Holloway Lodging Corporation

Consolidated Financial Statements
December 31, 2014 and 2013

March 11, 2015

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 11, 2015

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, 2014 and 2013 and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the years then ended 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence on a test basis 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 principles and 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, 2014 and 2013 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

(signed) *"PricewaterhouseCoopers LLP"*

Chartered Accountants

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Holloway Lodging Corporation

Consolidated Statements of Financial Position

As at December 31, 2014 and 2013

(in thousands of Canadian dollars)

	2014 $	2013 $
Assets		
Current assets		
Cash	3,473	852
Restricted cash	347	278
Capital reserve – internally restricted	–	108
Trade and other receivables (note 5)	5,697	2,394
Inventories	597	225
Prepaid expenses and deposits	2,258	1,820
	12,372	5,677
Non-current assets		
Property and equipment (notes 6, 7 and 8)	330,307	179,937
Franchise business (note 9)	14,700	–
Minority interest investments in hotel properties	190	846
Loan receivable (note 10)	–	4,828
Capital reserve – restricted	2,304	2,517
Other assets (note 11)	616	308
Deferred income tax assets (note 20)	21,800	5,295
Funds held on behalf of franchisees	167	–
	370,084	193,731
Total assets	382,456	199,408
Liabilities		
Current liabilities		
Trade payables and accrued liabilities (note 12)	12,210	5,091
Accrued interest on convertible debentures	1,309	–
Current portion of secured credit facilities (note 13)	9,007	1,004
Current portion of mortgages and loan payable (note 14)	6,248	4,261
	28,774	10,356
Non-current liabilities		
Secured credit facilities (note 13)	18,000	–
Mortgages and loan payable (note 14)	129,510	103,338
Convertible debentures (note 15)	88,061	–
Loan due to a related party	–	307
Funds to be spent on behalf of franchisees	167	–
	235,738	103,645
Total liabilities	264,512	114,001
Equity		
Equity attributable to shareholders of the Company	115,913	85,385
Non-controlling interest	2,031	22
Total equity	117,944	85,407
Total liabilities and equity	382,456	199,408

Contingencies and commitments (note 22)

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, 2014 and 2013

(in thousands of Canadian dollars)

	2014 $	2013 $
Hotel revenues		
Rooms	83,865	54,648
Food and beverage	9,159	3,809
Franchising	1,272	–
Other	3,241	1,500
	97,537	59,957
Hotel expenses		
Operating expenses	58,284	34,224
Property taxes and insurance	4,623	2,901
Management fees (note 10)	1,411	1,322
Depreciation and amortization	12,650	8,993
	76,968	47,440
Income before the following	20,569	12,517
Other (income) and expenses		
Interest and accretion on debt	12,174	7,546
Corporate and administrative	2,657	2,260
Acquisition and integration costs (notes 6 and 7)	816	–
Share-based compensation	418	378
Provision for settlement of management contract and loan receivable (note 10)	5,828	–
Investment income	(308)	(360)
Reversal of impairment of hotel properties, net (notes 7 and 8)	(10,258)	(3,450)
Gain on disposal of property and equipment, minority interest investments in hotel properties and repurchase of convertible debentures	(114)	(114)
Fair value adjustment and amounts reclassified to profit and loss on minority interest investments in hotel properties (note 7)	(689)	–
	10,524	6,260
Income before income taxes	10,045	6,257
Provision for (recovery of) income taxes (note 20)	(17,288)	1,787
Net income for the year	27,333	4,470
Attributable to:		
Shareholders of the Company	27,256	4,489
Non-controlling interest	77	(19)
	27,333	4,470
Basic and diluted earnings per share (note 17)	1.46	0.25

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, 2014 and 2013

(in thousands of Canadian dollars)

	2014 $	2013 $
Net income for the year	27,333	4,470
Other comprehensive income		
Items that may be subsequently reclassified to profit or loss		
Cumulative translation adjustments	178	123
Fair value adjustment of minority interest investments in hotel properties	379	–
Item reclassified in the year to profit or loss		
Previously recognized fair value adjustment of minority interest investments in hotel properties	(689)	–
Other comprehensive income	(132)	123
Comprehensive income for the year	27,201	4,593
Comprehensive income attributable to:		
Shareholders of the Company	27,124	4,612
Non-controlling interest	77	(19)
	27,201	4,593

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, 2014 and 2013

(in thousands of Canadian dollars)

	Common shares (note 16) **$**	**Contributed surplus $**	**Deficit $**	**Accumulated other comprehensive income (loss) $**	**Equity attributable to shareholders of the Company $**	**Non-controlling interest $**	**Total equity $**
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	–	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
Balance, January 1, 2014	223,713	2,327	(140,683)	28	85,385	22	85,407
Net income for the year	–	–	27,256	–	27,256	77	27,333
Other comprehensive income for the year	–	–	–	(132)	(132)	–	(132)
Comprehensive income for the year	–	–	27,256	(132)	27,124	77	27,201
Shares and options issued on acquisition of Royal Host Inc., net of shares acquired and issuance costs (note 6)	5,691	10	–	–	5,701	–	5,701
Non-controlling interest arising on acquisition of subsidiary (note 7)	–	–	–	–	–	2,739	2,739
Acquisition of non-controlling interest in subsidiary (note 7)	–	–	(90)	–	(90)	(11)	(101)
Dividends paid to shareholders	–	–	(2,611)	–	(2,611)	–	(2,611)
Distributions paid to non-controlling interests (note 7)	–	–	–	–	–	(255)	(255)
Share-based compensation	–	418	–	–	418	–	418
Exercise of stock options	51	(211)	–	–	(160)	–	(160)
Proceeds on sale of common shares	426	–	–	–	426	–	426
Repurchase of common shares	(22)	–	–	–	(22)	–	(22)
Repurchase of partnership units (note 7)	–	–	(258)	–	(258)	(541)	(799)
Balance, December 31, 2014	229,859	2,544	(116,386)	(104)	115,913	2,031	117,944

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, 2014 and 2013

(in thousands of Canadian dollars)

	2014 $	2013 $
Cash provided by (used in)		
Operating activities		
Net income for the year	27,333	4,470
Adjustments for non-cash items (note 21)	(9,084)	7,844
	18,249	12,314
Changes in items of working capital (note 21)	1,635	(406)
Net cash generated from operating activities	19,884	11,908
Investing activities		
Decrease in capital reserves and restricted cash	566	1,644
Additions to other assets	(50)	(65)
Acquisition of Royal Host Inc., net of cash acquired (note 6)	(16,033)	–
Proceeds from sale of hotel properties and equipment and minority interest investments in hotel properties, net of costs	10,074	148
Acquisition and additions to property and equipment	(14,373)	(3,948)
Acquisition of subsidiaries and repurchase of partnership units, net of cash acquired	(2,647)	–
Net cash used in investing activities	(22,463)	(2,221)
Financing activities		
Funds drawn on secured credit facilities	16,000	–
Repayment of secured credit facilities	(9,858)	(519)
Proceeds from mortgages and loan payable, net of deferred financing fees	10,943	3,296
Repayment of mortgages payable	(9,340)	(7,807)
Repayment of obligations under finance leases	–	(10)
Proceeds from sale of common shares and exercise of options, net of share issuance costs	429	–
Repurchase of common shares	(22)	(2,572)
Repurchase of convertible debentures	(86)	–
Dividends paid to shareholders	(2,611)	(2,535)
Distributions paid to non-controlling interests	(255)	–
Net cash provided by (used in) financing activities	5,200	(10,147)
Increase (decrease) in cash	2,621	(460)
Cash – Beginning of year	852	1,312
Cash – End of year	3,473	852
Supplemental cash flow information		
Interest paid	11,432	7,331

Cash 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, together with its subsidiaries, ("Holloway" or the "Company") is a hospitality company that owns and operates hotels and owns the Canadian master franchise rights to the Travelodge® and Thriftlodge® hotel brands in Canada. As at December 31, 2014, the Company owned 34 hotels in Canada, one hotel in the United States and a 62% interest in another hotel in Canada, with a total of 4,260 guest rooms and held minority ownership interests in two other hotels. The address of its registered office is 6009 Quinpool Road, 10th Floor, Halifax, Nova Scotia.

