the Company are recorded as finance leases and classified as property and equipment and obligations under finance leases. At the inception of the lease, the asset and the obligation under finance lease are recorded at the lesser of the fair value of the leased asset or the net present value of the minimum lease payments. Each lease payment is allocated between the obligation and interest expense over the lease period. Assets under finance leases are depreciated over the shorter of the useful life of the asset and the lease term. All other leases are classified as operating leases and lease payments are expensed in the period in which they are incurred.

### Provisions

Provisions for legal or constructive obligations are recognized in the financial statements as liabilities when all of the following three criteria are met: (i) the Company has a present legal or constructive obligation as a result of a past event; (ii) it is more likely than not that an outflow of resources will be required to settle the obligation; and (iii) the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted where the effect is material. The Company does not have any significant provisions recorded at December 31, 2013.

(in thousands of Canadian dollars)

## 3 Summary of significant accounting policies (continued)

### Income tax

Income tax comprises current and deferred taxes. Income tax is recognized in the statement of income except to the extent that it relates to items recognized directly in other comprehensive income or directly in equity, in which case the income tax is also recognized directly in other comprehensive income or equity, respectively.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

Management periodically evaluates positions taken in tax returns with respect to situations where tax regulation is subject to interpretation. Management establishes provisions where appropriate.

In general, deferred income tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred income tax is not recognized if it arises from the initial recognition of goodwill or the initial recognition of an asset or liability in a transaction other than a business combination that, at the time of the transaction, affects neither accounting nor taxable profit nor loss. Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except, in the case of subsidiaries, where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the balance sheet date and are expected to apply when the deferred tax asset is realized or the liability is settled. Deferred tax assets are recognized to the extent that is probable that future taxable income will be available against which the deductible temporary differences can be utilized.

Deferred income tax assets and liabilities are presented as non-current.

### Dividends

Dividends to the Company's shareholders are recognized as a liability in the financial statements in the period in which they are approved and declared by the Company's Board of Directors but not yet paid.

### Revenue

Revenue is generated primarily from room occupancy, food and beverage services, rental and other revenue. Revenue is recognized when it is probable that the economic benefits will flow to the Company, the service has been provided, the price for the services and costs can be measured reliably and collectability is reasonably assured.

(in thousands of Canadian dollars)

## 3 Summary of significant accounting policies (continued)

### Loyalty programs

Loyalty programs administered by third party hotel brands enable guests to earn credit for points redeemable for free accommodations or other benefits at a later date. The Company effectively acts as an agent for these third party programs. In accordance with IFRIC 13-*Customer Loyalty Programmes*, the costs of loyalty program points are recorded as a reduction in hotel revenues.

### Share repurchases

If the Company repurchases its own shares, those shares are deducted from equity and the associated shares are cancelled. No gain or loss is recognized and the consideration paid, including any directly attributable incremental costs, is recognized in equity.

### Employee benefits

i) Share-based compensation

The Company grants share options to certain employees and directors. Share options vest equally over three years and expire after five years. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. The fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over the tranche's vesting period by increasing contributed surplus based on the number of awards expected to vest. This number is reviewed at least annually, with any change in estimate being recognized immediately in compensation expense with a corresponding adjustment to contributed surplus.

ii) Termination benefits

The Company recognizes termination benefits when it is demonstrably committed to terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal.

(in thousands of Canadian dollars)

## 3 Summary of significant accounting policies (continued)

### New and amended standards adopted by the Company

The following standards have been adopted by the Company for the financial year beginning on January 1, 2013:

Amendment to IAS 1, "*Financial statement presentation*" regarding other comprehensive income. The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they subsequently will or will not be reclassified to profit or loss. These changes did not result in any adjustments to OCI or comprehensive income.

IFRS 10, *"Consolidated financial statements"* builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. The standard requires an entity to consolidate an investee, only if the investor possesses power over the investee, is exposed or has rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The Company assessed its consolidation conclusions on January 1, 2013 and determined that the adoption of IFRS 10 did not result in any change in the consolidation status of its subsidiaries.

IFRS 11, *"Joint arrangements"* focuses on the rights and obligations of the parties to the arrangement rather than its legal form. There are two types of joint arrangements: joint operations and joint ventures. Joint operations arise where the investors have rights to the assets and obligations for the liabilities of an arrangement. A joint operator accounts for its share of the assets, liabilities, revenue and expenses. Joint ventures arise where the investors have rights to the net assets of the arrangement; joint ventures are accounted for under the equity method. Proportional consolidation of joint arrangements is no longer permitted. The Company currently has no interests in joint arrangements, therefore the adoption of this standard had no impact on the Company's consolidated financial statements.

IFRS 12, "*Disclosures of interests in other entities"* includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, structured entities and other off balance sheet vehicles. This standard did not result in any additional disclosures for the Company.

IFRS 13, *"Fair value measurement"*, aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs. The adoption of IFRS 13 did not require any adjustment to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at January 1, 2013.

Amendments to IAS 36, "*Impairment of assets"*, on the disclosure of recoverable amounts for non-financial assets. This amendment removed certain disclosures of the recoverable amount of CGUs which had been included in IAS 36 by the issue of IFRS 13. The amendment is not mandatory for the Company until January 1, 2014, however the Company has decided to early adopt the amendment as of January 1, 2013. Refer to note 4 - property and equipment disclosure.

(in thousands of Canadian dollars)

## 3 Summary of significant accounting policies (continued)

### New standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning on or after January 1, 2014, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of Holloway, except the following set out below:

In May 2013, the IASB issued IFRIC 21, "Levies", an interpretation on the accounting for levies imposed by governments. IFRIC 21 is an interpretation of IAS 37, "Provisions, contingent liabilities and contingent assets". IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have a present obligation as a result of a past event (known as an obligating event). The interpretation clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. IFRIC 21 is effective for annual periods beginning on or after January 1, 2014. The Company is currently assessing the impact of adopting IFRIC 21.

IFRS 9, "Financial instruments" introduces new requirements for the classification and measurement of financial assets. IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 "Financial Instruments: Recognition and Measurement" to be measured at amortized cost or fair value in subsequent accounting periods following initial recognition. Specifically, financial assets that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of subsequent accounting periods.

Requirements for classification and measurement of financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, "Financial Instruments – Recognition and Measurement", except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

IFRS 9 was amended in November 2013, to (i) include guidance on hedge accounting, (ii) allow entities to early adopt the requirement to recognize changes in fair value attributable to changes in an entity's own credit risk, from financial liabilities designated under the fair value option, in OCI, without having to adopt the remainder of IFRS 9, and to (iii) remove the previous mandatory effective date for adoption of January 1, 2015, although the standard is available for early adoption.

(in thousands of Canadian dollars)

## 4 Critical accounting estimates and judgments

The preparation of financial statements requires management to use judgment in applying its accounting policies and estimates and assumptions about the future. Estimates and other judgments are continuously evaluated and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. The following discusses the most significant accounting judgments and estimates that the Company has made in the preparation of these financial statements:

### Critical accounting estimates and assumptions

### a) Property and equipment

On December 31, 2013, the Company increased the carrying value of 4 CGUs by reversing previously recorded impairments by $4,450 and decreased the carrying value of 1 CGU by recording impairment of $1,000. The fair value of the CGUs is based on their value in use and is determined by internal models, recent independent third party appraisals and comparable sales transactions. A CGU is reviewed at the individual hotel level, the lowest level for which identifiable cash flows are largely independent when measuring the fair value of property and equipment. The fair value is determined based on the discounted future cash flows expected to be received from the CGU. The fair value amounts have been determined using ten-year cash flow projections and a capitalized terminal value calculation as approved by management of the Company and made maximum use of observable inputs and outputs. For periods beyond the initial budget period, cash flows were extrapolated using growth rates determined to be reasonable for the specific CGU and market in which they operate and do not exceed the anticipated long term average growth rates for the Company's portfolio. These are Level 3 fair value measurements under the Fair Value Hierarchy (see note 27). Key factors of estimation uncertainty include:

| | |
|---|---|
| Discount rates | 12.25% to 12.75% |
| Capitalization rates | 10% to 10.5% |
| Growth rates | Consistent with industry and portfolio outlook |

The fair value may not reflect the realizable value in the event a particular CGU is sold by the Company.

