

Holloway Lodging Corporation

(formerly Holloway Lodging Real Estate
Investment Trust)

Consolidated Financial Statements
December 31, 2012 and 2011

March 11, 2013

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, 2013

Independent Auditor's Report

To the Shareholders of Holloway Lodging Corporation

We have audited the accompanying consolidated financial statements of **Holloway Lodging Corporation**, formerly known as Holloway Lodging Real Estate Investment Trust and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2012 and 2011 and the consolidated statements of income (loss), comprehensive income (loss), changes in shareholders' equity and cash flows for the years ended December 31, 2012 and 2011 and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Holloway Lodging Corporation and its subsidiaries, as at December 31, 2012 and 2011 and their financial performance and their cash flows for the years ended December 31, 2012 and 2011 in accordance with International Financial Reporting Standards.

(signed) "PricewaterhouseCoopers LLP"

Chartered Accountants

*PricewaterhouseCoopers LLP
Summit Place, 1601 Lower Water Street, Suite 400, Halifax, Nova Scotia, Canada B3J 3P6
T: +1 (902) 491 7400, F: +1 (902) 422 1166*

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

Holloway Lodging Corporation
Consolidated Statements of Financial Position
As at December 31, 2012 and 2011

(in thousands of Canadian dollars)

	December 31, 2012 \$	December 31, 2011 \$
Assets		
Current assets		
Cash and cash equivalents (note 25)	1,312	2,455
Restricted cash	253	249
Capital reserve – internally restricted	318	128
Trade and other receivables (note 5)	2,597	3,974
Inventories	203	273
Prepaid expenses and deposits	1,843	1,841
Assets held-for-sale (note 7)	–	42,091
	<u>6,526</u>	<u>51,011</u>
Non-current assets		
Property and equipment (note 8)	180,964	167,177
Minority interest investments in hotel properties (note 9)	861	850
Loan receivable (note 10)	4,879	4,938
Capital reserve – restricted	3,976	3,662
Deferred income tax assets (note 23)	7,082	7,082
Other assets (note 11)	333	509
	<u>198,095</u>	<u>184,218</u>
Total assets	<u>204,621</u>	<u>235,229</u>
Liabilities		
Current liabilities		
Line of credit (note 12)	1,523	4,822
Trade payables and accrued liabilities (note 13)	5,571	8,545
Accrued interest on convertible debentures	–	1,516
Current portion of mortgages payable (note 14)	10,070	14,328
Current portion of convertible debentures (note 15)	–	46,134
Current portion of obligations under finance leases	10	80
Class B LP units (note 19)	–	9
Mortgages on assets held-for-sale	–	23,156
	<u>17,174</u>	<u>98,590</u>
Non-current liabilities		
Mortgages payable (note 14)	101,613	101,569
Loans due to related parties (note 17)	291	14,768
Obligations under finance leases	–	10
Derivative liability (note 16)	32	10
	<u>101,936</u>	<u>116,357</u>
Total liabilities	<u>119,110</u>	<u>214,947</u>
Equity attributable to owners of the parent	<u>85,470</u>	<u>20,282</u>
Non-controlling interest	41	–
Total shareholders' equity	<u>85,511</u>	<u>20,282</u>
Total liabilities and shareholders' equity	<u>204,621</u>	<u>235,229</u>

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) "James Howe"
Chairman of the Audit
Committee

Holloway Lodging Corporation
Consolidated Statements of Income (Loss)
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

	2012	2011
	\$	\$
Hotel revenues		
Rooms	51,970	66,880
Food and beverage	4,475	7,138
Parking	358	1,348
Other	1,570	2,026
	<u>58,373</u>	<u>77,392</u>
Hotel expenses		
Departmental and operating expenses	34,244	48,248
Property taxes and insurance	2,795	4,076
Management fees	1,289	1,889
Depreciation and amortization	7,845	9,903
	<u>46,173</u>	<u>64,116</u>
Income before the following	<u>12,200</u>	<u>13,276</u>
Other (income) and expenses		
Interest on line of credit, mortgages payable and loans due to related parties	7,678	11,074
Interest on convertible debentures	195	4,234
Accretion on convertible debentures, loans due to related parties, mortgages and deferred financing fees	739	3,274
Corporate and administrative	2,523	2,365
Unit-based compensation	503	188
Investment income	(287)	(158)
Provision for impairment of loan receivable (note 10)	–	1,235
Provision for (reversal of) impairment of hotel properties (note 8)	(12,993)	3,265
Reversal of impairment of assets held-for-sale (note 7)	–	(2,567)
Loss on disposal of minority interest investments in hotel properties (note 9)	101	187
Loss (gain) on disposal of hotel properties and other assets (note 6)	(5,588)	1,528
Fair value adjustment of Class B LP units and derivative liabilities (note 30)	21	(252)
Gain on repurchase of convertible debentures and settlement of promissory notes (notes 15 and 18)	–	(2,698)
Depreciation and amortization – corporate assets	5	4
Gain on acquisition of subsidiary (note 6)	(433)	–
	<u>(7,536)</u>	<u>21,679</u>
Income (loss) before income taxes	19,736	(8,403)
Provision for income taxes (note 23)	–	–
Net income (loss) for the year	<u>19,736</u>	<u>(8,403)</u>
Attributable to		
Shareholders of the company	19,723	(8,403)
Non-controlling interest	13	–
	<u>19,736</u>	<u>(8,403)</u>
Basic and diluted earnings (loss) per share/unit (note 20):	1.11	(8.56)

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

Holloway Lodging Corporation

Consolidated Statements of Comprehensive Income (Loss)

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

	2012	2011
	\$	\$
Net income (loss) for the year	19,723	(8,403)
Other comprehensive income (loss)		
Cumulative translation adjustments	(96)	97
Fair value adjustments or adjustment on disposal of minority interest investments in hotel properties	307	303
	211	400
Comprehensive income (loss) for the year	19,934	(8,003)
Comprehensive income (loss) attributable to:		
Shareholders/unitholders and owners of Class B LP units	19,934	(8,003)

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

Holloway Lodging Corporation

Consolidated Statements of Changes in Shareholders' Equity

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

	Common shares (note 19) \$	Units (note 19) \$	Contributed surplus \$	Deficit \$	Accumulated other comprehensive income (loss) \$	Total attributed to shareholders/ unitholders \$	Non- controlling interest \$	Total shareholders' equity \$
Balance, January 1, 2011	–	180,219	1,374	(152,740)	(706)	28,147	–	28,147
Net loss for the year	–	–	–	(8,403)	–	(8,403)	–	(8,403)
Other comprehensive income	–	–	–	–	400	400	–	400
Unit-based compensation related to options	–	–	40	–	–	40	–	40
Units issued to trustees for services	–	98	–	–	–	98	–	98
Balance, December 31, 2011		180,317	1,414	(161,143)	(306)	20,282	–	20,282
Balance, January 1, 2012	–	180,317	1,414	(161,143)	(306)	20,282	–	20,282
Non-controlling interest on acquisition of subsidiary	–	–	–	–	–	–	28	28
Net income for the year	–	–	–	19,723	–	19,723	13	19,736
Other comprehensive income	–	–	–	–	211	211	–	211
Distributions paid to unitholders	–	–	–	(1,217)	–	(1,217)	–	(1,217)
Unit-based compensation related to options	–	–	503	–	–	503	–	503
Redemption of convertible debentures for units	–	46,660	–	–	–	46,660	–	46,660
Repurchase of units	–	(699)	–	–	–	(699)	–	(699)
Exchange of units	–	7	–	–	–	7	–	7
Exchange of units for common shares pursuant to corporate conversion	226,285	(226,285)	–	–	–	–	–	–
Balance, December 31, 2012	226,285	–	1,917	(142,637)	(95)	85,470	41	85,511