The results of operations for the year ended December 31, 2014 represent the operations of 17 hotels for the full year and 20 hotels for part of the year as the Company:

- sold the Holiday Inn Express® in Kamloops, BC on April 1, 2014;
- acquired the Days Inn® in Whitecourt, AB on June 6, 2014;
- acquired a controlling interest in the partnership that owns the Super 8® in St. John's, NL on June 25, 2014 which is now consolidated; and
- acquired 17 hotels as a result of the acquisition of Royal Host Inc. ("Royal Host") on July 1, 2014.

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.

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 11, 2015.

(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 for 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 operating expenses.

Cash

Cash includes cash on hand and balances 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.

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.

   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.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Financial instruments (continued)

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 cash, restricted cash, capital reserve – internally restricted and trade and other receivables. The Company's loans and receivables, included in non-current assets comprise its loan receivable, capital reserve – restricted and funds held on behalf of franchisees. 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 trade payables and accrued liabilities, accrued interest on convertible debentures, secured credit facilities, mortgages and loan payable, convertible debentures, loan due to a related party and funds to be spent on behalf of franchisees. 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. Convertible debentures, secured credit facilities, mortgages and loan payable and the loan due to a related party are 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 asset'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 consolidated 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 two 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 consolidated statement of income.

Property and equipment

Property and equipment is 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 consolidated 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
Landscaping	5 years
Signage	10 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 as gain or loss on disposal of property and equipment 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 the recoverable amount, 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 or reversal of impairment of hotel properties, net 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 consolidated 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 and 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.

Funds held on behalf of franchisees and funds to be spent on behalf of franchisees

Funds to be spent on behalf of Canadian Travelodge® and Thriftlodge® franchisees are for the purposes of advertising, promoting and publicizing the Travelodge® and Thriftlodge® brands and chain facilities in Canada or undertaking market research and training programs related to the brands and chain facilities.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Convertible debentures

Convertible debentures were recorded at their fair value on the acquisition of Royal Host, with debt issuance costs recorded as a reduction of the carrying value. Over the term of the debentures, the liability will increase to the face value using the effective interest method, with accretion expense included in interest and accretion on debt in the consolidated statement of income.

Provisions

Provisions for legal or constructive obligations are recognized in the consolidated 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, 2014.

Income tax

Income tax comprises current and deferred taxes. Income tax is recognized in the consolidated 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 taxes 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 basis 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 income 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 income 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.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Dividends

Dividends to the Company's shareholders are recognized as a liability in the consolidated 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, franchise 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.

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.

Debenture repurchases

If the Company repurchases its own debentures the difference between the book value and the consideration paid is recognized as a gain on repurchase of convertible debentures in the consolidated statement of income.

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 grant is considered a separate award with its own vesting period and grant date fair value. The fair value of each grant is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over the grant's vesting period by increasing contributed surplus based on the number of options 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 standard has been adopted by the Company for the financial year which began on January 1, 2014:

IFRIC 21, Levies

IFRIC 21 *"Levies"* ("IFRIC 21") has been amended to require entities to recognize a liability when payment is triggered under the terms of the relevant legislation. The Company adopted IFRIC 21 on January 1, 2014 on a retrospective basis. The adoption of IFRIC 21 had no impact on these consolidated financial statements.

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, 2015, 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:

IFRS 9, Financial instruments

IFRS 9, *"Financial instruments"* ("IFRS 9") 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"* ("IAS 39") 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, 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 ("OCI").

IFRS 9 was amended in November 2013 to: (i) include guidance on hedge accounting; and (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.

The final version of IFRS 9 was issued in July 2014 and includes: (i) a third measurement category for financial assets – fair value through other comprehensive income; (ii) a single, forward-looking expected loss impairment model; and (iii) a mandatory effective date for IFRS 9 of annual periods beginning on or after January 1, 2018, with early adoption permitted. The Company is currently evaluating the impact of the new standard on its financial statements.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

New standards and interpretations not yet adopted (continued)

IFRS 15, Revenue from Contracts and Customers

The IASB issued IFRS "*Revenue from Contacts and Customers*" ("IFRS 15") effective for annual periods beginning on or after January 1, 2017. IFRS 15 establishes a new control-based revenue recognition model and replaces IAS 18, *"Revenue" and IAS 11, "Construction Contracts",* and some revenue related interpretations. The Company is currently evaluating the impact of the new standard on its financial statements.

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 the Company has made in the preparation of these consolidated financial statements.

Critical accounting estimates and assumptions

a) Property and equipment

On December 31, 2014, the Company increased the carrying value of 3 CGUs by reversing previously recorded impairments by $9,000. 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 has been determined using ten-year cash flow projections and a capitalized terminal value calculation 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 25). Key factors of estimation uncertainty include:

Pre-tax discount rates	12.00% to 12.25%
Capitalization rate	10.25%
Growth rates	Consistent with industry and market/hotel 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 reversal is the amount by which the CGU's fair value exceeds its carrying 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 $62,631 and $68,882 for the 3 CGUs that were increased in value using internal models. The final value for the 3 CGUs increased in value was $65,631.

(in thousands of Canadian dollars)

4 Critical accounting estimates and judgments (continued)

Critical accounting estimates and assumptions (continued)

b) Minority interest investments in hotel properties

At December 31, 2014, 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. The carrying amount of the Company's minority interest investments in hotel properties would be between $59 and $350 if the capitalization rate used in the valuation differed by plus or minus 1% from management's estimates.

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 and franchise business

The Company records depreciation on its property and equipment and franchise business 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 income 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 income tax assets and liabilities of a change in tax rates is recognized in the consolidated 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 carrying amount of deferred income tax assets is reviewed at the end of each reporting period and increased or decreased based on the estimated taxable earnings that will be available to allow all or part of the asset to be recovered.

Deferred income tax assets and liabilities recorded require management's judgment in determining the amounts to be recognized. In particular, judgment is used when assessing the extent to which deferred income tax assets should be recognized with respect to estimated future taxable income, which impacts the amount of deferred income tax assets recorded related to differences on the tax basis of assets and available non-capital losses. 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 assets recorded in the consolidated statement of financial position. Significant estimates and judgments are used in determining the future consolidated taxable income, which includes consideration of the history of profitability, forecasting expected revenues and expenses as a result of the Royal Host acquisition and the impact of internalizing its hotel management previously performed by Pacrim Hospitality Services Inc. ("PHSI"). Actual results will differ from the amounts estimated for future taxable income. Management considers both favourable and unfavourable evidence in determining whether or not it is probable that the future economic benefits will flow to the entity and the amount of deferred income tax assets that should be recognized. In making its assessment, management considers past operating results, forecasted future results and economic conditions of the locations in which it operates. If total future forecasted taxable income used to determine the amount of the deferred income tax assets recorded decreased by $10,000, the deferred income tax assets recorded would decrease by $2,600, with a corresponding decrease to net income. There would be no impact on deferred tax assets recorded and net income if forecasted future taxable income increased.