The amount of the impairment loss is the amount by which the CGU's carrying value exceeds its fair value. The future cash flows expected from the use and eventual disposition involve assumptions of occupancy, room rates, revenues, expenses, the residual or terminal value for the CGU and discount rates. In addition to these estimates, management assesses the effect of new competition in the individual markets and the hotel industry predictions of hotel demand and supply. These estimates and assumptions are subject to change. Based on this information, management estimated that the range of reasonably possible values for the assets would be between $54,086 and $61,197 for the 4 CGUs that were increased in value using internal models and between $14,663 and $17,092 for the 1 CGU that was decreased in value. The final value for the 4 CGUs increased in value was $57,437 and the final value for the 1 CGU decreased in value was $15,783.

### b) Minority interest investments in hotel properties

At December 31, 2013, the Company's minority interest investments in hotel properties were not traded in an active market and their fair value was estimated using internal valuation models. Valuations for these investments require the use of inputs and capitalization rates that cannot be derived from current market prices but are based on management estimates of appropriate amounts. The carrying amount of the Company's minority interest investments in hotel properties would be between $664 and $1,075 if the capitalization rate used in the valuation differed by plus or minus 1% from management's estimates.

(in thousands of Canadian dollars)

## 4 Critical accounting estimates and judgments (continued)

### Critical accounting estimates and assumptions (continued)

#### c) Loan receivable

The carrying value of a loan receivable classified as impaired is determined using valuation techniques based on discounted future cash flows expected to be received from the loan. The estimated cash flows and the collectability of the principal balance at maturity are subject to significant judgment and uncertainty.

#### d) Depreciation of property and equipment

The Company records depreciation on its property and equipment using the straight-line method over the estimated useful life of each category. If different estimated useful lives of the assets or depreciation methods were used, the impact on the Company's net income could be material.

#### e) Income taxes

Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of income, other comprehensive income, or directly in equity, as applicable, in the year that includes the date of enactment or substantive enactment. The estimates of future taxable income, the years when the temporary differences are expected to reverse and the tax rates in those years have an impact on the deferred income tax asset recorded on the statement of financial position.

#### f) Critical judgments in applying accounting policies

The preparation of financial statements requires management to use judgment in applying its accounting policies. Judgments are continuously evaluated and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. The following details the most significant accounting judgments that the Company has made in the preparation of the financial statements and the application of accounting policies:

i) Fair value of minority interest investments in hotel properties

The Company follows the guidance of IAS 39 to determine when available-for-sale investments are impaired. This determination requires significant judgment. In making this judgment, the Company evaluates, among other factors, the duration and extent to which the fair value of an investment is less than its cost and the financial health of and short-term business outlook for the investee, including factors such as industry and sector performance, operational and financing cash flow, market competition factors and capital requirements.

If all of the declines in fair value below cost were considered significant or prolonged, the Company would incur a loss of $169 in its financial statements, being the transfer of the accumulated fair value adjustments recognized in other comprehensive income on the available-for-sale investments to the statement of income.

(in thousands of Canadian dollars)

## 4 Critical accounting estimates and judgments (continued)

### f) Critical judgments in applying accounting policies (continued)

ii) Property and equipment

The Company is required to test for impairment when there is an indication that the carrying value of a CGU may not be recoverable or when a previously recorded impairment could be reversed.

The Company has established a methodology for identifying indicators of impairment which includes looking at changes in operating performance, occupancy levels and other factors for each CGU. Additional factors including oil and gas or other business and economic market activity, regional development opportunities and new competition in the markets in which each CGU operates are also considered in the review methodology. These indicators determine whether the Company tests for impairment or reversal of previously recorded impairments at each balance sheet date.

iii) Accounts receivable and accrued liabilities

The Company makes judgments in assessing the carrying value of accounts receivable and the collectability and credit worthiness of various accounts as well as accrued liabilities related to various costs incurred at the balance sheet date.

iv) Loan receivable

The Company uses judgments in the valuation of the loan receivable from Pacrim Hospitality Services Inc. (“PHSI”) as the terms of the loan agreement do not provide access to financial information of PHSI and the valuation is based on monthly interest payments which fluctuate and the principal repayment not occurring until 2018.

## 5 Trade and other receivables

| | December 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| Trade receivables | 2,119 | 2,336 |
| Less: allowance for doubtful accounts | (40) | (102) |
| Trade receivables - net | 2,079 | 2,234 |
| Receivables from credit card companies | 295 | 254 |
| Other receivables | 20 | 109 |
| | 2,394 | 2,597 |

(in thousands of Canadian dollars)

## 6 Acquisition and disposal of hotel properties

### Acquisition of hotel property

On November 30, 2012, the Company acquired a 90% interest in the entity that owns the Holiday Inn Express hotel located in Stellarton, NS for a purchase price of $7.9 million, net of cash acquired. Holloway paid cash on closing of $2.4 million and assumed its pro rata share of the hotel's mortgage. Holloway also acquired common shares and its share of the shareholder loan with a face value of $3.9 million (Holloway's share is $3.5 million). At the same time, Superior Lodging Corp. ("Superior"), a related party, retained its 10% interest in the entity. The fair value of the net assets acquired exceeded the purchase price by $433 which has been recorded as a gain on acquisition in the consolidated statement of income. The results of operations of the hotel since the date of acquisition have been included in the consolidated statements of income.

Acquisition related costs of $36 were recognized in the statement of income for the year ended December 31, 2012.

The following table summarizes the consideration paid for the property, the fair value of assets acquired, liabilities assumed and the non-controlling interest at the acquisition date:

| | $ |
|---|---|
| **Consideration paid at November 30, 2012** | 2,421 |
| **Identifiable assets and liabilities** | |
| Cash | 345 |
| Land | 1,128 |
| Building | 7,678 |
| Furniture, fixtures and equipment and other | 490 |
| Signage | 81 |
| Franchise fees | 21 |
| Other net working capital balances | (10) |
| Mortgage payable | (6,560) |
| Shareholder loan (10% owner) | (291) |
| **Total identifiable net assets** | 2,882 |
| Non-controlling interest | (28) |
| Gain on acquisition | (433) |
| **Total** | 2,421 |

(in thousands of Canadian dollars)

## 6 Acquisition and disposal of hotel properties (continued)

The following methods and assumptions were used by the Company in estimating the fair value of the assets acquired, liabilities assumed and the non-controlling interest as at November 30, 2012:

- Cash, other net working capital balances and the mortgage payable have carrying values which approximate their fair values due to the short maturity of these instruments.
- Long-term assets — the fair value estimate was based on the hotel's value in use and was determined using an internal model which discounted the hotel's estimated future cash flows and a terminal value to determine the net present value.
- Shareholder loans — the fair value was determined based on the amount paid in the sale transaction using an internal model which discounted the loan's interest and principal payments to determine the net present value. As of November 30, 2012, the loan became interest bearing at the bank's floating rate plus 1.1% per annum as a result of the acquisition and matures on November 30, 2017.
- Non-controlling interest — the fair value was estimated using the purchase paid for the acquisition of 90% of the entity and extended to the remaining 10% non-controlling interest.
- Holloway recognized a gain of $433 as a result of measuring at fair value its 90% interest in the hotel.

Included in the consolidated financial statements at December 31, 2012 is revenue of $190 and net income of $308 (including the gain) from the acquired hotel. Had the property been consolidated from January 1, 2012, the statement of income would have included revenue of $3,366 and net income of $428 (including the gain).

### Disposal of hotel properties

On January 12, 2012, the Company closed the sale of its leasehold interest on the 5 Calgary Downtown Suites Hotel in Calgary, AB. The Company received gross proceeds of $22,600 including $500 subject to holdback which was received during the second quarter of 2012. After repayment of the mortgage and closing costs, the net proceeds from the sale were approximately $7,000. The Company recognized a gain on disposal of hotel property of $459.