Holloway Lodging Corporation
Consolidated Statements of Cash Flows
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

	2012 \$	2011 \$
Cash provided by (used in)		
Operating activities		
Net income (loss) for the years	19,736	(8,403)
Adjustments for non-cash items (note 25)	(9,800)	14,067
	9,936	5,664
Changes in items of working capital (note 25)	(2,999)	597
Net cash generated from operating activities	6,937	6,261
Investing activities		
Decrease (increase) in restricted cash	(3)	302
Decrease (increase) in capital reserves	(317)	2,570
Proceeds from sale of hotel properties, net of costs	51,177	18,103
Additional investment in minority interest investments in hotel properties	(41)	(18)
Proceeds from sale of minority interest investments in hotel properties	236	60
Additions to property and equipment	(2,706)	(2,627)
Acquisition of subsidiary, net of cash acquired	(2,076)	–
Net cash generated from (used in) investing activities	46,270	18,390
Financing activities		
Increase (decrease) in line of credit	(3,299)	2,304
Repayment of obligations under finance leases	(80)	(132)
Repayment of promissory notes payable	–	(129)
Proceeds from mortgages, net of deferred financing fees	–	717
Repayment of mortgages payable	(34,255)	(14,941)
Proceeds from (repayment of) loan due to a related party	(14,800)	13,000
Repayment of convertible debentures	–	(20,238)
Repurchase of convertible debentures	–	(3,607)
Repurchase of units	(699)	–
Distributions paid to unitholders	(1,217)	–
Net cash used in financing activities	(54,350)	(23,026)
Increase (decrease) in cash and cash equivalents	(1,143)	1,625
Cash and cash equivalents – Beginning of year	2,455	830
Cash and cash equivalents – End of year	1,312	2,455
Supplemental cash flow information		
Interest paid	9,605	14,617

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

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

1 General information

Holloway Lodging Corporation and its subsidiaries together (“Holloway” or the “Company”) is a hospitality company that owns and operates hotels. As at December 31, 2012, the Company owned sixteen hotels in Canada, one hotel in the United States and a 90% interest in another hotel, with 1,790 guest rooms and suites and held minority ownership interests in four other hotels. The address of its registered office is 6009 Quinpool Road, 10th Floor, Halifax, Nova Scotia.

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

The results of operations for the year ended December 31, 2012 represent the operations of seventeen hotels for the full year and four hotels for part of the year. The leasehold interest on the 5 Calgary Downtown Suites Hotel in Calgary, AB was sold on January 12, 2012, the Radisson Hotel and Suites in Fort McMurray, AB was sold on February 1, 2012 and the Super 8 hotel in Three Hills, AB was sold on June 29, 2012. The Company acquired a 90% interest in the Holiday Inn Express in Stellarton, NS on November 30, 2012. For the results of operations for the year ended December 31, 2011, the Company owned twenty hotels for the full year and two hotels for part of the year. The Radisson Suite hotel in Halifax, NS was sold on June 30, 2011 and the Holiday Inn Express in Halifax, NS was sold in August 15, 2011.

2 Basis of preparation

These consolidated financial statements have been prepared in compliance with International Financial Reporting Standards (“IFRS”) and IFRIC interpretations as issued by the International Accounting Standards Board (“IASB”).

These consolidated financial statements were approved for issue by the Board of Directors for issue on March 11, 2013.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(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 minority interest investments in hotel properties, derivative liability and Class B LP units. The derivative liability and Class B LP units are measured at fair value through profit and loss and the minority interest investments in hotel properties 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

The financial statements consolidate the accounts of the Company and its subsidiaries. Subsidiaries are those entities which the Company controls by having the power to govern the financial and operating policies. Subsidiaries are fully consolidated from the date on which control is obtained by the Company and are de-consolidated from the date that control ceases. Intercompany transactions, balances, income and expenses and profits and losses are eliminated.

The Company applies the acquisition method to account for business combinations. Identifiable assets and liabilities in a business combination are measured initially at their fair values at the acquisition date. Any difference between the fair value of the net assets acquired and the consideration paid is recorded as a gain or loss on acquisition in the income statement. The Company recognises any non-controlling interest in the subsidiary at the non-controlling interest's proportionate share of the recognised amounts of acquiree's identifiable net assets. Any acquisition related costs are expensed as they are incurred.

Foreign currency translation

i. Functional and presentation currency

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

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

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(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 statement of income (loss) in operating expenses.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held with banks and other short-term highly-liquid investments with original maturities of three months or less.

Financial instruments

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

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

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

Financial instruments in this category are recognized initially and subsequently at fair value. Derivatives are also included in this category unless they are designated as hedges. The Company has issued warrants which qualify as a derivative liability. Holloway's Class B LP units were also classified in this category prior to conversion. Gains and losses on re-measurement to fair value of warrants and Class B LP units are included in fair value adjustment of Class B LP units and derivative liability.

- 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. The Company's available-for-sale assets comprise its minority interest investments in hotel properties.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Financial instruments (continued)

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains and losses arising from remeasurement are recognized in other comprehensive income except for exchange gains and losses on the translation of debt securities, which are recognized in the consolidated statement of 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 statement of income (loss) and are included in “gain or loss on disposition of minority investment in hotel property”. Available-for-sale investments are classified as non-current, unless an investment matures within twelve months, or management expects to dispose of it within twelve months.

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

- iii) **Loans and receivables:** Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company’s loans and receivables, included in current assets due to their short-term nature comprise trade and other receivables, cash and cash equivalents, restricted cash and capital reserves – internally restricted. The Company’s loan and receivables, included in non-current assets comprise its loan receivable and capital reserve – restricted. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment. The carrying amount of a loan receivable classified as impaired is reduced to the present value of estimated future cash flows discounted at the initial effective interest rate of the loan.
- iv) **Financial liabilities at amortized cost:** Financial liabilities at amortized cost include line of credit, trade payables and accrued liabilities, accrued interest on convertible debentures, mortgages payable, convertible debentures, obligations under finance leases and loans due to related parties. Trade payables and accrued liabilities are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method. Mortgages payable and loans due to related parties 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 waiver for a covenant breach has not been received by the period end date. Otherwise, they are presented as non-current liabilities.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(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.

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

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

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

- i) **Financial assets carried at amortized cost:** The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.
- 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 statement of income (loss). This amount represents the loss in accumulated other comprehensive income that is reclassified to the statement of income (loss).

Impairment losses on available-for-sale investments, when recorded in the statement of income (loss), 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.

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.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(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 four hotel partnerships or co-tenancies ranging from 6.00% to 19.06%. These investments are accounted for as available-for-sale investments and are measured at fair value at each reporting period with changes in value recognized in other comprehensive income. Significant or prolonged declines in fair value are removed from other comprehensive income and recognized in the statement of income (loss).

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. 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. Repair and maintenance costs are charged to the statement of income (loss) during the period in which they are incurred.