(in thousands of Canadian dollars)

4 Critical accounting estimates and judgments (continued)

Critical accounting estimates and assumptions (continued)

f) Business combinations

The purchase price allocation process requires management to use significant estimates and assumptions, and fair value estimates including, but not limited to:

- estimated fair values of tangible assets;
- estimated fair values of intangible assets;
- estimated fair values of liabilities;
- estimated deferred income tax assets and liabilities; and
- estimated fair value of pre-acquisition contingencies.

While management uses its best estimates and assumptions as a part of the purchase price allocation process to accurately value the assets acquired and liabilities assumed at the business combination date, estimates and assumptions are inherently uncertain and subject to refinement. As a result, during the purchase price allocation period, which is generally one year from the business combination date, any adjustments are recorded to the assets acquired and liabilities assumed.

Although management believes the assumptions and estimates made in the past have been reasonable and appropriate, they are based in part on historical experience and information obtained from the management of the acquired companies and are inherently uncertain. Examples of critical estimates in valuing certain of the assets acquired and liabilities assumed include but are not limited to:

- future expected cash flows from the hotel properties;
- future expected cash flows from the franchise business;
- discount rates applied to future expected cash flows;
- capitalization rates applied to future expected cash flows;
- the fair value of convertible debentures, including future obligations to debentureholders; and
- uncertain tax positions and the fair value of both current and deferred income tax related assets and liabilities assumed in connection with a business combination which are initially estimated as of the acquisition date and are re-evaluated quarterly as management continues to collect information in order to determine their estimated value, with any adjustments to preliminary estimates recorded during the measurement period.

Changes in any of the assumptions or estimates used in determining the fair value of assets acquired and liabilities assumed could impact the initial amounts assigned to assets and liabilities in the purchase price allocation. Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

(in thousands of Canadian dollars)

4 Critical accounting estimates and judgments (continued)

Critical accounting estimates and assumptions (continued)

g) 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 the Company has made in the preparation of the consolidated financial statements and the application of accounting policies:

i) Fair value of minority interest investments in hotel properties

The Company must determine when available-for-sale investments are impaired which 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 flows, 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 $141 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 consolidated statement of income.

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 methodology. These indicators determine whether the Company tests for impairment or reversal of previously recorded impairments at each balance sheet date.

iii) Trade and other receivables and accrued liabilities

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

(in thousands of Canadian dollars)

5 Trade and other receivables

	December 31, 2014 $	December 31, 2013 $
Trade receivables	5,316	2,119
Less: allowance for doubtful accounts	(243)	(40)
Trade receivables – net	5,073	2,079
Receivables from credit card companies	297	295
Other receivables	327	20
	5,697	2,394

6 Acquisition of Royal Host Inc.

On July 1, 2014 (the "acquisition date"), the Company acquired all of the outstanding common shares of Royal Host, a Halifax-based hospitality company that owned 17 hotels across Canada as well as the Canadian master franchise rights to the Travelodge® and Thriftlodge® hotel brands in Canada.

As consideration, the Company paid $1.00 in cash and issued 0.1 of a Holloway common share for each Royal Host common share. Total consideration was $16,380 in cash and 1,637,963 common shares valued at $4.26 per share (shares not in thousands). At the acquisition date, Royal Host owned 294,679 shares of Holloway (shares not in thousands). The amounts presented below are net of these shares. The Company funded $16,000 of the cash portion of the purchase price from a secured credit facility and the remaining balance with cash on hand. In addition to the consideration paid, the Company assumed all of the outstanding debt of Royal Host.

The acquisition of Royal Host is expected to provide the Company with significantly broader geographic and market diversification, operational and expense synergies as well as redevelopment opportunities for certain properties.

(in thousands of Canadian dollars)

6 Acquisition of Royal Host Inc. (continued)

The purchase price has been allocated, on a preliminary basis, to the assets acquired and liabilities assumed based on their estimated fair values as follows:

	$
Assets acquired	
Cash	347
Trade and other receivables	3,740
Inventories	317
Prepaid expenses and deposits	1,622
Land	38,463
Buildings and components	91,286
Renovations in progress	1,213
Furniture, fixtures and equipment	7,133
Paving	44
Computer equipment and websites	392
Leasehold improvements	31
Franchise business	15,000
Other assets	158
Funds held on behalf of franchisees	12
	159,758
Less liabilities assumed	
Trade payables and accrued liabilities	5,810
Accrued interest on convertible debentures	1,008
Convertible debentures	88,146
Secured credit facilities	19,861
Mortgages payable	22,038
Deferred income tax liabilities	783
	137,646
	22,112
Consideration	
Cash	16,380
Common shares issued, net of shares acquired	5,722
Replacement options issued	10
	22,112

The valuation techniques used to measure the fair value of the franchise business and hotel properties acquired were based on either the assets' value in use or fair value less costs to sell and were determined using an internal model with capitalized historical and future earnings using market appropriate capitalization rates and performance metrics.

The Company will finalize the purchase price allocation upon completion of review of certain working capital balances and determination of the fair value of the tangible and intangible assets acquired. Any future adjustments resulting from this review will be recorded as an adjustment to the purchase price allocation.

The acquisition was accounted for using the purchase method. As such, the results of operations reflect revenue and expenses of Royal Host from the date of acquisition. Included in these financial statements at December 31, 2014, is revenue of $33,172 and net income of ($840).

(in thousands of Canadian dollars)

6 Acquisition of Royal Host Inc. (continued)

Had Royal Host been consolidated from January 1, 2014, the financial statements would show additional revenue of approximately $33,632 and a change to net income of approximately ($2,177) for the year ended December 31, 2014. Costs of acquisition and integration of $704 related to this acquisition were recognized in the consolidated statement of income.

7 Acquisitions and disposals of property and equipment

Holiday Inn Express®, Kamloops, BC

On April 1, 2014, the Company sold the Holiday Inn Express® in Kamloops, BC for gross proceeds of $8,900. After repayment of the outstanding secured credit facility and closing costs, the net cash proceeds were $7,872. The Company recognized a reversal of impairment of hotel properties of $1,217 in the consolidated statement of income.

Holiday Inn Express®, Stellarton, NS

On April 17, 2014, the Company acquired the remaining 10% interest in the entity that owns the Holiday Inn Express® in Stellarton, NS from Superior Lodging Corp. ("Superior"), a company owned by a director of Holloway, for a purchase price of $413. The interest acquired consisted of common shares in the capital of the entity and a shareholder loan owed by the entity to Superior. The fair value of the shareholder loan and non-controlling interest acquired were lower than the purchase price and as a result, the Company recognized a charge of $90 directly in equity.

The following table summarizes the consideration paid for the 10% interest at the acquisition date:

	$
Consideration	413
Loan and non-controlling interest	
Shareholder loan	312
Non-controlling interest	11
Total loan and non-controlling interest	323
Difference between consideration paid and shareholder loan and non-controlling interest recorded directly in equity	90
Total	413

Costs of acquisition of $3 related to this acquisition were recognized in the consolidated statement of income.