On February 1, 2012, the Company sold the Radisson Hotel and Suites in Fort McMurray, AB for gross proceeds of $25,100, which included a vendor take-back loan receivable of $3,000. The Company recognized a gain on disposal of hotel property of $4,074. After repayment of the mortgage and closing costs, the net cash proceeds were $11,069. The vendor take-back loan receivable had a one-year term and bore interest at 10%. The loan plus accrued interest of $50 was repaid on April 2, 2012.

On June 29, 2012, the Company sold the Super 8 hotel in Three Hills, AB for gross proceeds of $4,500. After repayment of the mortgage and closing costs, the net proceeds from the sale were approximately $676. The Company recognized a gain on disposal of hotel property of $1,068.

(in thousands of Canadian dollars)

## 7 Property and equipment

| | For the year ended December 31, 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Opening net book value $** | **Additions and acquisitions $** | **Disposals $** | **Depreciation $** | **Net reversal of impairment $** | **Foreign exchange $** | **Closing net book value $** |
| Land | 15,942 | – | – | – | 778 | 59 | 16,779 |
| Land lease | 309 | – | – | (9) | – | – | 300 |
| Buildings | 154,888 | 996 | – | (4,888) | 2,435 | 266 | 153,697 |
| Renovations | 200 | (185) | – | – | – | – | 15 |
| Furniture, fixtures and equipment | 7,482 | 2,895 | – | (3,464) | 212 | 61 | 7,186 |
| Paving | 1,126 | 24 | – | (262) | 25 | 1 | 914 |
| Landscaping | 15 | 7 | – | (5) | – | – | 17 |
| Signage | 669 | 15 | (17) | (124) | – | 2 | 545 |
| Computer equipment and websites | 240 | 344 | (1) | (157) | – | 1 | 427 |
| Vehicles | 93 | – | – | (36) | – | – | 57 |
| | 180,964 | 4,096 | (18) | (8,945) | 3,450 | 390 | 179,937 |

(in thousands of Canadian dollars)

## 7 Property and equipment (continued)

| | As at December 31, 2013 | | | |
|---|---|---|---|---|
| | Cost<br>$ | Accumulated impairment losses<br>$ | Accumulated depreciation<br>$ | Net book value<br>$ |
| Land | 26,034 | (9,255) | – | 16,779 |
| Land lease | 500 | (116) | (84) | 300 |
| Buildings | 247,271 | (63,516) | (30,058) | 153,697 |
| Renovations | 15 | – | – | 15 |
| Furniture, fixtures and equipment | 29,077 | (4,401) | (17,490) | 7,186 |
| Paving | 2,942 | (529) | (1,499) | 914 |
| Landscaping | 39 | – | (22) | 17 |
| Signage | 1,029 | – | (484) | 545 |
| Computer equipment and websites | 1,577 | – | (1,150) | 427 |
| Vehicles | 202 | – | (145) | 57 |
| | 308,686 | (77,817) | (50,932) | 179,937 |

As at December 31, 2013, the Company recognized a reversal of previously recorded impairment losses of $4,450 and an additional impairment loss of $1,000 in respect of various CGUs. Management of the Company assessed these CGUs for impairment or reversal of previously recorded impairments because of changes in the competitive environment in their respective markets, significantly improved or declining performance relative to forecasted results or noteworthy changes in the economic factors of the market in which the CGU operates. Refer to note 4 for discussion regarding the use of estimates in determination of the values of the CGUs.

The $15 loss on disposal of hotel properties and equipment represents the disposal of miscellaneous equipment during the year.

(in thousands of Canadian dollars)

## 7 Property and equipment (continued)

| | For the year ended December 31, 2012 | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Opening net book value $** | **Additions and acquisitions $** | **Disposals $** | **Depreciation $** | **Net reversal of impairment $** | **Foreign exchange $** | **Closing net book value $** |
| Land | 15,301 | 1,127 | (687) | – | 220 | (19) | 15,942 |
| Land lease | 407 | – | – | (10) | (88) | – | 309 |
| Buildings | 140,539 | 8,874 | (2,444) | (4,420) | 12,409 | (70) | 154,888 |
| Renovations in progress | 247 | (47) | – | – | – | – | 200 |
| Furniture, fixtures and equipment | 8,396 | 1,787 | (179) | (2,869) | 375 | (28) | 7,482 |
| Paving | 1,334 | – | (43) | (240) | 77 | (2) | 1,126 |
| Landscaping | 20 | – | – | (5) | – | – | 15 |
| Signage | 696 | 91 | (17) | (101) | – | – | 669 |
| Computer equipment and websites | 223 | 123 | (11) | (94) | – | (1) | 240 |
| Vehicles | 14 | 89 | – | (10) | – | – | 93 |
| | 167,177 | 12,044 | (3,381) | (7,749) | 12,993 | (120) | 180,964 |

(in thousands of Canadian dollars)

## 7 Property and equipment (continued)

| | As at December 31, 2012 | | | |
|---|---|---|---|---|
| | Cost<br>$ | Accumulated impairment losses<br>$ | Accumulated depreciation<br>$ | Net book value<br>$ |
| Land | 25,958 | (10,016) | – | 15,942 |
| Land lease | 500 | (116) | (75) | 309 |
| Buildings | 245,691 | (65,789) | (25,014) | 154,888 |
| Renovations in progress | 200 | – | – | 200 |
| Furniture, fixtures and equipment | 26,154 | (4,603) | (14,069) | 7,482 |
| Paving | 2,912 | (552) | (1,234) | 1,126 |
| Landscaping | 32 | – | (17) | 15 |
| Signage | 1,060 | – | (391) | 669 |
| Computer equipment and websites | 1,332 | – | (1,092) | 240 |
| Vehicles | 269 | – | (176) | 93 |
| | 304,108 | (81,076) | (42,068) | 180,964 |

As at December 31, 2012, the Company recognized a reversal of previously recorded impairment losses of $19,829 and additional impairment losses of $6,836 in respect of various CGUs.

Included in the net book value of furniture, fixtures and equipment and computer equipment are assets under finance leases as at December 31, 2013 of $92 (December 31, 2012 - $214). The debt related to these assets has been paid in full.

## 8 Minority interest investments in hotel properties

The Company has minority interests in 3 hotels (December 31, 2012 – 4 hotels) ranging from 6.00% to 19.06%. The investments are accounted for as available-for-sale financial assets. During the year ended December 31, 2013, the Company received $38 for an outstanding receivable related to the Super 8® hotel in Trois Rivieres, QC, which it sold in June 2010. The Company recognized a loss of $10. The Company also sold its investment in the Super 8® hotel in Langley, BC for proceeds of $106 in cash and a vendor take-back loan receivable of $33, and recognized a gain of $139, as the investment had previously been written down to $nil. The vendor take-back loan receivable is due June 2015 and bears interest at 6%. During the year ended December 31, 2012, the Company sold its investment in the Super 8® hotel in Amherst, NS for $236 and recognized a loss on sale of $101.

| | For the years ended | |
|---|---|---|
| | December 31, 2013<br>$ | December 31, 2012<br>$ |
| **Opening value** | 861 | 850 |
| Sale of investment | (106) | (236) |
| Receipt of funds related to loan receivable | (38) | – |
| Change in value recorded in the statement of comprehensive income | – | 307 |
| Gain (loss) recognized in statement of income | 129 | (101) |
| Additional investment | – | 41 |
| **Ending value** | 846 | 861 |

(in thousands of Canadian dollars)

## 9 Loan receivable

| | December 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| Pacrim Hospitality Services Inc. ("PHSI") | 6,063 | 6,114 |
| Less: Provision for impairment | (1,235) | (1,235) |
| Net | 4,828 | 4,879 |

The loan receivable from PHSI, the company that manages the Company's hotels, is unsecured, is due on February 1, 2018, is repayable at any time without penalty and bears interest at the lesser of 13% and the Company's trailing three-month adjusted funds from operations per share divided by the volume weighted average price of the shares on the TSX plus 1%.