The major categories of property and equipment are depreciated on a straight-line basis as follows:

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

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

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

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

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Assets held-for-sale

Non-current assets are classified as assets held-for-sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. The assets are stated at the lower of carrying amount and fair value less costs to sell.

For those assets held-for-sale carried at fair value less costs to sell, the value is based on adjustments to the fair value for anticipated costs to dispose of the asset including any commissions, brokerage fees and legal costs.

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. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units or "CGUs"). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Value in use is defined as the present value of the expected future cash flows of the relevant asset or CGU, as determined by management.

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

Reversals of any previous impairment losses are presented as reversal of impairment of hotel properties in the statement of income (loss).

Other assets

Other assets consist of franchise fees and agreements. 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 financial statements. The Non-competition, Right of First Opportunity and Participation Agreement was amortized on a straight-line basis over the five-year term of the agreements. These agreements expired on June 21, 2012.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Leases

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

Provisions

Provisions for legal or constructive obligations are recognized in the financial statements as liabilities when all of the following three criteria are met: (i) the Company has a present legal or constructive obligation as a result of a past event; (ii) it is more likely than not that an outflow of resources will be required to settle the obligation; and (iii) the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted where the effect is material. The Company does not have any significant provisions recorded at December 31, 2012.

Income tax

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

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

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

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Income tax (continued)

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

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

Dividends/Distributions

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

Revenue

Revenue is generated primarily from room occupancy, food and beverage services and parking. 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.

Share/unit repurchases

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

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Employee benefits

i) Share/unit-based compensation

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

ii) Termination benefits

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

Comparative figures

Certain of the 2011 comparative figures have been restated to comply with the financial statements presentation adopted for 2012.

Accounting standards and amendments issued but not yet adopted

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2013, with earlier application permitted except IFRS 9 which is effective January 1, 2015. The Company is in the process of assessing the impact of these standards and amendments.

- i) IFRS 9, *Financial Instruments*, was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit and loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated other comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments – Recognition and Measurement*, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Accounting standards and amendments issued but not yet adopted (continued)

- ii) IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12, *Consolidation – Special Purpose Entities* and IAS 27, *Consolidated and Separate Financial Statements*.
- iii) IFRS 11, *Joint Arrangements*, requires a venture to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venture will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers*.
- iv) IFRS 12, *Disclosure of Interest in Other Entities*, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard replaced the disclosure requirements in IAS 27 consolidated and separate financial statements, IAS 28 *Investments in Associates* and IAS 31 *Interest in Joint Ventures*.
- v) IFRS 13, *Fair Value Measurement*, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.
- vi) There have been amendments to existing standards, including IAS 27, *Separate Financial Statements (IAS 27)*, and IAS 28, *Investments in Associates and Joint Ventures (IAS 28)*. IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10-13.
- vii) IAS 1, *Presentation of Financial Statements*, has been amended to require entities to separate items presented in OCI into two groups, based on whether or not items may be recycled in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. The amendment is effective for annual periods beginning on or after July 1, 2012 with earlier application permitted.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Accounting standards and amendments issued but not yet adopted (continued)

- viii) IAS 12, *Income Taxes*, was amended to introduce an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. As a result of the amendment, there is a rebuttable presumption that the carrying amount of the investment property will be recovered through sale when considering the expected manner or recovery or settlement. SIC 21, *Income Taxes – Recovery of Revalued Non-Depreciable Assets*, will no longer apply to investment properties carried at fair value. The amendment also incorporates into IAS 12 the remaining guidance previously contained in SIC 21, which is withdrawn. The amendment is effective for annual periods beginning on or after July 1, 2012 with earlier application permitted. The Company has no investment property and therefore expects these amendments will have no impact on the consolidated 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 that the Company has made in the preparation of the financial statements:

Critical accounting estimates and assumptions

a) Property and equipment

On December 31, 2012, the Company increased the carrying value of 7 CGUs by reversing previously recorded impairments by \$19,829 and decreased the carrying value of 4 CGUs by recording impairment of \$6,836. The fair value of the CGUs is based on their value in use and is determined by recent independent third party appraisals, comparable sales transactions and internal models. A CGU is reviewed at the individual hotel level, the lowest level for which identifiable cash flows are largely independent when measuring the fair value of property and equipment. The fair value is determined based on the discounted future cash flows expected to be received from the CGU. The fair value amounts have been determined using ten-year cash flow projections and a capitalized terminal value calculation as approved by management of the Company and made maximum use of observable inputs and outputs. For periods beyond the initial budget period, cash flows were extrapolated using growth rates determined to be reasonable for the specific CGU and market in which they operate and do not exceed the anticipated long term average growth rates for the Company's portfolio. Key factors of estimation uncertainty include:

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

4 Critical accounting estimates and judgments (continued)

Critical accounting estimates and assumptions (continued)

a) Property and equipment (continued)

Discount rates	11.5% to 12.5%
Capitalization rates	9.5% to 10.5%
Growth rates	Consistent with industry and portfolio outlook

These ranges are consistent with previous value in use calculations for the Company's CGUs.

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

The amount of the impairment loss is the amount by which the CGU's carrying value exceeds its fair value. The future cash flows expected from the use and eventual disposition involve assumptions of occupancy, room rates, revenues, expenses, the residual or terminal value for the CGU and discount rates. In addition to these estimates, management assesses the effect of new competition in the individual markets and the hotel industry predictions for recovery from the recession. 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 \$92,737 and \$104,893 for the 7 CGUs that were increased in value and \$28,335 and \$32,445 for the 4 CGUs that were decreased in value using internal models.

For the 7 CGUs increased in value a valuation of \$98,457 was determined for the purposes of reversal of previously recognized impairment. For the 4 CGUs decreased in value a valuation of \$30,262 was determined for further impairment.

b) Minority interest investments in hotel properties

At December 31, 2012, the Company's minority interest investments in hotel properties were not traded in an active market and their fair value was estimated using valuation techniques. Valuations for these investments require the use of inputs and capitalization rates that cannot be derived from current market prices but are based on management estimates of appropriate amounts.

The carrying amount of the Company's minority interest investments in hotel properties would be between \$689 and \$1,072 if the capitalization rate used in the valuation differed by plus or minus 1% from management's estimates.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

4 Critical accounting estimates and judgments (continued)

c) Loan receivable

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

d) Depreciation of property and equipment

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

e) Income taxes

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

f) Critical judgments in applying accounting policies

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

i) Fair value of minority interest investments in hotel properties

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

If all of the declines in fair value below cost were considered significant or prolonged, the Company would incur a loss of \$161 in its financial statements, being the transfer of the accumulated fair value adjustments recognized in other comprehensive income on the available-for-sale investments to the statement of income (loss).

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

4 Critical accounting estimates and judgments (continued)

f) Critical judgments in applying accounting policies (continued)

ii) Property and equipment

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

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

iii) Accounts receivable and accrued liabilities

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

iv) Loan receivable

The Company uses judgments in the valuation of the loan receivable from PHSI as the terms of the loan agreement do not provide access to financial information of PHSI and the valuation is based on cash flows not occurring until 2018.

5 Trade and other receivables

	December 31, 2012	December 31, 2011
	\$	\$
Trade receivables	2,336	3,358
Less: allowance for doubtful accounts	(102)	(166)
Trade receivables - net	2,234	3,192
Receivables from credit card companies	254	323
Other receivables	109	459
	<u>2,597</u>	<u>3,974</u>

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

6 Acquisition and disposal of hotel properties

Disposal of hotel properties

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

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

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

On June 30, 2011, the Company sold the Radisson Suite hotel in Halifax, NS for gross proceeds of \$12,324. The Company recognized a loss on disposal of hotel property of \$215. After repayment of the mortgage and closing costs, the net cash proceeds, including \$963 released from capital reserves-restricted, were \$6,125.