(in thousands of Canadian dollars)

7 Acquisitions and disposals of property and equipment (continued)

Days Inn®, Whitecourt, AB

On June 6, 2014, the Company acquired the Days Inn® in Whitecourt, AB for a gross purchase price of $8,890. Holloway paid cash on closing of $3,000 and financed the remainder with a mortgage of $5,000 and a promissory note to the vendor of $890. The promissory note has a two year term and bears interest at 6.00% with one half of the note due in June 2015. The mortgage bears interest at a floating rate based on the lender's base rate minus 0.75% and has a fifteen year term.

The following table summarizes the fair value of the assets acquired and consideration paid at the acquisition date:

	$
Assets acquired	
Land	1,000
Buildings and components	6,990
Furniture, fixtures and equipment	798
Paving	50
Signage	22
Computer equipment	10
Franchise fees	20
	8,890
Consideration	
Cash	3,000
Mortgage payable	5,000
Loan payable	890
	8,890

The fair values and allocation of assets was based on the purchase and sale agreement for the property.

Included in the consolidated financial statements at December 31, 2014, is revenue of $1,450 and net income of $399. Had the property been consolidated from January 1, 2014, the financial statements would show additional revenue of approximately $1,085 and additional net income of approximately $54 for the year ended December 31, 2014. Costs of acquisition of $60 related to this acquisition were recognized in the consolidated statement of income.

(in thousands of Canadian dollars)

7 Acquisitions and disposals of property and equipment (continued)

Super 8®, St. John's, NL

On June 25, 2014, the Company acquired an additional 35% interest in the partnership that owns the Super 8® in St. John's, NL for a purchase price of $2,088. Prior to this transaction, Holloway owned an 18% minority interest in the partnership.

As the initial 18% minority interest was an available-for-sale financial instrument, it was remeasured to its fair value prior to the acquisition of control which resulted in a gain of $299. A gain of $390, previously recorded in other comprehensive income, was also recognized in the consolidated statement of income. Costs of acquisition of $49 related to this acquisition were recognized in the consolidated statement of income.

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

	$
Consideration (cash)	2,088
Fair value of initial 18% minority interest investment	1,019
	3,107
Identifiable assets and liabilities	
Cash	652
Capital reserve	315
Land	1,396
Building and components	7,189
Furniture, fixtures and equipment	457
Paving	4
Signage	13
Computer equipment	23
Franchise fees	9
Other net working capital balances	(169)
Mortgage payable	(4,043)
Total identifiable assets and liabilities	5,846
Non-controlling interest	(2,739)
Total	3,107

(in thousands of Canadian dollars)

7 Acquisitions and disposals of property and equipment (continued)

Super 8®, St. John's, NL (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 June 25, 2014:

- Cash, other net working capital balances and the mortgage payable – the carrying values approximate their fair values due to the short maturity of these instruments;
- Long-term assets – the fair value was based on the hotel's value in use and was determined using an internal model which discounted the hotel's future cash flows and a terminal value to determine the net present value; and
- Non-controlling interest – the fair value was estimated using the purchase price paid for the acquisition of 35% of the partnership and extended to the remaining 47% non-controlling interest.

Included in the consolidated financial statements at December 31, 2014, is revenue of $1,547 and net income of $193. Had the property been consolidated from January 1, 2014, the financial statements would show additional revenue of approximately $1,194 and additional net income of approximately $57 for the year ended December 31, 2014.

Subsequent to acquiring control of the Super 8® in St. John's NL, the partnership repurchased partnership units totalling $799, which has been recorded as a reduction of the non-controlling interest and retained earnings. As a result of the partnership repurchases, Holloway owns 62% of the partnership as at December 31, 2014.

In December 2014, the partnership paid a $1,000 distribution, of which $255 was paid to non-controlling interests.

(in thousands of Canadian dollars)

8 Property and equipment

	For the year ended December 31, 2014							
	Opening net book value $	**Royal Host acquisition** (note 6) $	**Additions and acquisitions** $	**Disposals** $	**Depreciation** $	**Reversal of impairment** $	**Foreign exchange** $	**Closing net book value** $
Land	16,779	38,463	2,236	(1,849)	–	1,230	81	56,940
Land lease	300	–	–	–	(8)	–	–	292
Buildings and components	153,697	91,286	15,216	(7,139)	(7,814)	8,902	452	254,600
Renovations in progress	15	1,213	1,666	–	–	–	–	2,894
Furniture, fixtures and equipment	7,186	7,133	3,355	(681)	(3,765)	90	58	13,376
Paving	914	44	110	(251)	(198)	36	(4)	651
Landscaping	17	–	21	–	(6)	–	–	32
Signage	545	–	55	(31)	(119)	–	(1)	449
Computer equipment and websites	427	392	691	(51)	(415)	–	–	1,044
Leasehold improvements	–	31	–	(29)	(2)	–	–	–
Vehicles	57	–	2	–	(30)	–	–	29
	179,937	138,562	23,352	(10,031)	(12,357)	10,258	586	330,307

(in thousands of Canadian dollars)

8 Property and equipment (continued)

	As at December 31, 2014			
	Cost $	Accumulated impairment losses $	Accumulated depreciation $	Net book value $
Land	64,231	(7,291)	–	56,940
Land lease	500	(116)	(92)	292
Buildings and components	345,136	(53,980)	(36,556)	254,600
Renovations in progress	2,894	–	–	2,894
Furniture, fixtures and equipment	37,335	(4,242)	(19,717)	13,376
Paving	2,445	(481)	(1,313)	651
Landscaping	46	–	(14)	32
Signage	1,035	–	(586)	449
Computer equipment and websites	1,873	–	(829)	1,044
Vehicles	205	–	(176)	29
	455,700	(66,110)	(59,283)	330,307

(in thousands of Canadian dollars)

8 Property and equipment (continued)

	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 and components	154,888	996	–	(4,888)	2,435	266	153,697
Renovations in progress	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)

8 Property and equipment (continued)

	As at December 31, 2013			
	Cost $	Accumulated impairment losses $	Accumulated depreciation $	Net book value $
Land	26,034	(9,255)	–	16,779
Land lease	500	(116)	(84)	300
Buildings and components	247,271	(63,516)	(30,058)	153,697
Renovations in progress	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, 2014, the Company recognized a reversal of previously recorded impairment losses of $9,000 in respect of various CGUs. As at December 31, 2013, the Company recognized a reversal of previously recorded impairment losses of $4,450 and an impairment loss of $1,000 in respect of various CGUs. Refer to note 4 for discussion regarding the use of estimates in determination of the values of the CGUs.

Included in the net book value of furniture, fixtures and equipment and computer equipment are assets under finance leases as at December 31, 2014 of $2 (December 31, 2013 – $92). The debt related to these assets has been paid in full.

(in thousands of Canadian dollars)

9 Franchise business

The following table summarizes significant changes in the franchise business for the year ended December 31, 2014:

	$
Beginning balance	–
Royal Host acquisition (note 6)	15,000
Amortization	(300)
Ending balance	14,700

The franchise business is amortized on a straight-line basis over 25 years.

10 Settlement of hotel management agreements and loan receivable

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 was 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 acquired the hotel for a term of ten years and automatic renewals for successive five year terms.

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 these ten 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 provided that PHSI receive reimbursable expenses plus a base management fee for the Pomeroy Hotels of 1.8%, until the Company generated adjusted funds from operations that exceeded certain targets.

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

Upon certain change of control events, as set out in the First Management Agreement, PHSI was 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 would 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 would be withheld by Holloway Lodging Limited Partnership and used to repay the loan in full.