PHSI continues to meet the interest obligations under the terms of loan and in the absence of evidence to the contrary, the Company considers the loan to be performing and cannot determine if a further provision for impairment is necessary at this time. Management's assessment of the valuation of this loan is largely based on estimated cash flows that will not occur until 2018 when the principal is due and, therefore, there is significant uncertainty associated both with the amount of the provision recorded and the remaining carrying value of the loan.

## 10 Other assets

| | Franchise fees $ | Agreements $ | Reports $ | Total $ |
|---|---|---|---|---|
| **For the year ended December 31, 2013** | | | | |
| Opening net book value | 333 | – | – | 333 |
| Additions | 15 | – | 50 | 65 |
| Disposals | – | – | – | – |
| Foreign exchange | 2 | – | – | 2 |
| Amortization for the year | (81) | – | (11) | (92) |
| Closing net book value | 269 | – | 39 | 308 |
| **As at December 31, 2013** | | | | |
| Cost | 706 | – | 50 | 756 |
| Accumulated amortization | (437) | – | (11) | (448) |
| Net book value | 269 | – | 39 | 308 |
| **For the year ended December 31, 2012** | | | | |
| Opening net book value | 457 | 52 | – | 509 |
| Additions | 21 | – | – | 21 |
| Disposals | (91) | – | – | (91) |
| Amortization for the year | (54) | (52) | – | (106) |
| Closing net book value | 333 | – | – | 333 |
| **As at December 31, 2012** | | | | |
| Cost | 689 | – | – | 689 |
| Accumulated amortization | (356) | – | – | (356) |
| Net book value | 333 | – | – | 333 |

(in thousands of Canadian dollars)

## 11 Line of credit

The Company has an available line of credit for $5,000. As at December 31, 2013, the Company had drawn $1,004 (December 31, 2012 - $1,523). The line of credit bears interest at prime plus 2.0%, is payable on demand and is secured by a demand collateral mortgage and charge on the Holiday Inn Express hotel in Kamloops, BC.

## 12 Trade payables and accrued liabilities

| | December 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| Trade payables | 2,381 | 2,445 |
| Accrued expenses and liabilities | 2,710 | 3,126 |
| | 5,091 | 5,571 |

## 13 Mortgages payable

| | December 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| Mortgages payable, bearing interest at a weighted average rate of 6.52% (December 31, 2012 – 6.63%) and maturing on various dates from April 2016 to July 2028. Individual first charges on all but two of the hotel properties have been pledged as security for individual mortgages. | 108,043 | 112,212 |
| Less: deferred financing fees | 444 | 529 |
| Less: current portion | 4,261 | 10,070 |
| | 103,338 | 101,613 |

The amount of mortgages payable denominated in US dollars is $4,162 (December 31, 2012 - $4,003).

Estimated future principal repayments over the next five years are as follows:

| | $ |
|---|---|
| Year ending December 31, 2014 | 4,261 |
| 2015 | 4,525 |
| 2016 | 12,830 |
| 2017 | 79,185 |
| 2018 | 5,069 |
| Thereafter | 2,173 |

(in thousands of Canadian dollars)

## 13 Mortgages payable (continued)

The following table summarizes significant changes in mortgages payable for the years ended December 31, 2013 and 2012:

| | For the years ended | |
|---|---|---|
| | December 31, 2013 $ | December 31, 2012 $ |
| **Beginning balance** | 111,683 | 115,897 |
| Mortgage recognized on acquisition | – | 6,560 |
| Proceeds from new debt | 3,400 | – |
| Additions to deferred financing fees | (104) | (125) |
| Amortization of deferred financing fees | 190 | 159 |
| Repayment of debt | (7,807) | (10,709) |
| Impact of foreign exchange | 237 | (99) |
| **Ending balance** | 107,599 | 111,683 |

In July 2013, the Company extended the mortgage on the Holiday Inn Express in Stellarton, NS for $6,340 at a fixed rate of 4.80% for a 5 year term. In August 2013, the Company refinanced the mortgage on the Super 8® hotel in Drayton Valley, AB for $3,400 at the lender's floating base interest rate less 0.65% for a 15 year term. In September 2013, Holloway negotiated a $527 penalty-free prepayment on the mortgage on the Super 8® hotel in Truro, NS.

In April 2012, the Company refinanced the maturing mortgage on the Holiday Inn Express in Moncton, NB for $4,250 at a rate of 5.99% for a 5 year term. The Company used this refinancing as an opportunity to reduce its debt by paying down $403 of principal. In August 2012, Holloway negotiated a $424 penalty-free prepayment on the mortgage on the Super 8® hotel in Truro, NS. In August 2012, the Company repaid at maturity the $2,500 mortgage on the Super 8® hotel in Windsor, NS.

## 14 Convertible debentures

On January 23, 2012, the REIT redeemed the remaining $46,660 principal amount of the 6.5% convertible debentures by issuing 17,855,601 units to the debentureholders. The number of units issued to the debentureholders was determined by dividing the aggregate principal amount of the debentures outstanding by 95% of the weighted average trading price per unit for the 20 consecutive trading days ending on the fifth trading day preceding the redemption date (the “current market price”). The 20 trading day period commenced on and included December 15, 2011 and ended on and included January 16, 2012. The current market price was determined to be approximately $2.76 (rounded) and the units were issued to the debentureholders at a conversion price of $2.60 (rounded).

The following table summarizes significant changes in convertible debentures for the years ended December 31, 2013 and 2012:

| | For the years ended | |
|---|---|---|
| | December 31, 2013 $ | December 31, 2012 $ |
| **Beginning balance** | – | 46,134 |
| Accretion of discount and deferred financing fees | – | 526 |
| Redemption of outstanding debentures for units | – | (46,660) |
| **Ending balance** | – | – |

(in thousands of Canadian dollars)

## 15 Loan due to a related party

**Superior Lodging Corp. ("Superior")**

On November 30, 2012, the Company acquired a 90% interest in the entity that owns the Holiday Inn Express hotel in Stellarton, NS. The loan due to Superior is the shareholder loan that Superior retained (note 6). Superior is a related party as its majority owner is a director of Holloway. The principal balance of the loan is due November 30, 2017. The loan bears interest at the banks floating rate of prime plus 1.1%.

**Geosam Capital Inc. ("Geosam")**

On July 29, 2011, the Company drew $14,000 from Geosam as administrative agent for itself and a third party on a non-revolving bridge loan. The loan bore interest at 12.5%. On January 12, 2012 and February 2, 2012, the Company repaid $5,500 and $9,300, respectively.

The following table summarizes significant changes in the loans for the years ended December 31, 2013 and 2012:

| | For the years ended | |
|---|---|---|
| | December 31, 2013 $ | December 31, 2012 $ |
| **Superior Lodging Corp.** | | |
| **Beginning balance** | 291 | – |
| Fair value at acquisition | – | 291 |
| Accretion | 16 | – |
| **Ending balance** | 307 | 291 |
| **Geosam Capital Inc.** | | |
| **Beginning balance** | – | 14,768 |
| Accretion | – | 32 |
| Repayment | – | (14,800) |
| **Ending balance** | – | – |
| **Total** | 307 | 291 |

## 16 Shareholders' equity

Under a plan of arrangement effective on December 31, 2012, unitholders of the REIT received one common share for each unit held. See note 1.

The Company is authorized to issue an unlimited number of common shares. Each common share is transferable and represents an equal undivided beneficial interest in any distribution from the Company. All shares are of the same class and have equal rights and privileges and are not issued or traded with a par value.