On August 15, 2011, the Company sold the Holiday Inn Express hotel in Halifax, NS for gross proceeds of \$6,500. The Company recognized a loss on disposal of hotel property of \$1,314. After repayment of the mortgage and closing costs, the net cash proceeds were \$2,744.

Acquisition of hotel property

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

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

6 Acquisition and disposal of hotel properties (continued)

Acquisition of hotel property (continued)

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

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

Acquisition related costs of \$36 have been recognized in the statement of income (loss) for the year ended December 31, 2012.

7 Assets held-for-sale

Non-current assets are classified as assets held-for-sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. The assets are stated at the lower of carrying amount and fair value less costs to sell.

At December 31, 2011, the management of the Company had entered into agreements to sell the 5 Calgary Downtown Suites Hotel in Calgary, AB and the Radisson Hotel and Suites in Fort McMurray, AB with the closing of those potential sales anticipated to occur within 12 months. As a result, the net book value of the applicable assets and associated liabilities were presented as held-for-sale.

Mortgage liabilities associated with the assets held-for-sale were \$23,156 at December 31, 2011. Subsequent to December 31, 2011, both hotels were sold and the mortgages were repaid. Refer to note 6.

Management of the Company assessed these CGUs for impairment or reversal of impairment because of changes in the competitive environment in their respective markets, significantly improved or declining performance relative to forecasted results or noteworthy changes in the economic factors of the region in which the CGU operates.

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

7 Assets held-for-sale (continued)

The fair value amounts were estimated using 10 year cash flow projections and a capitalized terminal value calculation as approved by management of the Company and made maximum use of observable inputs and outputs. For periods beyond the initial budget period, cash flows were extrapolated using growth rates determined to be reasonable for the specific market or hotel property to which they relate and do not exceed the anticipated long-term average growth rates for the Company's portfolio. Key assumptions included the following:

Discount rates	11% to 12.5%
Capitalization rates	9.5% to 10.5%
Growth rates	Consistent with industry and portfolio outlook

For those assets held-for-sale carried at fair value less costs to sell, the value is based on adjustments to the fair value for anticipated costs to dispose of the asset including any commissions, brokerage fees and legal costs.

The Company does not have any assets held-for-sale at December 31, 2012.

The net book value of the assets classified as held-for-sale were as follows:

	As at December 31, 2011			
	Cost	Accumulated impairment	Accumulated depreciation	Net book value
	\$	\$	\$	\$
Land	2,029	—	—	2,029
Building	46,555	(3,949)	(4,168)	38,438
Renovations in progress	165	—	—	165
Furniture, fixtures and equipment and other	4,276	(711)	(2,171)	1,394
Paving	75	(17)	(32)	26
Signage	31	—	(8)	23
Computer equipment and websites	294	—	(278)	16
	53,425	(4,677)	(6,657)	42,091

	For the year ended December 31, 2011			
	Opening net book value	Reclassification of amounts held-for-sale	Reversal of impairment	Closing net book value
	\$	\$	\$	\$
Land	—	2,029	—	2,029
Building	—	35,960	2,478	38,438
Renovations in progress	—	165	—	165
Furniture, fixtures and equipment and other	—	1,308	86	1,394
Paving	—	23	3	26
Signage	—	23	—	23
Computer equipment and websites	—	16	—	16
	—	39,524	2,567	42,091

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

8 Property and equipment

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

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

8 Property and equipment (continued)

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

As at December 31, 2012, the Company recognized a reversal of previously recorded impairment losses of \$19,829 and additional impairment losses of \$6,836 in respect of various CGUs. Management of the Company assessed these CGUs for impairment or reversal of previously recorded impairments because of changes in the competitive environment in their respective markets, significantly improved or declining performance relative to forecasted results or noteworthy changes in the economic factors of the market in which the CGU operates. Refer to note 4 for discussion regarding the use of estimates in determination of the values of the CGUs.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

8 Property and equipment (continued)

	For the year ended December 31, 2011							
	Opening net book value	Additions	Disposals	Depreciation	Net book value of assets reclassified as held-for-sale	Impairments	Foreign exchange	Closing net book value
	\$	\$	\$	\$	\$	\$	\$	\$
Land	22,243	–	(2,933)	–	(2,029)	(2,012)	32	15,301
Land lease	418	–	–	(11)	–	–	–	407
Buildings	197,044	644	(14,726)	(5,617)	(35,960)	(1,000)	154	140,539
Renovations in progress	169	243	–	–	(165)	–	–	247
Furniture, fixtures and equipment and other	13,428	1,545	(1,432)	(3,547)	(1,308)	(300)	10	8,396
Paving	1,623	–	(66)	(251)	(23)	47	4	1,334
Landscaping	26	–	–	(6)	–	–	–	20
Signage	848	58	(72)	(120)	(23)	–	5	696
Computer equipment and websites	277	137	(7)	(169)	(16)	–	1	223
Vehicles	22	–	–	(8)	–	–	–	14
Tenant inducements	102	–	(102)	–	–	–	–	–
	236,200	2,627	(19,338)	(9,729)	(39,524)	(3,265)	206	167,177

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

8 Property and equipment (continued)

	As at December 31, 2011			
	Cost	Accumulated impairment losses	Accumulated depreciation	Net book value
	\$	\$	\$	\$
Land	26,015	(10,714)	–	15,301
Land lease	500	(28)	(65)	407
Buildings	244,512	(82,923)	(21,050)	140,539
Renovations in progress	247	–	–	247
Furniture, fixtures and equipment and other	25,561	(5,404)	(11,761)	8,396
Paving	3,056	(683)	(1,039)	1,334
Landscaping	32	–	(12)	20
Signage	986	–	(290)	696
Computer equipment and websites	1,320	–	(1,097)	223
Vehicles	180	–	(166)	14
	<u>302,409</u>	<u>(99,752)</u>	<u>(35,480)</u>	<u>167,177</u>

As at December 31, 2011, the Company recognized a reversal of previously recorded impairment losses of \$4,961 and additional impairment losses of \$8,226 in respect of various CGUs.

The net book value of assets under finance leases as at December 31, 2012 was \$214 (December 31, 2011 - \$335).

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

9 Minority interest investments in hotel properties

The Company has minority interests in four hotels (December 31, 2011 – 5 hotels) ranging from 6.00% to 19.06%. The investments are accounted for as available-for-sale financial assets. During the year ended December 31, 2012, the Company sold its investment in the Super 8 hotel in Amherst, NS for \$236 and recognized a loss on sale of \$101. During the year ended December 31, 2011, the Company sold its investment in the Super 8 hotel in Barrie, ON for \$61 and recognized a loss on sale of \$187.

	For the years ended	
	December 31, 2012	December 31, 2011
	\$	\$
Opening value	850	777
Sale of investment	(236)	(61)
Change in value recorded in the statement of comprehensive income	307	303
Loss recognized in statement of income	(101)	(187)
Additional investment	41	18
Ending value	861	850

10 Loan receivable

	December 31, 2012	December 31, 2011
	\$	\$
Pacrim Hospitality Services Inc.	6,114	6,173
Less: Allowance	(1,235)	(1,235)
Net	4,879	4,938

The loan receivable from PHSI, the company that manages the Company's hotels, is unsecured, is due on February 1, 2018, is repayable at any time without penalty and bears interest at the lesser of 13% and the trailing three-month yield on the units of the Company (calculated in accordance with the loan agreement) plus 1%.