(in thousands of Canadian dollars)

10 Settlement of hotel management agreements and loan receivable (continued)

On July 7, 2010, pursuant to the acquisition of the Super 8® in Windsor, NS, PHSI agreed to defer its management and accounting fees until June 30 of each year until June 30, 2013. PHSI was entitled to receive a payment calculated as 3/5 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 of each year. Any unpaid balance of the fees was applied against the principal balance of the loan receivable from PHSI.

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

The Second Management Agreement could be terminated as it applied 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.

The loan receivable from PHSI, was unsecured, was due on February 1, 2018, was repayable at any time without penalty and bore 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%.

In December 2014, Holloway entered into an agreement with PHSI to internalize all of its hotel management. Under the terms of the agreement, Holloway agreed to settle the loan receivable for nil consideration as well as make a cash payment of $1,000 to PHSI in January 2015. The Company provided a full allowance of $4,828 against the loan and recorded an expense of $1,000 in 2014. This amount has been recorded as provision for settlement of management contract and loan receivable in the consolidated statement of income.

Effective January 30, 2015, Holloway internalized all of its hotel management and all management contracts have been terminated.

(in thousands of Canadian dollars)

11 Other assets

The following table summarizes significant changes in franchise fees and other intangible assets for the years ended December 31, 2014 and 2013:

	Franchise fees $	Other $	Total $
For the year ended December 31, 2014			
Opening net book value	269	39	308
Royal Host acquisition (note 6)	158	–	158
Additions	54	181	235
Disposals	(23)	–	(23)
Foreign exchange	4	–	4
Amortization for the year	(53)	(13)	(66)
Closing net book value	409	207	616
As at December 31, 2014			
Cost	860	231	1,092
Accumulated amortization	(451)	(24)	(476)
Net book value	409	207	616
For the year ended December 31, 2013			
Opening net book value	333	–	333
Additions	15	50	65
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

12 Trade payables and accrued liabilities

	December 31, 2014 $	December 31, 2013 $
Trade payables	3,147	2,381
Accrued expenses and liabilities	7,313	2,710
Accrued termination payment (note 10)	1,000	–
Deposits	750	–
	12,210	5,091

13 Secured credit facilities

	December 31, 2014 $	December 31, 2013 $
Clarke Inc. credit facilities	19,000	–
HSBC credit facility	6,007	–
Clarke Inc. Master Trust credit facility	2,000	–
Line of credit	–	1,004
	27,007	1,004
Less: Current portion	(9,007)	(1,004)
	18,000	–

(in thousands of Canadian dollars)

13 Secured credit facilities (continued)

Clarke Inc. credit facilities

The Company drew $16,000 on its secured credit facility with Clarke Inc. ("Clarke") for the acquisition of Royal Host. The facility bears interest at 6.50% and does not require any principal repayments until maturity on March 31, 2016, which can be extended by the Company until March 31, 2017. The facility is secured by one hotel property with a net book value of $2,300 at December 31, 2014, a corporate general security agreement and an assignment of the equity interests of certain subsidiaries.

The Company has a loan with Clarke with a balance of $3,000. The facility bears interest at 7.00% and does not require any principal repayments until maturity on December 31, 2015. The maximum capacity under this facility is $6,000 and the Company has the ability to draw up to an additional $3,000 on this facility in one additional draw. The facility is secured by one hotel property with a net book value of $11,034 at December 31, 2014. Subsequent to year end, the facility was repaid in full (note 28).

HSBC credit facility

The Company's HSBC credit facility has availability that is dictated by certain credit measures and bears interest at the Canadian bank prime rate plus 1.50%. The interest rate at December 31, 2014 was 4.50% and is due on December 31, 2015. At December 31, 2014, the maximum capacity of the credit facility was $25,000. The available balance at December 31, 2014 was $18,271 as there are letters of credit outstanding totalling $722. The facility is secured by a registered charge on seven hotel properties with a net book value of $57,592 at December 31, 2014.

Clarke Inc. Master Trust credit facility

The Company has a loan with Clarke Inc. Master Trust (the "Clarke Pension Plan") with a balance and maximum capacity of $2,000. The loan was to mature in January 2015 and had an interest rate of 7.00%. In September 2014, the terms of the loan were amended to extend the maturity to June 2016 and decrease the interest rate to 6.50% commencing October 1, 2014. The facility is secured by two hotel properties with a net book value of $6,421 at December 31, 2014. Subsequent to year end, the facility was repaid in full (note 28).

Line of credit

The Company previously had an available line of credit for $5,000. The line of credit bore interest at prime plus 2.00%, was payable on demand and was secured by a demand collateral mortgage and charge on the Holiday Inn Express® in Kamloops, BC. As at December 31, 2013, the Company had drawn $1,004. The line of credit was repaid in full and cancelled upon the sale of this property.

(in thousands of Canadian dollars)

14 Mortgages and loan payable

	December 31, 2014 $	December 31, 2013 $
Mortgages payable, bearing interest at a weighted average rate of 6.21% (December 31, 2013 – 6.52%) and maturing on various dates from April 2016 to July 2029. Individual first charges on 21 hotel properties have been pledged as security for individual mortgages.	135,321	108,043
Promissory note payable, bearing interest at 6.00% and maturing in June 2016.	890	–
Less: Deferred financing fees	(453)	(444)
	135,758	107,599
Less: Current portion	(6,248)	(4,261)
	129,510	103,338

The Canadian equivalent amount of mortgages payable denominated in US dollars is $4,403 (December 31, 2013 – $4,162).

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

	$
Year ending December 31, 2015	6,248
2016	14,942
2017	94,073
2018	10,728
2019	5,080
Thereafter	5,140

The following table summarizes significant changes in mortgages and loan payable for the years ended December 31, 2014 and 2013:

	For the years ended	
	December 31, 2014 $	December 31, 2013 $
Beginning balance	107,599	111,683
Mortgages assumed on Royal Host acquisition (note 6)	22,038	–
Proceeds from new mortgages and loan payable	11,090	3,400
Mortgage assumed on acquisition of control of Super 8® St. John’s	4,043	–
Additions to deferred financing fees	(161)	(104)
Amortization of deferred financing fees	152	190
Repayment of debt	(9,340)	(7,807)
Impact of foreign exchange	337	237
Ending balance	135,758	107,599

(in thousands of Canadian dollars)

15 Convertible debentures

In October 2005, Royal Host issued $60,000 in convertible debentures ("Series B debentures"), of which $23,600 was outstanding on the acquisition date. The debentures bear interest at 6.25% payable semi-annually on April 30 and October 31 and were previously due on October 31, 2020.

In September 2006, Royal Host issued $60,000 in convertible debentures ("Series C debentures"), of which $40,661 was outstanding on the acquisition date. The debentures bear interest at 7.50% payable semi-annually on March 31 and September 30 and are due on September 30, 2018.

In June 2007, Royal Host issued $60,000 in convertible debentures ("Series D debentures"), of which $29,052 was outstanding on the acquisition date. The debentures bore interest at 6.25% payable semi-annually on June 30 and December 31 and were previously due on June 30, 2019.

The estimated fair value of the Series B, Series C and Series D debentures with a face value of $93,313 was $88,146 at the acquisition date based on the closing market price of the debentures which are publicly traded.

On July 31, 2014, Holloway assumed the debentures of Royal Host which began trading under the symbols HLC.DB, HLC.DB.A and HLC.DB.B on August 8, 2014. On October 31, 2014, the Series B debentures (HLC.DB) due October 31, 2020 and the Series D debentures (HLC.DB.B) due June 30, 2019 were consolidated and the maturity date of the new Series B debentures (HLC.DB) was amended to February 28, 2020.