(in thousands of Canadian dollars)

## 16 Shareholders' equity (continued)

### Issued and outstanding common shares

The following table summarizes the number of common shares issued and outstanding and the related ascribed values as at December 31, 2013 and 2012:

| | Number of shares issued and outstanding | Ascribed value $ |
|---|---|---|
| **Balance, January 1, 2012** | 984,772 | 180,317 |
| Issuance of units on redemption of convertible debentures (note 14) | 17,855,601 | 46,660 |
| Exchange of Class B LP units | 2,587 | 7 |
| Units purchased under NCIB | (191,850) | (699) |
| Fractional shares eliminated on unit consolidation | (8) | – |
| **Balance, December 31, 2012** | 18,651,102 | 226,285 |
| Shares purchased under NCIB | (721,100) | (2,572) |
| **Balance, December 31, 2013** | 17,930,002 | 223,713 |

On April 27, 2011, the Company initiated a normal course issuer bid ("NCIB") to repurchase over the 12 month period commencing on April 29, 2011 and ending on April 28, 2012, up to 62,703 of its issued and outstanding shares, such amount representing 10% of the Company's public float as of April 26, 2011. The Company repurchased and cancelled 2,550 shares at a cost of $10 (average price of $4.01 per unit).

On January 23, 2012, the Company issued 17,855,601 units pursuant to the redemption of the 6.5% convertible debentures.

On August 13, 2012, the Company initiated an NCIB to repurchase over the 12 month period commencing on August 15, 2012 and ending on August 14, 2013, up to 1,083,505 of its issued and outstanding shares, such amount representing 10% of the Company's public float as of August 13, 2012. The Company repurchased and cancelled 902,400 shares at a cost of $3,230 (average price of $3.58 per share).

On August 13, 2013, the Company initiated an NCIB to repurchase over the 12 month period commencing on August 15, 2013 and ending on August 14, 2014, up to 896,900 of its issued and outstanding shares, such amount representing 5% of the Company's issued and outstanding shares as of August 12, 2013. At December 31, 2013, the Company had repurchased and cancelled 8,000 shares at a cost of $32 (average price of $4.03 per share).

(in thousands of Canadian dollars)

## 16 Shareholders' equity (continued)

### Issued and outstanding common shares (continued)

The following table provides the total common shares outstanding as well as the impact of outstanding options and warrants, if exercised.

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Common shares outstanding | 17,930,002 | 18,651,102 |
| Options outstanding (exercisable) | 277,000 | 178,642 |
| Warrants outstanding (exercisable) | 52,500 | 52,500 |
| Total common shares reflecting exercise | 18,259,502 | 18,882,244 |

### Options

Movements in the number of options outstanding and their related weighted average exercise prices are as follows:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | Average exercise price in $ per share | Options | Average exercise price in $ per share | Options |
| At January 1 | 4.91 | 514,809 | 57.00 | 20,577 |
| Granted | – | – | 3.70 | 497,500 |
| Forfeited | 3.86 | (101,500) | 136.96 | (2,602) |
| Expired | 147.60 | (3,809) | 195.20 | (666) |
| At December 31 | 3.86 | 409,500 | 4.91 | 514,809 |

Out of the 408,000 outstanding options (2012 – 514,809), 275,500 options are exercisable (2012 – 178,642).

Options outstanding at the end of the year have the following expiry date and exercise prices:

| | | Common shares | |
|---|---|---|---|
| Expiry date | Exercise price in $ per unit | 2013 | 2012 |
| March 2013 | 147.60 | – | 3,809 |
| October 2016 | 9.20 | 12,000 | 13,500 |
| August 2017 | 3.70 | 397,500 | 497,500 |
| | | 409,500 | 514,809 |

(in thousands of Canadian dollars)

## 16 Shareholders' equity (continued)

### Options (continued)

On August 22, 2012, the Company issued 497,500 options to purchase Holloway common shares to directors and certain employees with an option price of $3.70 per share. The options vest equally over three years and expire after five years. The fair value of the options was measured at the grant date using the Black-Scholes option pricing model with the following assumptions:

| | Option grant August, 2012 |
|---|---|
| Exercise price | $3.70 |
| Closing price on grant date | $3.65 |
| Volatility | 102% |
| Annual dividend yield | 3.3% |
| Expected option life | 5 years |
| Annual risk-free interest rate | 1.5% |
| Per share fair value of option grant | $2.27 |

Compensation expense is recognized over the vesting period by increasing contributed surplus based on the number of options expected to vest. The total compensation expense recognized in the statement of income for options granted was $378 (2012 - $503).

## 17 Earnings per share

Basic earnings per share is calculated by dividing the net income attributable to shareholders of the Company by the weighted average number of shares outstanding during the year.

| | For the years ended | |
|---|---|---|
| | December 31, 2013 $ | December 31, 2012 $ |
| Net income attributable to shareholders of the Company | 4,489 | 19,723 |
| Weighted average number of shares outstanding | 18,137,856 | 17,727,238 |
| Earnings per share | 0.25 | 1.11 |

Diluted earnings per share is calculated by adjusting the weighted average number of shares outstanding to assume conversion of all potentially dilutive instruments convertible into shares. During 2013 and 2012, the company had two categories of potentially dilutive instruments - options and warrants. This calculation is done to determine the number of shares that could have been acquired at fair value based on the subscription rights of the warrants and options. For both 2013 and 2012, the options and warrants are anti-dilutive. Accordingly, diluted earnings per share is equal to basic earnings per share.

(in thousands of Canadian dollars)

## 18 Expenses by nature

| | For the years ended | |
|---|---|---|
| | December 31, 2013 $ | December 31, 2012 $ |
| Salaries, wages and employee benefits | 17,336 | 17,461 |
| Materials, supplies, repairs and utilities | 8,464 | 8,225 |
| Food, beverage and service costs | 3,269 | 3,400 |
| Insurance | 346 | 311 |
| Property taxes | 2,543 | 2,484 |
| Management fees | 1,322 | 1,289 |
| Royalty and franchise fees | 3,905 | 3,658 |
| Legal and other fees | 1,194 | 1,894 |
| Depreciation and amortization | 9,036 | 7,850 |
| Interest and financing costs | 7,546 | 8,612 |
| Provision for and reversal of impairments and gain or loss on acquisition or disposals | (3,564) | (18,913) |
| Other | 2,663 | 2,653 |
| | 54,060 | 38,924 |

## 19 Wages and employee benefits expense

Wages and employee benefits expense:

| | For the years ended | |
|---|---|---|
| | December 31, 2013 | December 31, 2012 |
| Salaries and wages | 15,057 | 14,986 |
| Benefits | 1,533 | 1,613 |
| RRSP/pension expense | 22 | 27 |
| Directors fees | 284 | 269 |
| Share-based compensation (non-cash) | 378 | 503 |
| Termination benefits | 62 | 63 |
| | 17,336 | 17,461 |

(in thousands of Canadian dollars)

## 19 Wages and employee benefits expense (continued)

Compensation of key management:

Key management include the Company's directors, Chairman, Chief Executive Officer, Chief Operating Officer and Chief Financial Officer. Compensation awarded to key management included:

| | For the years ended | |
|---|---|---|
| | **December 31, 2013** | **December 31, 2012** |
| Salaries and benefits | 500 | 420 |
| Consulting fees – Chairman/CEO, interim CFO | 100 | 106 |
| Share-based compensation | 347 | 468 |
| Directors fees | 284 | 269 |
| | 1,231 | 1,263 |

## 20 Income taxes

| | **2013 $** | **2012 $** |
|---|---|---|
| Components of the provision for income taxes are as follows: | | |
| Deferred income taxes | 1,787 | 4,852 |
| Benefit of recording previously unrecognized deferred tax assets | – | (4,852) |
| Provision for income taxes | 1,787 | – |

(in thousands of Canadian dollars)

## 20 Income taxes (continued)

### Reconciliation of total tax expense

The effective rate on the Company's income before income tax differs from the expected amount that would arise using the combined statutory income tax rates. A reconciliation of the difference is as follows:

| | For the years ended | |
|---|---|---|
| | **December 31, 2013** | **December 31, 2012** |
| Income before income taxes | 6,257 | 19,736 |
| Income tax rate | 25.75% | 26.61% |
| Income tax expense at the combined statutory income tax rate | 1,611 | 5,252 |
| Non-taxable portion of capital (gains) and losses | (133) | (435) |
| Non-taxable gain on acquisition of subsidiary | – | (115) |
| Non-deductible share-based compensation | 97 | 134 |
| Impact of unused tax losses and deductible temporary differences not recognized as deferred tax assets | 156 | (4,852) |
| Other | 56 | 16 |
| Income tax provision | 1,787 | – |

The Corporation's effective tax rate was 25.75% (2012 – 26.61%).