During 2011 and early 2012, the Company sold four properties that were previously managed by PHSI. This reduced the revenue stream PHSI receives from the Company resulting in, management believes, an increased credit risk associated with the full repayment of the loan on February 1, 2018. The terms of the loan agreement do not provide the Company with access to financial information of PHSI and therefore the above is the only objective factor the Company had to consider. Because of this increased credit risk, the Company provided an allowance of \$1,235 against the loan as at December 31, 2011.

In June 2012, Holloway sold a fifth hotel previously managed by PHSI. PHSI continues to meet the interest obligations under the terms of loan and in the absence of evidence to the contrary, the Company considers the loan to be performing and does not believe a further provision for impairment is necessary at this time.

Management's assessment of the valuation of this loan is largely based on estimated cash flows that will not occur until 2018, and, therefore, there is significant uncertainty associated both with the amount of the allowance recorded and the remaining carrying value of the loan.

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

11 Other assets

	Franchise fees \$	Agreements \$	Total \$
For the year ended December 31, 2011			
Opening net book value	567	151	718
Disposals	(31)	–	(31)
Amortization for the year	(79)	(99)	(178)
Closing net book value	457	52	509
As at December 31, 2011			
Cost	845	500	1,345
Accumulated amortization	(388)	(448)	(836)
Net book value	457	52	509
For the year ended December 31, 2012			
Opening net book value	457	52	509
Additions	21	–	21
Disposals	(91)	–	(91)
Amortization for the year	(54)	(52)	(106)
Closing net book value	333	–	333
As at December 31, 2012			
Cost	689	–	689
Accumulated amortization	(356)	–	(356)
Net book value	333	–	333

12 Line of credit

The Company has an available line of credit for \$5,000. As at December 31, 2012, the Company had drawn \$1,523 (December 31, 2011 - \$4,822). The line of credit bears interest at prime plus 2.5%, is payable on demand and is secured by a demand collateral mortgage and charge on the Holiday Inn Express in Kamloops, BC.

13 Trade payables and accrued liabilities

	December 31, 2012 \$	December 31, 2011 \$
Trade payables	2,445	2,555
Accrued land lease	–	1,993
Accrued expenses and liabilities	3,126	3,997
	5,571	8,545

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

14 Mortgages payable

	December 31, 2012 \$	December 31, 2011 \$
Mortgages payable, bearing interest at a weighted average rate of 6.63% (December 31, 2011 – 6.68%) and maturing on various dates from October 2013 to July 2017. Individual first charges on all but two of the hotel properties have been pledged as security for individual mortgages.	112,212	116,460
Less: deferred financing fees	529	563
Less: current portion	10,070	14,328
	<u>101,613</u>	<u>101,569</u>

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

	\$
Year ending December 31, 2013	10,070
2014	3,787
2015	7,146
2016	11,467
2017	79,742

The following table summarizes significant changes in mortgages payable for the years ended December 31, 2012 and 2011:

	<u>For the years ended</u>	
	<u>December 31, 2012</u>	<u>December 31, 2011</u>
Beginning balance	115,897	152,593
Mortgage recognized on acquisition	6,560	–
New debt	–	966
Deferred financing fees	34	(478)
Repayment of debt	(10,709)	(14,125)
Transfer to mortgages on assets held-for-sale	–	(23,156)
Impact of foreign exchange	(99)	97
Ending balance	<u>111,683</u>	<u>115,897</u>

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

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

14 Mortgages payable (continued)

In August 2012, the Company repaid at maturity the \$2,500 mortgage on the Super 8 hotel in Windsor, NS. The hotel is unencumbered.

In July 2011, the Company refinanced a mortgage secured by the Super 8 hotel in Yellowknife, NWT. The Company increased the outstanding mortgage balance by \$765 and reduced the annual interest rate by 0.75%. This mortgage matures in July 2016. In August 2011, the Company refinanced a mortgage secured by the Super 8 hotel in Truro, NS. The outstanding mortgage balance remained the same while the interest rate decreased by 0.75%. This mortgage matures in September 2016. In December 2011, the Company refinanced a mortgage secured by the Super 8 hotel in Drayton Valley, AB. The outstanding balance increased by \$200 and the interest rate is floating at the 90 day bankers' acceptance rate plus 501 basis points.

15 Convertible debentures

On August 1, 2006, the Company issued \$20,238 in convertible, redeemable debentures with an interest rate of 8.0%. The debentures were repaid in full on July 29, 2011.

On June 21, 2007, the Company issued \$45,000 in convertible, redeemable debentures with an interest rate of 6.5%. On July 18, 2007, the Company issued an additional \$6,844 in convertible, redeemable debentures with the same terms as the June 21, 2007 debentures, pursuant to the underwriters exercising their over-allotment option.

The convertible debentures were valued at their estimated fair value according to the terms and conditions in place at the time of their issuance. The difference between the gross proceeds and the estimated fair value of the debt of \$5,300 on the August 1, 2006 issuance, \$4,150 on the June 21, 2007 issuance and \$644 on the July 18, 2007 issuance represents the value of the conversion feature of the debentures and accordingly, has been recorded as a derivative liability. In accordance with IFRS, an obligation to issue units associated with the Company's convertible debentures is classified as a derivative liability and measured at fair value with any subsequent changes in value recognized in the statement of loss. These changes in value are included in fair value adjustment of Class B LP units and derivative liabilities.

On April 27, 2011, the Company initiated a Normal Course Issuer Bid ("NCIB") to repurchase, over the 12 months commencing on April 29, 2011 and ending on April 28, 2012, up to \$5,184 of its issued and outstanding 6.5% convertible debentures due June 30, 2012, such amount representing 10% of the Company's public float as of April 26, 2011. During the year ended December 31, 2011, the Company purchased and cancelled \$5,184 face value of the convertible debentures at a cost of \$3,518 (average cost of \$67.86 per \$100 face value – price not in thousands). The Company recorded a gain on repurchase of convertible debentures of \$1,550 which represents the difference between the book value at the time of repurchase and the amount paid.

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

15 Convertible debentures (continued)

The Company had 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, by issuing the number of units calculated by dividing the aggregate principal amount by 95% of the “current market price” of the units on the maturity date (calculated in accordance with the trust indenture). On December 22, 2011, the Company announced that it would redeem all outstanding 6.5% convertible unsecured debentures in full on January 23, 2012 and that it would satisfy the redemption price of the debentures by issuing Company units in lieu of cash, in accordance with the terms of the trust indenture.

On January 23, 2012, the REIT redeemed the remaining \$46,660 principal amount of the 6.5% convertible debentures by issuing 17,855,601 units (714,224,023 pre-consolidation units) to the debentureholders. The number of units issued to the debentureholders was determined by dividing the aggregate principal amount of the debentures outstanding by 95% of the weighted average trading price per unit for the 20 consecutive trading days ending on the fifth trading day preceding the redemption date (the “current market price”). The 20 trading day period commenced on and included December 15, 2011 and ended on and included January 16, 2012. The current market price was determined to be approximately \$2.76 (\$0.069 pre-consolidation) (rounded) and the units were issued to the debentureholders at a conversion price of \$2.60 (\$0.065 pre-consolidation) (rounded).