Both series of debentures can be converted at the option of the holder for $285 in cash and 28 shares of the Company for each $1,000 principal amount of debentures outstanding (amounts not in thousands).

The Company has the option to repay the principal amount of the debentures, in whole or in part, at maturity or redeem the debentures, in whole or in part, at or prior to maturity, in cash or by issuing the number of equivalent shares of the Company. The number of shares to be issued is calculated by dividing the aggregate principal amount by 95% of the current market price of the shares (calculated in accordance with the indenture).

The debentures contain a redemption option (the "Redemption Option") whereby the Company can redeem all or part of the debentures at face value. The Redemption Option is required to be accounted for as an embedded derivative financial instrument. On initial recognition, the Redemption Option is recorded at its calculated fair value and grouped with the debentures. The Redemption Option is adjusted to its fair value at each reporting date and any change in fair value is included in interest and accretion on debt in the consolidated statement of income. On initial recognition, the carrying value of the liability portion of the debentures was increased by the amount of the debt premium arising from the Redemption Option, which is amortized over the term of the debentures.

The debentures are recorded as financial liabilities at amortized cost and were recorded at fair value and are amortized using the effective interest method.

	December 31, 2014 $	December 31, 2013 $
Face value of convertible debentures	93,222	–
Discount and embedded derivative	(5,043)	–
Deferred financing fees	(118)	–
Total	88,061	–

(in thousands of Canadian dollars, except share and option amounts)

15 Convertible debentures (continued)

The following table summarizes significant changes in convertible debentures for the year ended December 31, 2014:

	$
Beginning balance	–
Assumption of debentures of Royal Host, net of embedded derivative	88,146
Change in fair value of embedded derivative	(265)
Deferred financing fees	(130)
Accretion of discount and amortization of deferred financing fees	396
Debentures repurchased under NCIB, net of gain	(86)
Ending balance	88,061

On January 13, 2014, Royal Host initiated a Normal Course Issuer Bid ("NCIB") to repurchase, over the 12 months commencing on January 13, 2014 and ending on January 12, 2015, up to $1,993 of its issued and outstanding Series B debentures, $3,448 of its issued and outstanding Series C debentures and $2,206 of its issued and outstanding Series D debentures, such amounts representing 10% of the Company's public float as of January 3, 2014.

Subsequent to the acquisition of Royal Host, and the assumption of the debentures by Holloway, the Company continued to operate under this NCIB. The Company repurchased and cancelled $91 face value of the convertible debentures at a cost of $86 (average cost of $94.46 per $100 face value – prices not in thousands). The Company recorded a gain on repurchase of debentures of $5 which represents the difference between the book value at the time of repurchase and the amount paid.

16 Shareholders' equity

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.

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, 2014 and 2013:

	Number of shares issued and outstanding (not in thousands)	Ascribed value $
Balance, January 1, 2013	18,651,102	226,285
Repurchase of common shares under NCIB	(721,100)	(2,572)
Balance, December 31, 2013	17,930,002	223,713
Issued on acquisition of Royal Host, net of shares acquired and issuance costs (note 6)	1,343,284	5,691
Exercise of stock options	11,275	51
Sale of common shares	94,600	426
Repurchase of common shares under NCIB	(5,400)	(22)
Balance, December 31, 2014	19,373,761	229,859

(in thousands of Canadian dollars, except share and option amounts)

16 Shareholders' equity (continued)

On August 13, 2013, the Company initiated a 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. The Company repurchased and cancelled 13,400 shares at a cost of $55 (average price of $4.07 per share – price not in thousands).

At the acquisition date, Royal Host owned 294,679 shares of Holloway. In July 2014, 94,600 of these shares were sold for proceeds of $426. The remaining 200,079 were cancelled under the NCIB.

On August 13, 2014, the Company initiated a NCIB to repurchase over the 12 month period commencing on August 15, 2014 and ending on August 14, 2015, up to 978,628 of its issued and outstanding shares, such amount representing 5% of the Company's issued and outstanding shares as of August 13, 2014. At December 31, 2014, the Company had not repurchased any shares under this NCIB.

The following table provides the total common shares outstanding as well as the impact of outstanding options and warrants, if exercised, and the conversion of convertible debentures into common shares:

	December 31, 2014	December 31, 2013
Common shares outstanding	19,373,761	17,930,002
Conversion of convertible debentures	2,663,353	–
Options outstanding (exercisable)	434,332	277,000
Warrants outstanding (exercisable)	–	52,500
Total common shares reflecting exercise and conversion	22,471,446	18,259,502

Options

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

	2014		2013	
	Average exercise price in $ per share	Options	Average exercise price in $ per share	Options
At January 1	3.86	409,500	4.91	514,809
Replacement options granted (note 6)	4.43	6,644	–	–
Granted	6.37	325,000	–	–
Exercised	3.70	(87,930)	–	–
Forfeited	4.43	(215)	3.86	(101,500)
Expired	–	–	147.60	(3,809)
At December 31	5.14	652,999	3.86	409,500

Of the 652,999 outstanding options (2013 – 409,500), 434,332 options are exercisable (2013 – 277,000).

(in thousands of Canadian dollars, except share and option amounts)

16 Shareholders' equity (continued)

Options (continued)

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

Expiry date	Exercise price in $ per share	December 31, 2014	December 31, 2013
October 2016	9.20	12,000	12,000
August 2017	3.70	310,000	397,500
April 2017	4.43	5,999	–
November 2019	6.37	310,000	–
December 2019	6.37	15,000	–
		652,999	409,500

On November 18, 2014 and December 16, 2014, the Company granted a total of 325,000 options to purchase Holloway common shares to directors and certain employees with an exercise price of $6.37 per share. The options vest equally over three years and expire after five years. The fair value of the options were measured at their respective grant dates using the Black-Scholes option pricing model with the following assumptions:

	Option grant December 2014	Option grant November 2014
Exercise price	$6.37	$6.37
Closing price on grant date	$6.05	$6.38
Volatility	33.9%	34.2%
Annual dividend yield	2.3%	2.2%
Expected option life	5 years	5 years
Annual risk-free interest rate	1.5%	1.6%
Per share fair value of option grant	$1.42	$1.65

Compensation expense is recognized over the vesting period by increasing contributed surplus based on the number of options expected to vest. The total share-based compensation expense recognized in the consolidated statement of income for options was $418 (2013 – $378).

17 Earnings per share

Basic

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, 2014 $	December 31, 2013 $
Net income attributable to shareholders of the Company	27,256	4,489
Weighted average number of shares outstanding	18,651,279	18,137,856
Basic earnings per share	1.46	0.25

(in thousands of Canadian dollars, except share and option amounts)

17 Earnings per share (continued)

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of shares and warrants outstanding to assume conversion of all potentially dilutive instruments convertible into shares. 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 convertible debentures and options. During the year ended December 31, 2014, the Company had two categories of potentially dilutive instruments – convertible debentures and options. During the year ended December 31, 2013, the Company had two categories of potentially dilutive instruments – warrants and options. For the year ended December 31, 2013, the options and warrants were anti-dilutive. Accordingly, diluted earnings per share in 2013 is equal to basic earnings per share. Diluted earnings per share for 2014 is presented below:

	For the years ended	
	December 31, 2014 $	December 31, 2013 $
Diluted income attributable to shareholders of the Company	27,256	4,489
Weighted average number of diluted shares	18,722,223	18,137,856
Diluted earnings per share	1.46	0.25