### Deferred tax

Components of the net deferred income tax assets are as follows:

| | December 31, 2012 $ | Recognized in net income $ | December 31, 2013 $ |
|---|---|---|---|
| **Deferred income tax assets** | | | |
| Property and equipment | 6,913 | (1,793) | 5,120 |
| Non-capital losses | 222 | (3) | 219 |
| **Deferred income tax liabilities** | | | |
| Deferred financing fees | (53) | 9 | (44) |
| Net deferred income tax asset | 7,082 | (1,787) | 5,295 |

The Company has recognized deferred tax assets of $5,339 for which it is probable there will be sufficient taxable profits from operations and reversals of taxable temporary differences to facilitate utilization of the underlying tax deductible amounts.

(in thousands of Canadian dollars)

## 20 Income taxes (continued)

### Deferred tax (continued)

The estimated recovery periods for the deferred tax balances are as follows:

| | December 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| **Deferred tax assets** | | |
| Deferred tax assets to be recovered within 12 months | 1,015 | 912 |
| Deferred tax assets to be recovered after more than 12 months | 4,324 | 6,223 |
| **Deferred tax liabilities** | | |
| Deferred tax liabilities to be settled within 12 months | (9) | (34) |
| Deferred tax liabilities to be settled after more than 12 months | (35) | (19) |
| | 5,295 | 7,082 |

Deductible temporary differences and unused tax losses for which no deferred tax assets have been recognized are attributable to the following:

| | December 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| Non-capital losses | 32,593 | 32,665 |
| Realized capital losses | 5,393 | 5,393 |
| Loans receivable | 618 | 618 |
| Property and equipment | 37,727 | 39,359 |
| Other assets | 189 | 202 |
| Other | 232 | 258 |
| | 76,752 | 78,495 |

The Company has Canadian non-capital loss carry forwards which expire in the following years:

| Year of expiry | Loss $ |
|---|---|
| 2025 | 1,043 |
| 2026 | 2,837 |
| 2027 | 4,519 |
| 2028 | 6,525 |
| 2029 | 7,133 |
| 2030 | 5,418 |
| 2031 | 2,180 |
| 2032 | 78 |
| 2033 | 400 |
| Total | 30,133 |

(in thousands of Canadian dollars)

## 20 Income taxes (continued)

**Deferred tax** (continued)

The Company's US subsidiary has non-capital loss carry forwards which expire in the following years:

| Year of expiry | USD loss $ |
|---|---|
| 2027 | 251 |
| 2028 | 342 |
| 2029 | 550 |
| 2030 | 637 |
| 2031 | 827 |
| 2032 | 311 |
| 2033 | 192 |
| Total | 3,110 |

## 21 Seasonality

The Company's financial results for any individual quarter are not necessarily indicative of results to be expected for the full year. Revenues from hotel operations tend to fluctuate throughout the year. The Company's third quarter revenues are generally the strongest and the first, second and fourth quarter revenues are generally comparable.

## 22 Supplemental cash flow information

Adjustments for non-cash items:

| | For the years ended | |
|---|---|---|
| | December 31, 2013 $ | December 31, 2012 $ |
| Share-based compensation | 378 | 503 |
| Depreciation and amortization | 9,036 | 7,850 |
| Accretion on mortgages, convertible debentures, loan due to a related party and deferred financing fees | 207 | 739 |
| Loss (gain) on disposal of minority interest investments in hotel properties | (129) | 101 |
| Loss (gain) on disposal of hotel properties and equipment | 15 | (5,588) |
| Gain on acquisition of subsidiary | – | (433) |
| Reversal of impairment of hotel properties, net | (3,450) | (12,993) |
| Fair value adjustment of Class B LP units and derivative liability | – | 21 |
| Provision for deferred income taxes | 1,787 | – |
| | 7,844 | (9,800) |

(in thousands of Canadian dollars)

## 22 Supplemental cash flow information (continued)

Changes in items of working capital:

| | For the years ended | |
|---|---|---|
| | December 31, 2013 $ | December 31, 2012 $ |
| Trade and other receivables | 221 | 1,534 |
| Inventories | (22) | 77 |
| Prepaid expenses and deposits | 23 | 109 |
| Trade payables and accrued liabilities | (628) | (3,203) |
| Accrued interest on convertible debentures | – | (1,516) |
| | (406) | (2,999) |

Cash is comprised of the following:

| | December 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| Cash on hand and balances with banks | 852 | 1,312 |

## 23 Agreements

**Hotel Management Agreement**

**Pacrim Hospitality Services Inc. ("PHSI")**

On June 7, 2006, the Company entered into a long-term management agreement with PHSI, to manage the hotels purchased by the Company, with an initial term of ten years and an automatic renewal for successive five year terms commencing on the last day of the initial term (the "First Management Agreement"). PHSI is entitled to a base management fee of 3% of gross hotel revenues, an incentive fee, a purchasing fee of 4% of the cost of exceptional operating supplies and furniture, fixtures and equipment and a construction fee of 3% of the cost of construction materials, labour and equipment in connection with any construction or capital expenditures.

On November 24, 2006, the parties entered into an amending agreement such that the initial term with respect to each hotel shall commence on the date on which the Company acquires the hotel for a term of ten years and automatic renewals for successive five year terms.

(in thousands of Canadian dollars)

## 23 Agreements (continued)

**Hotel Management Agreement** (continued)

**Pacrim Hospitality Services Inc. ("PHSI")** (continued)

On June 22, 2007, the Company entered into a management agreement with Pomeroy Hospitality Ltd. ("Pomeroy") to manage ten hotels purchased by the Company, with a term of five years. On February 1, 2008, PHSI acquired management of ten of the Company's hotel properties located in northern Alberta and British Columbia from Pomeroy. Under the terms of an agreement among the Company, PHSI and Pomeroy, Pomeroy assigned its interest in the hotel management agreement between Pomeroy and the Company to PHSI on February 1, 2008 in return for a $6,350 one-time payment from PHSI. At the same time, the existing hotel management agreement between the Company and PHSI was amended to include the Pomeroy Hotels. Among other things, the amended hotel management agreement between the Company and PHSI provides that PHSI receive reimbursable expenses plus a base management fee for the Pomeroy Hotels of 1.8%, until the Company generates adjusted funds from operations that exceeds certain targets.

In order to facilitate the assignment, the Company loaned PHSI the funds paid to Pomeroy in consideration of the assignment (note 9).

Upon certain change of control events, as set out in the First Management Agreement, PHSI is entitled to terminate the entire First Management Agreement upon 60 days prior written notice to Holloway Lodging Limited Partnership and the Company and to receive a lump sum payment of $1,500 in connection with such termination, without detracting from any other remedies available to it under the terms of the First Management Agreement. In addition, PHSI shall be entitled to receive a one-time fee in the amount of the aggregate outstanding principal and accrued and unpaid interest on the loan as of the termination date of the First Management Agreement. Such fee shall be withheld by Holloway Lodging Limited Partnership and used to repay the loan in full.

On July 7, 2010, pursuant to the acquisition of the Super 8 hotel in Windsor, NS, PHSI agreed to defer its management and accounting fees until June 30$^{th}$ of each year until June 30, 2013. PHSI was entitled to receive a payment calculated as 3/5$^{th}$ of 50% of the hotel's "free cash flow" for the prior twelve months. Free cash flow was defined as net operating income less first mortgage debt service and 3% of total revenues for reserve for replacement. The payment was due on or before July 25$^{th}$ of each year. Any unpaid balance of the fees was applied against the principal balance of the loan receivable from PHSI (note 9).

On October 15, 2012, Holloway entered into a second hotel management agreement (the "Second Management Agreement") with PHSI under which PHSI is responsible for managing the day-to-day property and administrative operations of the hotels acquired subsequent to this date. PHSI has the right to manage hotels acquired by Holloway in Canada and at Holloway's discretion, hotels acquired in the United States. PHSI is entitled to a base management fee of 2.5 % of gross hotel revenues, an incentive fee and purchasing and sales cost recoveries. Holloway retains the right to manage construction projects internally or through third party project management firms.