	December 31, 2012 \$	December 31, 2011 \$
Debt component	—	42,345
Accretion of convertible debentures	—	3,932
Deferred financing fees	—	(143)
	—	46,134
Less: current portion	—	46,134
	—	—

The following table summarizes significant changes in convertible debentures for the years ended December 31, 2012 and 2011:

	For the years ended	
	December 31, 2012 \$	December 31, 2011 \$
Beginning balance	46,134	68,735
Accretion of discount and deferred financing fees	526	2,699
Repayment of debentures at maturity	—	(20,238)
Repurchase and cancellation of debentures under NCIB	—	(5,062)
Redemption of outstanding debentures for units	(46,660)	—
Ending balance	—	46,134

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

16 Derivative liability

Warrants

The amount recognized as a long-term derivative liability of \$32 (2011 - \$10) represents the value of the outstanding warrants issued with respect to the loans due to related parties (note 17). The warrants are measured at fair value with any subsequent changes in value recognized in the statement of income. The Black-Scholes option pricing model was used for valuing the 52.5 outstanding warrants with the following assumptions:

	December 31, 2012	December 31, 2011
End of period unit price	\$3.81	\$3.60
Exercise price of warrants	\$5.40	\$16.00
Term remaining on warrants (years)	1.58	2.58
Volatility	60%	60%
Annual dividend/distribution yield	3.54%	—
Discount rate	1.06%	0.99%

Expected volatility used in the pricing model is based on an assessment of the historical volatilities of comparable lodging and hospitality REITs in North America. Historical volatilities of several different REITs were examined over different historical timeframes.

17 Loans due to related parties

Geosam Capital Inc.

On June 15, 2011, the Company entered into an agreement with a related party, Geosam Capital Inc. ("Geosam") as administrative agent for itself and a third party, to collectively provide a non-revolving bridge loan in an amount up to \$20,000. On July 29, 2011, the Company drew \$14,000 to repay the 8.0% convertible debentures.

The loan had an original maturity date of March 31, 2013 and an interest rate of 12.5%, payable monthly. The Company could repay the loan in whole, or in part, without premium or penalty at any time prior to the maturity date. The loan was secured by a general security agreement over the assets of the Company and a fixed charge second or third mortgages on a number of hotel properties. The mandatory repayment provisions of the loan stipulated that the Company must apply 75% of the sales proceeds of any asset, net of mortgage repayments, and 100% of all offering proceeds from the issuance of debt or equity securities to the loan amount outstanding.

As required by the loan agreement, the Company issued warrants to the lender to purchase 3.75 units (150 units pre-consolidation) for every \$1,000 drawn on the loan. Warrants for 52.5 units (2,100 pre-consolidation) were issued. The warrants are exercisable for three years from the date of issuance and have an exercise price of \$5.40.

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

17 Loans due to related parties (continued)

The loan was valued at its estimated fair value according to the terms and conditions in place at the time of issuance. The difference between the gross proceeds and the estimated fair value of the debt of \$202 represented the value of the warrants and accordingly, was recorded as a derivative liability. The difference between the recorded value of the loan and its face value was accreted to interest expense, using the effective interest rate method, over the term of the loan until it was repaid in full.

On August 30, 2011, the Company repaid \$1,000 of the loan amount outstanding following the sale of the Holiday Inn Express in Halifax, NS. One of the lenders agreed to waive its \$1,000 repayment for a fee of \$100.

On January 12, 2012, the Company repaid \$5,500 of the loan outstanding following the sale of the 5 Calgary Downtown Suites hotel in Calgary, AB. The Company repaid the remaining outstanding balance of \$9,300 on February 2, 2012, following the sale of the Radisson Hotel and Suites in Fort McMurray, AB.

Superior Lodging Corp.

On November 30, 2012, the Company acquired a 90% interest in the entity that owns the Holiday Inn Express hotel located in Stellarton, NS. The loan due to Superior is the shareholder loan that Superior retained (note 6). Superior is a related party as its majority owner is a director of Holloway. The principal balance of the loan is due November 30, 2017. The loan bears interest at an annual rate of 4.1%.

The following table summarizes significant changes in the loans for the years ended December 31, 2012 and 2011:

	For the years ended	
	December 31, 2012	December 31, 2011
	\$	\$
Superior Lodging Corp.		
Fair value at acquisition	291	–
Geosam Capital Inc.		
Beginning balance	14,768	–
Fair value at issuance	–	13,798
Accretion	32	170
Transfer of promissory notes (note 18)	–	1,800
Repayment of debt	(14,800)	(1,000)
Ending balance	291	14,768

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

18 Promissory notes payable

On December 22, 2008, the Company issued two promissory notes for \$3,000 and \$552, respectively, payable to Winport Developments Limited Partnership, a related party to finance the acquisition of the minority interest investments in hotel properties. The notes were assigned by Winport Developments Limited Partnership, a related party to its partners/owners. The partners included various Dynamic mutual funds, a Gluskin Sheff mutual fund, Canadian Mortgage Capital Corporation, Holloway Investments Inc., a related party and SLC Development Corporation, a related party. The \$3,000 promissory note bore interest at 6% per year until December 22, 2011 and 12% per year, thereafter. The \$552 note did not bear interest and therefore was discounted by \$183 at December 22, 2008, representing the net present value of the implicit interest. The discount was being accreted to interest expense over five years, the expected term of the promissory notes. The principal of the note was repayable on the sale of Holloway's minority ownership interests or the sale of the underlying properties.

On December 21, 2011, the Company settled the remaining interest-bearing promissory note in the amount of \$2,778 for \$1,800 which was added to the loan due to a related party (note 17). The difference of \$978 between the outstanding principal amount of the interest-bearing promissory notes and the settlement amount was recorded as a gain on settlement of promissory notes.

On December 21, 2011, the Company repurchased the non-interest-bearing promissory notes in the amount of \$458 for a cash payment of \$129. The difference of \$329 between the outstanding principal amount of the non-interest-bearing promissory notes and the settlement amount was recorded as a gain on settlement of promissory notes.

The following table summarizes significant changes in promissory notes payable for the years ended December 31, 2012 and 2011:

	For the years ended	
	December 31, 2012	December 31, 2011
	\$	\$
Beginning balance	–	3,203
Accretion of discount	–	33
Repayment of debt	–	–
Transfer to loan due to a related party	–	(1,800)
Cash payment	–	(129)
Gain on settlement of promissory notes	–	(1,307)
Ending balance	–	–

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

19 Shareholders' equity

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

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

Issued and outstanding common shares/units

The following presents the number of common shares/units issued and outstanding and the related ascribed values as at December 31, 2012 and December 31, 2011:

	Number of shares/units issued and outstanding	Ascribed value \$
Balance, January 1, 2011	975,793	180,219
Issuance of units to trustees for services	8,979	98
Balance, December 31, 2011	984,772	180,317
Issuance of units on redemption of convertible debentures (note 15)	17,855,601	46,660
Exchange of Class B LP units for REIT units	2,587	7
Units purchased under NCIB	(191,850)	(699)
Balance, December 31, 2012	18,651,110	226,285

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

On January 23, 2012, the Company issued 17,855,601 units (714,224,023 pre-consolidation units) pursuant to the redemption of the 6.5% convertible debentures.