18 Expenses by nature

	For the years ended	
	December 31, 2014 $	December 31, 2013 $
Salaries, wages and employee benefits	30,530	17,336
Materials, supplies, repairs and utilities	15,483	8,464
Food, beverage and service costs	5,313	3,269
Insurance	729	346
Property taxes	3,894	2,543
Management fees – third party and internal	2,176	1,322
Royalty and franchise fees	5,118	3,905
Legal and other fees	1,206	1,194
Depreciation and amortization	12,732	9,036
Interest and accretion on debt	12,174	7,546
Reversal of impairments, fair value adjustments and gain or loss on acquisitions or disposals	(11,061)	(3,564)
Provision for settlement of management contract and loan receivable	5,828	–
Other	3,678	2,663
	87,800	54,060

(in thousands of Canadian dollars)

19 Wages and employee benefits expense

	For the years ended December 31, 2014 $	December 31, 2013 $
Salaries and wages	26,695	15,057
Benefits	3,116	1,533
RRSP/pension expense	24	22
Directors fees	262	284
Share-based compensation (non-cash)	418	378
Termination benefits	15	62
	30,530	17,336

Compensation of key management:

Key management include the Company's directors, Chairman and Officers. Compensation awarded to key management included:

	For the years ended December 31, 2014 $	December 31, 2013 $
Salaries and benefits	816	500
Consulting fees – Chairman	158	100
Share-based compensation	398	347
Directors fees	262	284
	1,634	1,231

20 Income taxes

	2014 $	2013 $
Components of the provision for (recovery of) income taxes are as follows:		
Deferred income taxes	2,146	1,787
Benefit of recording previously unrecognized deferred tax assets	(19,434)	–
Provision for (recovery of) income taxes	(17,288)	1,787

(in thousands of Canadian dollars)

20 Income taxes (continued)

The following table is a reconciliation of the expected income tax provision (recovery) at the statutory rate to the amounts recognized in the consolidated statement of income for the years ended December 31, 2014 and 2013:

	For the years ended	
	December 31, 2014 $	December 31, 2013 $
Income before income taxes	10,045	6,257
Combined statutory income tax rate	25.90%	25.75%
Income tax expense at the combined statutory income tax rate	2,602	1,611
Non-deductible expenses	297	97
Non-taxable component of realized and unrealized gains	(696)	(133)
Other	(57)	56
Benefit of recording previously unrecognized deferred income tax assets	(19,434)	156
Provision for (recovery of) income taxes	(17,288)	1,787

The statutory tax rate was 25.90% for the year ended December 31, 2014 (2013 – 25.75%). The income tax provision will not require an outlay of cash due to available non-capital loss carry forwards.

Deferred income taxes

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

	December 31, 2013 $	Recognized in net income $	Recognized on acquisition of Royal Host $	December 31, 2014 $
Deferred income tax assets				
Property and equipment	5,120	9,205	(1,447)	12,878
Non-capital losses	219	4,489	5,733	10,441
Net capital losses	–	1,505	–	1,505
Loan receivable	–	2,032	–	2,032
Marketable securities	–	(9)	9	–
Deferred income tax liabilities				
Deferred financing fees	(44)	(220)	217	(47)
Convertible debentures	–	223	(1,380)	(1,157)
Franchise business and other assets	–	63	(3,915)	(3,852)
Net deferred income tax assets	5,295	17,288	(783)	21,800

The Company has recognized deferred income tax assets of $26,856 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 income taxes (continued)

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

	December 31, 2014 $	December 31, 2013 $
Deferred income tax assets		
Deferred income tax assets to be recovered within 12 months	1,870	1,015
Deferred income tax assets to be recovered after more than 12 months	24,986	4,324
Deferred income tax liabilities		
Deferred income tax liabilities to be settled within 12 months	(309)	(9)
Deferred income tax liabilities to be settled after more than 12 months	(4,747)	(35)
	21,800	5,295

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

	December 31, 2014 $	December 31, 2013 $
Non-capital losses	3,885	32,593
Realized capital losses	–	5,393
Loans receivable	–	618
Property and equipment	877	37,727
Other assets	–	189
Other	–	232
	4,762	76,752

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

Year of expiry	Loss $
2027	133
2028	46
2029	13,154
2030	8,554
2031	10,846
2032	5,489
2033	1,178
Total	39,400

(in thousands of Canadian dollars)

20 Income taxes (continued)

Deferred income taxes (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	238
2034	192
Total	3,348

As at December 31, 2014, the Company had capital loss carryforwards totalling $11,384 that are available to reduce capital gains in future years. These losses do not expire.

21 Supplemental cash flow information

Adjustments for non-cash items:

	For the years ended December 31, 2014 $	December 31, 2013 $
Accretion on debt and change in fair value of embedded derivative	287	207
Share-based compensation	418	378
Depreciation and amortization	12,732	9,036
Provision for settlement of management contract and loan receivable	5,828	–
Reversal of impairment of hotel properties, net	(10,258)	(3,450)
Gain on disposal of property and equipment, minority interest investments in hotel properties and repurchase of convertible debentures	(114)	(114)
Fair value adjustment and amounts reclassified to profit and loss on minority interest investments in hotel properties	(689)	–
Provision for (recovery of) income taxes	(17,288)	1,787
	(9,084)	7,844

Changes in items of working capital:

	For the years ended December 31, 2014 $	December 31, 2013 $
Trade and other receivables	(464)	221
Inventories	(50)	(22)
Prepaid expenses and deposits	1,188	23
Funds held on behalf of franchisees	(155)	–
Trade payables and accrued liabilities	660	(628)
Accrued interest on convertible debentures	301	–
Funds to be spent on behalf of franchisees	155	–
	1,635	(406)

(in thousands of Canadian dollars)

22 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.

Commitments

Franchise agreements

Under the terms of the hotel franchise agreements expiring at various dates through the year 2027, franchise fees (including royalty fees, reservation and marketing assessments) are due to franchise companies on 33 of the 36 hotels owned by the Company (2013 – 17 of 18 hotels). The franchise fees paid to franchisors for all but one hotel are calculated based on a percentage of revenue, with one hotel being based on an annual membership fee.

At December 31, 2014, 10 hotels make payments for a portion of their franchise fees to the Travelodge® franchise business subsidiary of the Company (December 31, 2013 – nil). These fees have been eliminated in these consolidated financial statements.

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, 2015	699
2016	309
2017	265
2018	97
2019	39

Lease revenue

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

	Lease revenue $
Year ending December 31, 2015	702
2016	540
2017	533
2018	459
2019	424

(in thousands of Canadian dollars)

23 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, 2014 $	December 31, 2013 $
Geosam Capital Inc., a former shareholder with significant ownership interest		
Consulting fees and rent	25	100
Included in accounts payable and accrued liabilities	–	8
Clarke Inc., a shareholder with significant ownership interest		
IT support fees	83	–
Interest expense	642	–
Included in accounts payable and accrued liabilities	276	–
Clarke Pension Plan, a pension plan administered by a shareholder with significant ownership interest		
Interest expense	157	–
Included in accounts payable and accrued liabilities	42	–

24 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, 2014 $	December 31, 2013 $
Revenues		
Canada	94,948	57,506
United States	2,589	2,451
	97,537	59,957

	December 31, 2014 $	December 31, 2013 $
Property and equipment		
Canada	324,089	173,957
United States	6,218	5,980
	330,307	179,937

All other non-current assets are held in Canada.