(in thousands of Canadian dollars)

## 23 Agreements (continued)

### Hotel Management Agreement (continued)

### Pacrim Hospitality Services Inc. ("PHSI") (continued)

The Second Management Agreement can be terminated as it applies to any hotel on 30 days written notice by either Holloway or PHSI at their discretion with no fee payable by either party to the other except in very limited circumstances.

On May 1, 2013, the Company internalized the hotel accounting services previously performed by PHSI.

### Non-competition, Right of First Opportunity and Participation Agreement

On June 22, 2007, the Company entered into a non-competition, right of first opportunity and participation agreement with Pomeroy Gold Ltd. The agreement had a five year term and provided for (a) limitations on the development of hotels within a defined area without the consent of each party to the agreement; (b) the right of first opportunity for Holloway to purchase certain hotels; and (c) the right for Holloway to invest in certain Pomeroy developments. The agreement expired on June 21, 2012.

## 24 Contingencies and commitments

### Contingencies

In the course of the Company's ordinary activities, the Company is involved in administrative proceedings, litigations and claims. The Company believes that either there are valid defences to any actions or that the outcome will not have a material impact on the Company's consolidated financial position or results of operations.

(in thousands of Canadian dollars)

## 24 Contingencies and commitments (continued)

### Commitments

#### Franchise agreements

The following fees are payable under the terms of the various franchise agreements covering the hotel properties:

| | As a % of gross room revenue |
|---|---|
| **To Super 8 Motels, Inc.** | |
| Royalty fee | 5% |
| Marketing assessment | 3% |
| **To Holiday Hospitality Franchising Inc. Group** | |
| Royalty fee | 5% - 6% |
| Marketing assessment | 1.5% - 2% |
| Reservation assessment | 1% |
| **To Pomeroy Inn & Suites Inc.** | |
| Royalty fee | 5% |
| Marketing assessment | 3% |
| **To Travelodge Canada** | |
| Royalty fee (years 1 to 4) | 10% of brand production |
| Royalty fee (years 5 to 10) | 3% |
| Marketing assessment (years 1 to 4) | 3% of brand production |
| Marketing assessment (years 5 to 10) | 3% |
| **To Best Western International, Inc.** | |
| Royalty fees | $1.21 - $1.45/room/day |
| Marketing assessment | $11.00/room/month |
| Annual dues | $5 |

#### Operating leases

The Company leases office space and has various equipment operating leases.

The minimum annual lease payments over the next five years are as follows:

| | Operating leases $ |
|---|---|
| Year ending December 31, 2014 | 130 |
| 2015 | 123 |
| 2016 | 116 |
| 2017 | 28 |
| 2018 | – |

(in thousands of Canadian dollars)

## 24 Contingencies and commitments (continued)

### Lease revenue

The Company is committed to leasing space in some of its hotels to outside parties. The minimum annual revenue over the next five years is expected to be as follows:

| | $ |
|---|---|
| Year ending December 31, 2014 | 382 |
| 2015 | 339 |
| 2016 | 195 |
| 2017 | 195 |
| 2018 | 135 |

## 25 Related party transactions

The information below details the related party transactions not disclosed elsewhere in these consolidated financial statements, including amounts received or receivable, paid or payable and year-end balances.

| | December 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| Superior Lodging Corp., a company in which a director is a member of management and has an ownership interest | | |
| Royalty fees | 506 | 522 |
| Included in accounts payable and accrued liabilities | 32 | 32 |
| Geosam Capital Inc., a shareholder with significant ownership interest | | |
| Consulting fees | 100 | 83 |
| Interest expense on loan | – | 127 |
| Included in accounts payable and accrued liabilities | 8 | 8 |

(in thousands of Canadian dollars)

## 26 Segment reporting

In measuring performance, the Company does not distinguish or group its operations on a geographic or any other basis, and accordingly, results have been aggregated into a single reportable segment.

### Geographical information

| | For the years ended | |
|---|---|---|
| | **December 31, 2013 $** | **December 31, 2012 $** |
| **Revenues** | | |
| Canada | 57,506 | 56,170 |
| United States | 2,451 | 2,203 |
| | 59,957 | 58,373 |

| | **December 31, 2013 $** | **December 31, 2012 $** |
|---|---|---|
| **Property and equipment** | | |
| Canada | 173,957 | 175,110 |
| United States | 5,980 | 5,854 |
| | 179,937 | 180,964 |

## 27 Financial instruments and fair values

### Measurement categories, fair values, valuation methods and assumptions

As explained in note 3, financial assets and liabilities have been classified into categories that determine their basis of measurement and, for items measured at fair value, whether changes in fair value are recognized in the statement of income or comprehensive income. Those categories are: fair value through profit or loss; loans and receivables; available-for-sale assets; and, for liabilities, amortized cost. The following table shows the carrying values of assets and liabilities for each of these categories at December 31, 2013 and 2012.

(in thousands of Canadian dollars)

## 27 Financial instruments and fair values (continued)

| | December 31, 2013 | | December 31, 2012 | |
|---|---|---|---|---|
| | Carrying value $ | Fair value $ | Carrying value $ | Fair value $ |
| **Assets** | | | | |
| Loans and receivables | | | | |
| Cash | 852 | 852 | 1,312 | 1,312 |
| Restricted cash | 278 | 278 | 253 | 253 |
| Capital reserve – internally restricted | 108 | 108 | 318 | 318 |
| Capital reserve – restricted | 2,517 | 2,517 | 3,976 | 3,976 |
| Trade and other receivables | 2,394 | 2,394 | 2,597 | 2,597 |
| Loan receivable | 4,828 | 4,014 | 4,879 | 3,749 |
| | 10,977 | 10,163 | 13,335 | 12,205 |
| Available-for-sale | | | | |
| Minority interest investments in hotel properties | 846 | 846 | 861 | 861 |
| **Liabilities** | | | | |
| Amortized cost | | | | |
| Line of credit | 1,004 | 1,004 | 1,523 | 1,523 |
| Trade payables and accrued liabilities | 5,091 | 5,091 | 5,571 | 5,571 |
| Mortgages payable | 107,599 | 104,625 | 111,683 | 106,231 |
| Loan due to a related party | 307 | 307 | 291 | 291 |
| Obligations under finance leases | – | – | 10 | 10 |
| | 114,001 | 111,027 | 119,078 | 113,626 |
| Fair value through profit and loss | | | | |
| Derivative liability | – | – | 32 | 32 |

The carrying value of the following items approximate their fair value due to the immediate or short-term maturities of these financial instruments: cash, restricted cash, capital reserves – internally restricted and restricted, trade and other receivables, line of credit and trade payables and accrued liabilities.

(in thousands of Canadian dollars)

## 27 Financial instruments and fair values (continued)

The methods and assumptions used in estimating the fair value of other financial assets and liabilities are as follows:

- Minority interest investments in hotel properties: The fair value is determined using internal valuation techniques. The Company uses an earnings approach based on the hotel's recent operating performance to determine the value of the investment and deducts the outstanding debt on the hotel property.

- Mortgages payable, obligations under finance leases and loan due to a related party: The fair value is determined using internal valuation techniques which incorporate the discounted future cash flows using discount rates that reflect current market conditions for debt instruments with similar interest rates, terms and risk. The fair values do not necessarily represent the amounts the Company might pay in actual market transactions.

- Derivative liability: Prior to their reclassification to equity, the fair value of the warrants was determined using the Black-Scholes option pricing model.

**Fair value hierarchy**

The following table classifies financial assets and liabilities that are recognized on the statement of consolidated financial position at fair value in a hierarchy that is based on the significance of the inputs used in making the measurements. The levels in the hierarchy are:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;

- Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices); and

- Level 3 – Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

| | December 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| Level 2 | | |
| Derivative liability | – | 32 |
| Level 3 | | |
| Minority interest investments in hotel properties | 846 | 861 |

(in thousands of Canadian dollars)

## 28 Risk management

The Company's activities expose it to a variety of financial risks: interest rate risk, credit risk, currency risk and liquidity risk. Senior management is responsible for setting acceptable levels of risk and reviewing risk management activities as necessary.