On March 28, 2012, the Company consolidated on the basis of one post-consolidation unit for every 40 pre-consolidation units and Class B LP units. Consequently, the weighted average number of units outstanding and the number of units, options and warrants, as well as the price per unit associated with the Company's outstanding warrants, were adjusted retroactively to give effect to the consolidation.

On August 13, 2012, the Company initiated an NCIB to repurchase over the 12 month period commencing on August 15, 2012 and ending on August 14, 2013, up to 1,083,505 of its issued and outstanding units, such amount representing 10% of the Company's public float as of August 13, 2012. At December 31, 2012, the Company had purchased and cancelled 189,300 units at a cost of \$689. (average price of \$3.64 per unit).

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

19 Shareholders' equity (continued)

Class B Limited Partnership units ("Class B LP units")

At December 31, 2011, Holloway's Class B LP units were presented as a liability at fair value. As the Class B LP units were convertible on a one-for-one basis for units the fair value reflected the market value of the outstanding Class B LP units based on the applicable closing price of the units.

Changes in the liability were presented as "fair value adjustment of Class B LP units and derivative liabilities" in the statements of income (loss). On November 6, 2012, the remaining Class B LP units were converted into units. The number of Class B LP units outstanding at December 31, 2012 was nil (December 31, 2011 – 2,587).

The following table provides the total shares/units outstanding including the Class B LP units as well as the impact of outstanding options and warrants, if exercised, and the conversion of convertible debentures into common shares/units.

	December 31, 2012	December 31, 2011
Common shares/units outstanding	18,651,110	984,772
Class B LP units outstanding	–	2,587
Options outstanding (exercisable)	178,642	11,444
Warrants outstanding (exercisable)	52,500	52,500
Conversion of convertible debentures (conversion price \$6.15) ¹	–	189,675
Total common shares/units reflecting exercise and conversion	<u>18,882,252</u>	<u>1,240,978</u>

Options

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

	2012		2011	
	Average exercise price in \$ per share	Options	Average exercise price in \$ per share	Options
At January 1	57.00	20,577	167.20	24,346
Granted	3.70	497,500	9.20	13,700
Forfeited	136.96	(2,602)	184.00	(6,844)
Expired	195.20	(666)	166.00	(10,625)
At December 31	4.91	<u>514,809</u>	57.00	<u>20,577</u>

¹ Represents conversion of convertible debentures at the option of the holders. The Company redeemed the debentures on January 23, 2012 by issuing 17,855,601 units (714,224,023 pre-consolidation units).

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

19 Shareholders' equity (continued)

Out of the 514,809 outstanding options (2011 – 20,577), 178,642 options were exercisable (2011 – 11,444).

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

Expiry date	Exercise price in \$ per unit	Common shares	
		2012	2011
March 2012	195.20	–	666
March 2013	147.60	3,809	6,211
October 2016	9.20	13,500	13,700
August 2017	3.70	497,500	–
		<u>514,809</u>	<u>20,577</u>

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

	Options grant August, 2012	Option grant October, 2011
Exercise price	\$3.70	\$9.20
Closing unit price on grant date	\$3.65	\$10.00
Volatility	102%	85%
Annual dividend/distribution yield	3.3%	–
Expected option life	5 years	5 years
Annual risk-free interest rate	1.5%	2.3%
Per unit fair value of option grant	\$2.27	\$6.50

Compensation expense is recognized over the vesting period by increasing contributed surplus based on the number of options expected to vest. The total compensation expense recognized in the statement of income (loss) for options granted was \$503 (2011 - \$40).

20 Earnings per share/unit

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

	For the years ended	
	December 31, 2012	December 31, 2011
	\$	\$
Net income (loss) attributable to shareholders of the Company	19,723	(8,403)
Weighted average number of shares/units and Class B LP units outstanding	17,727,238	981,738
Earnings (loss) per share/unit	1.11	(8.56)

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars except unit amounts)

20 Earnings per share/unit (continued)

Diluted earnings per share/unit is calculated by adjusting the weighted average number of shares/units outstanding to assume conversion of all potentially dilutive instruments convertible into shares. During 2012, the company had two categories of potentially dilutive instruments options and warrants. For both 2012 and 2011 the option and warrants are anti-dilutive.

21 Expenses by nature

	For the years ended	
	December 31,	December 31,
	2012	2011
	\$	\$
Food, beverage and service costs	3,400	4,665
Materials, supplies, repairs and utilities	8,225	11,244
Salaries, wages and employee benefits	17,461	22,947
Insurance	311	423
Property taxes	2,484	3,653
Land lease	–	2,116
Management fees	1,289	1,889
Royalty and franchise fees	3,658	4,150
Legal and other fees	1,894	2,074
Depreciation and amortization	7,850	9,907
Interest and financing costs	8,612	18,582
Provision for and reversal of impairments, gain or loss on acquisition or disposals and gain on repurchase or settlement of liabilities	(18,913)	950
Other	2,653	3,353
	38,924	85,953

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars except unit amounts)

22 Wages and employee benefits expense

Wages and employee benefits expense:

	For the years ended	
	December 31, 2012	December 31, 2011
Salaries and wages	14,986	20,418
Benefits	1,613	2,204
RRSP/pension expense	27	37
Trustee fees (cash-based payment)	269	67
Share/unit-based compensation	503	188
Termination benefits	63	33
	17,461	22,947

Compensation of key management:

Key management include the Company's directors, Chief Operating Officer, Chief Financial Officer and the former Chief Executive Officer who resigned December 31, 2011. Compensation awarded to key management included:

	For the years ended	
	December 31, 2012	December 31, 2011
Salaries and benefits	420	542
Consulting fees – interim CFO	6	32
Share/unit-based compensation (options and shares/units issued to trustees and key management)	468	175
Trustee fees (cash-based payment)	269	67
	1,163	816

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars except unit amounts)

23 Income taxes

	2012 \$	2011 \$
Components of the provision for income taxes are as follows:		
Deferred income taxes	4,852	(1,271)
Benefit of recording previously unrecognized deferred tax assets	(4,852)	–
Change in tax rate	–	1,271
	<hr/>	<hr/>
Provision for income taxes	–	–
	<hr/>	<hr/>

Reconciliation of total tax expense

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

	For the years ended	
	December 31, 2012	December 31, 2011
Income (loss) before income taxes	19,736	(8,403)
Income tax rate	26.61%	50.00%
	<hr/>	<hr/>
Income tax expense (recovery) at the combined statutory income tax rate	5,252	(4,202)
Non-taxable portion of capital (gains) and losses	(435)	353
Non-taxable gain on acquisition of subsidiary	(115)	–
Non-deductible unit-based compensation	134	94
Impact of unused tax losses and deductible temporary differences not recognized as deferred tax assets	(4,852)	2,441
Impact on deferred tax asset of change in future tax rate due to the plan to convert to a corporation	–	1,271
Other	16	43
	<hr/>	<hr/>
Income tax recovery	–	–
	<hr/>	<hr/>

The Corporation's rate was 26.61% (2011 – 50.00%). The decrease is a result of the conversion to a corporation on December 31, 2012.