(in thousands of Canadian dollars)

25 Financial instruments and fair values

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, 2014 and 2013:

	December 31, 2014		December 31, 2013	
	Carrying value $	Fair value $	Carrying value $	Fair value $
Assets				
Loans and receivables				
Cash	3,473	3,473	852	852
Restricted cash	347	347	278	278
Capital reserve – internally restricted	–	–	108	108
Trade and other receivables	5,697	5,697	2,394	2,394
Loan receivable	–	–	4,828	4,014
Capital reserve – restricted	2,304	2,304	2,517	2,517
Funds held on behalf of franchisees	167	167	–	–
	11,988	11,988	10,977	10,163
Available-for-sale				
Minority interest investments in hotel properties	190	190	846	846
Liabilities				
Amortized cost				
Trade payables and accrued liabilities	12,210	12,210	5,091	5,091
Accrued interest on convertible debentures	1,309	1,309	–	–
Secured credit facilities	27,007	26,986	1,004	1,004
Mortgages and loan payable	135,758	126,039	107,599	104,625
Convertible debentures	88,061	86,216	–	–
Loan due to a related party	–	–	307	307
Funds to be spent on behalf of franchisees	167	167	–	–
	264,512	252,927	114,001	111,027

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 reserve – internally restricted, trade and other receivables, capital reserve – restricted, funds held on behalf of franchisees, trade payables and accrued liabilities, accrued interest on convertible debentures, loan due to a related party and funds to be spent on behalf of franchisees.

(in thousands of Canadian dollars)

25 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.

- Secured credit facilities and mortgages and loan payable: 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.

- Convertible debentures: The convertible debentures have two components of value: the conventional debentures and the Redemption Option (note 15). The fair value of the convertible debentures is based on the quoted market price for the debentures. The Redemption Option has been accounted for as an embedded derivative that is required to be bifurcated from the underlying debentures, valued using an option pricing model and accounted for as a financial asset with the amount of any redemption option being added to the carrying value of the convertible debentures. Any change in the fair value of the Redemption Option is recorded in interest and accretion on debt in the consolidated statement of income. The Redemption Option is classified as level 2 as defined below.

Fair value hierarchy

The following table classifies financial assets and liabilities that are recognized on the consolidated statement of 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, 2014 $	December 31, 2013 $
Level 2		
Redemption option	357	–
Level 3		
Minority interest investments in hotel properties	190	846

(in thousands of Canadian dollars)

26 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 6.21% (December 31, 2013 – 6.52%) with a weighted average maturity of 3.2 years (December 31, 2013 – 3.8 years).

The Company has three mortgages and a secured credit facility at floating rates. For the year ended December 31, 2014, if interest rates on the Company's floating rate debt had been 1% higher/lower, net income would change by $183 (December 31, 2013 – $51).

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 $5,697 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.

Trade receivables are due within 30 days; therefore amounts over 30 days are considered overdue. 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)

26 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, 2014 $	December 31, 2013 $
Trade and other receivables under 30 days aged	3,804	1,554
Trade and other receivables over 30 days aged	2,136	880
Less: Allowance for doubtful accounts	(243)	(40)
	5,697	2,394

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 (December 31, 2013 – $16).

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 statement of income by $32 (December 31, 2013 - $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 two credit facilities which expire in 2015 and are presented as current liabilities. One of the facilities was repaid in full subsequent to year end and the Company expects to renew the other facility with similar terms at its maturity on December 31, 2015.

In October 2014, the Company extended the mortgage on one hotel property which was to mature in April 2017 to November 2018 with a new blended interest rate of 5.54%, reduced from 5.99%. In December 2014, the Company refinanced the mortgage on one hotel property which was to mature in December 2015 to October 2019 with a new interest rate of 4.85%, reduced from 6.45%. Subsequent to year end, the Company extended a mortgage on one hotel property which was to mature in July 2016 to February 2020 with a new interest rate of 4.25%, reduced from 6.00%.

(in thousands of Canadian dollars)

26 Risk management (continued)

d) Liquidity risk (continued)

The Company monitors and forecasts its cash balances and cash flows generated from operations to meet its required obligations. At December 31, 2014, the Company had drawn $27,007 (December 31, 2013 – $1,004) from its available secured credit facilities of $49,000 (December 31, 2013 – $5,000).

Based on the Company's overall cash generation capability and current 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 tables 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, 2014			
	Less than 3 months	3 months to 1 year	1 to 5 years	Over 5 years
Trade payables and accrued liabilities	12,210	–	–	–
Convertible debentures (face value)	–	–	40,601	52,621
Convertible debentures interest	1,523	4,811	21,530	548
Secured credit facilities	–	9,007	18,000	–
Secured credit facilities interest	412	1,204	325	–
Mortgages and loan payable	1,562	4,686	124,823	5,140
Mortgages and loan payable interest	2,023	6,069	12,739	1,052
Funds to be spent on behalf of franchisees	–	–	167	–

	December 31, 2013			
	Less than 3 months	3 months to 1 year	1 to 5 years	Over 5 years
Trade payables and accrued liabilities	5,091	–	–	–
Secured credit facility	1,004	–	–	–
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	–

(in thousands of Canadian dollars)

27 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.

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 secured credit facilities, mortgages and loan payable, convertible debentures and loan due to a related party ("Debt") divided by total assets plus accumulated impairments, depreciation and amortization ("GBV"). The Company's Articles 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 and share-based compensation ("earnings base") to the sum of the annual principal and interest payments on secured credit facilities, mortgages and loan payable, convertible debentures and loan due to a related party ("debt service"). The Company's covenants require the debt service coverage ratio exceed various levels ranging from 1.25 – 1.40.

	December 31, 2014 $	December 31, 2013 $
Capital structure		
Secured credit facilities	27,007	1,004
Mortgages and loan payable	135,758	107,599
Convertible debentures	88,061	–
Loan due to a related party	–	307
Total debt	250,826	108,910
Equity	117,944	85,407
Total capital	368,770	194,317
Ratios		
Total debt	250,826	108,910
Gross book value	508,625	328,605
Debt to GBV – including convertible debentures	49.3%	33.1%
Debt to GBV – excluding convertible debentures	32.0%	33.1%

(in thousands of Canadian dollars)

27 Capital management (continued)

	For the years ended December 31, 2014 $	December 31, 2013 $
Earnings base	30,059	19,674
Debt service	16,731	11,338
Debt service coverage ratio	1.80	1.74

The Company is also subject to financial covenants on certain of its mortgages payable and secured credit facilities, which include customary terms and conditions for borrowings of this nature. At December 31, 2014 and 2013, all covenants measured on an annual basis were in compliance.

28 Subsequent events

On January 13, 2015, the Company initiated a NCIB to repurchase a maximum of $4,102 principal amount of its issued and outstanding Series B convertible debentures and $3,437 principal amount of its issued and outstanding Series C convertible debentures. The NCIB will be in effect until January 12, 2016 or such earlier time as the bid is completed or terminated at the option of the Company.

On January 23, 2015, the Company sold the Ramada® hotel in Trenton, ON for proceeds of $3,950. A portion of the proceeds were used to repay the $3,000 secured credit facility in full. The Company expects to record a gain on sale of approximately $200 in the first quarter of 2015.

On January 30, 2015, the Company bought the Ramada® hotel in Whitehorse, YT for $8,200.

On February 4, 2015, the Company sold the Travelodge® hotel in Etobicoke, ON for proceeds of $13,000. A portion of the proceeds were used to repay the $2,000 secured credit facility in full. The Company expects to record a gain on sale of approximately $1,700 in the first quarter of 2015.