The Company's overall risk management program seeks to minimize potential adverse effects on the Company's financial performance.

### a) Interest rate risk

The Company is exposed to interest rate risk on its lending and borrowing activities. It manages its exposure to interest rate risk by primarily using fixed rate debt so cash flow is not impacted significantly by a change in interest rates. The weighted average interest rate on its mortgages payable is 6.52% (December 31, 2012 - 6.63%) with a weighted average maturity of 3.8 years (December 31, 2012 - 4.2 years).

The Company has one mortgage at a floating rate equivalent to the lender's floating base interest rate less 0.65%. The Company's line of credit is at a floating rate. For the year ended December 31, 2013, if interest rates on the Company's floating rate debt had been 1% higher/lower, the net income would change by $51 (December 31, 2012 - $47).

### b) Credit risk

The credit risk on cash is limited because the counter-parties are banks with high credit ratings assigned by international credit-rating agencies.

The amount of trade and other receivables disclosed on the consolidated statement of financial position of $2,394 is net of an allowance for doubtful accounts, estimated by management based on prior experience and their assessment of the current economic environment.

Historically, there have been no significant collection issues and the Company does not believe it is subject to any significant concentration of credit risk. The Company assesses the creditworthiness of customers requesting credit, prior to approval. Listings of trade receivables are reviewed by and discussed with hotel operations personnel on a monthly basis.

The allowance for doubtful accounts is generally recorded for trade receivable balances outstanding for more than 120 days. Amounts charged to the allowance are generally written off when there is no expectation of recovering additional cash.

(in thousands of Canadian dollars)

## 28 Risk management (continued)

### b) Credit risk (continued)

The following table sets forth details of trade and other receivables and the related allowance for doubtful accounts:

| | December 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| Trade and other receivables under 30 days aged | 1,554 | 1,840 |
| Trade and other receivables over 30 days aged | 880 | 859 |
| Less: Allowance for doubtful accounts | (40) | (102) |
| | 2,394 | 2,597 |

The Company is exposed to credit risk on its loan receivable (note 9).

### c) Currency risk

The Company earns revenue and incurs expenses in US currency from its hotel in Myrtle Beach, South Carolina, US, and as such, is subject to risk as a result of foreign exchange rate fluctuations. The Company manages its exposure to currency risk by billing for its services in the US in the underlying currency related to the expenditure. As this natural hedging effectively matches the revenue and expenses, the Company's management considers there to be little currency risk. The Company does not hedge foreign currency exposures. However, a $0.01 change in the US dollar exchange rate will change the cumulative translation adjustments recognized in other comprehensive income by $16 (year ended December 31, 2012 - $17).

In addition, the Company is exposed to some currency risk as it pays certain franchise and royalty payments in US dollars. A $0.01 change in the US dollar exchange rate will change the foreign exchange gain or loss recognized in the consolidated statement of income by $25.

### d) Liquidity risk

The Company's objective is to have sufficient liquidity to meet its liabilities when due, as well as to maintain compliance with the liquidity covenants in its financing agreements and its capital management requirements and objectives. Cash flow forecasting is performed at the hotel level and aggregated in head office.

The Company has no mortgages maturing in the next 12 months.

The Company monitors and forecasts its cash balances and cash flows generated from operations to meet its required obligations. At December 31, 2013, the Company had drawn $1,004 (December 31, 2012 - $1,523) from its available line of credit of $5,000.

(in thousands of Canadian dollars)

## 28 Risk management (continued)

### d) Liquidity risk (continued)

Based on the overall cash generation capability and overall financial position, while there can be no assurance, management believes the Company will be able to meet all financial obligations as they become due.

The table below analyzes the Company's non-derivative financial liabilities into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

| | December 31, 2013 | | | |
|---|---|---|---|---|
| | Less than 3 months | 3 months to 1 year | 2 to 5 years | Over 5 years |
| Line of credit | 1,004 | – | – | – |
| Trade payables and accrued liabilities | 5,091 | – | – | – |
| Mortgages payable | 1,065 | 3,196 | 101,835 | 1,947 |
| Mortgages payable interest | 1,708 | 5,123 | 16,217 | 367 |
| Loan due to a related party | – | – | 307 | – |

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Less than 3 months | 3 months to 1 year | 2 to 5 years | Over 5 years |
| Line of credit | 1,523 | – | – | – |
| Trade payables and accrued liabilities | 5,571 | – | – | – |
| Mortgages payable | 886 | 9,184 | 102,142 | – |
| Mortgages payable interest | 1,716 | 5,461 | 21,610 | – |
| Obligations under finance leases | 10 | – | – | – |
| Loan due to a related party | – | – | 291 | – |

## 29 Capital management

The Company defines capital as the aggregate of equity and interest-bearing debt. The objectives of the Company's capital management program are to maintain a level of capital that complies with existing debt covenants, optimizes the cost of capital, funds its business strategies, provides returns to shareholders and builds long-term shareholder value.

In managing its capital structure, the Company monitors performance throughout the year to ensure anticipated working capital requirements and capital expenditures are funded from operations, available cash on deposit and, where applicable, borrowings. The Company will make adjustments to its capital structure to meet the objectives of the broader corporate strategy or in response to changes in economic conditions and risk. In order to maintain or adjust the capital structure, the Company may issue, redeem or repay debt, issue or redeem shares, adjust the amount of dividends paid to shareholders or sell assets to reduce debt.

(in thousands of Canadian dollars)

## 29 Capital management (continued)

The Company monitors capital using certain financial metrics, including (but not limited to):

- a debt to gross book value ("Debt to GBV") ratio defined as line of credit, mortgages payable, loan due to a related party, obligations under finance leases and derivative liability ("Debt") divided by total assets plus accumulated impairments, depreciation and amortization ("GBV"). The Company's by-laws state that the Company's Debt to GBV should not exceed 60%; and

- a debt service coverage ratio defined as earnings before interest, income taxes, depreciation, amortization, non-cash accretion, fair value adjustments of Class B LP units and derivative liability and share-based compensation ("earnings base") to the sum of the annual principal and interest payments on mortgages, debentures, loan due to a related party and finance leases ("debt service").

| | December 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| **Capital structure** | | |
| Line of credit | 1,004 | 1,523 |
| Derivative liability | – | 32 |
| Obligations under finance leases | – | 10 |
| Mortgages payable | 107,599 | 111,683 |
| Loan due to a related party | 307 | 291 |
| Total debt | 108,910 | 113,539 |
| Equity | 85,407 | 85,511 |
| Total capital | 194,317 | 199,050 |
| **Ratios** | | |
| Total debt | 108,910 | 113,539 |
| Gross book value | 328,605 | 328,121 |
| Debt to GBV | 33.1% | 34.6% |

| | For the years ended | |
|---|---|---|
| | December 31, 2013 $ | December 31, 2012 $ |
| Earnings base | 19,674 | 17,343 |
| Debt service | 11,338 | 11,884 |
| Debt service coverage ratio | 1.74 | 1.46 |

(in thousands of Canadian dollars)

## 29 Capital management (continued)

The Company is also subject to financial covenants on its mortgages payable, which are measured on an annual basis and include customary terms and conditions for borrowings of this nature. These include the debt service coverage ratio presented previously.

At December 31, 2013, no covenants were in violation. At December 31, 2012, covenants on certain mortgages were in violation. These mortgages all matured in 2013 and were included in current liabilities at December 31, 2012. The carrying amount of the mortgages was $6,523.

## 30 Subsequent events

On February 10, 2014, the Company entered into a credit agreement for a $17,000 term loan to be used for general corporate purposes and the acquisition of additional hotels. The term loan bears interest at 6.5 % and does not require any principal payments until its maturity on March 31, 2016. The Company may prepay all or part of the term loan at any time following the six month anniversary of the first loan draw. The Company has not drawn the term loan as of March 3, 2014.