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars except unit amounts)

23 Income taxes (continued)

Deferred tax

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

	December 31, 2011 \$	Recognized in net loss \$	December 31, 2012 \$
Deferred income tax assets			
Property and equipment	–	6,913	6,913
Non-capital losses	7,361	(7,139)	222
Deferred income tax liabilities			
Convertible debentures	(192)	192	–
Deferred financing fees	(87)	34	(53)
Net deferred income tax asset	<u>7,082</u>	<u>–</u>	<u>7,082</u>

The Company has recognized deferred tax assets of \$7,135 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.

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

	December 31, 2012 \$	December 31, 2011 \$
Deferred tax assets		
Deferred tax assets to be recovered within 12 months	912	6,445
Deferred tax assets to be recovered after more than 12 months	6,223	916
Deferred tax liabilities		
Deferred tax liabilities to be settled within 12 months	(34)	(279)
Deferred tax liabilities to be settled after more than 12 months	(19)	–
	<u>7,082</u>	<u>7,082</u>

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars except unit amounts)

23 Income taxes (continued)

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

	December 31, 2012	December 31, 2011
	\$	\$
Non-capital losses	32,665	12,644
Realized capital losses	5,393	6,503
Loans receivable	618	618
Minority interest investments in hotel properties	—	151
Property and equipment and assets held-for-sale	39,359	84,568
Other assets	202	44
Other	258	77
	<u>78,495</u>	<u>104,605</u>

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

Year of expiry	Loss \$
2026	1,043
2027	2,837
2028	4,965
2029	7,141
2030	7,133
2031	5,418
2032	2,192
Total	<u>30,729</u>

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

Year of expiry	USD loss \$
2027	243
2028	341
2029	549
2030	637
2031	819
2032	180
Total	<u>2,769</u>

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars except unit amounts)

24 Seasonality

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

25 Supplemental cash flow information

Adjustments for non-cash items:

	For the years ended	
	December 31, 2012	December 31, 2011
	\$	\$
Share/unit-based compensation	503	188
Depreciation and amortization	7,850	9,907
Accretion on mortgages, convertible debentures, loan due to a related party and deferred financing fees	739	3,274
Loss on disposal of minority interest investments in hotel properties	101	187
Loss (gain) on acquisition or disposal of hotel properties	(5,588)	1,528
Gain on acquisition of subsidiary	(433)	-
Gain on repurchase of convertible debentures and settlement of promissory notes	-	(2,698)
Provision for impairment of loan receivable	-	1,235
Provision for (reversal of) impairment of hotel properties	(12,993)	3,265
Reversal of impairment on assets held-for-sale	-	(2,567)
Fair value adjustment of Class B LP units and derivative liabilities	21	(252)
	<u>(9,800)</u>	<u>14,067</u>

Changes in items of working capital:

	For the years ended	
	December 31, 2012	December 31, 2011
	\$	\$
Trade and other receivables	1,534	(787)
Inventories	77	(12)
Prepaid expenses and deposits	109	776
Trade payables and accrued liabilities	(3,203)	(221)
Accrued interest on convertible debentures	(1,516)	841
	<u>(2,999)</u>	<u>597</u>

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars except unit amounts)

25 Supplemental cash flow information (continued)

Cash and cash equivalents are comprised of the following:

	December 31, 2012 \$	December 31, 2011 \$
Cash on hand and balances with banks	1,312	2,455

26 Agreements

Hotel Management Agreement

Pacrim Hospitality Services Inc.

On June 7, 2006, the Company entered into a long-term management agreement with PHSI, a related party until December 31, 2011, 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 (“First Management Agreement”). PHSI is entitled to a base management fee of 3% of gross hotel revenues, an incentive fee, a purchasing fee of 4% of the cost of exceptional operating supplies and furniture, fixtures and equipment, a construction fee of 3% of the cost of construction materials, labour and equipment in connection with any construction or capital expenditures and an accounting fee ranging from \$23 to \$30 per year per hotel depending on the size of the hotel when accounting services are provided by PHSI. In addition, Intergy, a division of PHSI, provides certain reservation services for the Company’s hotels. A commission of up to 10% is paid on reservations made through Intergy.

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

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

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars except unit amounts)

26 Agreements (continued)

In order to facilitate the assignment, the Company loaned PHSI the funds paid to Pomeroy in consideration of the assignment (note 10).

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

Pacrim Hospitality Services Inc. (continued)

On July 7, 2010, pursuant to the acquisition of the Super 8 hotel in Windsor, NS, PHSI agreed to defer its management and accounting fees until June 30th of each calendar year. PHSI is entitled to receive a payment calculated as 3/5th of 50% of the hotel's "free cash flow" for the prior twelve months (thirteen months for 2010-2011). Free cash flow is defined as net operating income less first mortgage debt service and 3% of total revenues for reserve for replacement. The payment is due on or before July 25th of each year. Any unpaid balance of the fees will be applied against the principal balance of the loan receivable from PHSI (note 10). The terms of the agreement will be revisited annually before June 30th for the foregoing twelve months.

On October 15, 2012, Holloway entered into a second hotel management agreement (the "Second Management Agreement") with PHSI under which PHSI is responsible for managing the day-to-day property and administrative operations of the hotels acquired subsequent to the date. PHSI has the right to manage hotels acquired by Holloway in Canada and at Holloway's discretion, hotels acquired in the United States. PHSI is entitled to a base management fee of 2.5 % of gross hotel revenues, an incentive fee, purchasing and sales cost recoveries, and accounting fee per hotel of \$20 to \$25 for limited service hotels and a fee to be negotiated for full service hotels, and a construction management fee to be negotiated on a project-by-project basis. Holloway retains the right to manage construction projects internally or through third party project management firms.

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

Non-competition, Right of First Opportunity and Participation Agreement

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

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars except unit amounts)

27 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.

Franchise agreements

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

	As a % of gross room revenue
To Super 8 Motels, Inc.	
Royalty fee	5%
Marketing assessment	3%
To Holiday Hospitality Franchising Inc. Group	
Royalty fee	5% - 6%
Marketing assessment	1.5% - 2%
Reservation assessment	1%
To Pomeroy Inn & Suites Inc.	
Royalty fee	5%
Marketing assessment	3%
To Best Western International, Inc.	
Annual dues	\$54

Operating leases

The Company has various equipment operating leases at several properties.

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

	Operating leases \$
Year ending December 31, 2013	187
2014	103
2015	75
2016	48
2017	16

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars except unit amounts)

27 Contingencies and commitments (continued)

Lease revenue

The Company is committed to leasing space in some of its hotels to outside parties. The minimum annual revenue from future rentals, is expected to be as follows:

	\$
Year ending December 31, 2013	443
2014	314
2015	290
2016	168
2017	139

28 Related party transactions

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

PHSI and Winport Developments Inc. were considered related parties, until December 31, 2011, the resignation date of Glenn Squires, Holloway's former CEO.

	December 31, 2012 \$	December 31, 2011 \$
PHSI, a company in which a former member of management has a significant ownership interest		
Hotel management, accounting and related fees	—	2,352
Head office rent and office operating expenses	—	126
Reimbursable expenses related to hotels managed under reduced fee	—	448
Reservation services commissions paid to Intergy, a division of PHSI	—	318
Interest income on loan receivable	—	62
Capital purchasing fees and project management fees capitalized to property and equipment	—	95
Included in accounts payable and accrued liabilities	—	214
Winport Developments Inc., a company in which a former member of management has a significant ownership interest		
Interest income on loan	—	17
Superior Lodging Corp., a company in which a director is a member of management and has an ownership interest		
Royalty fees	522	527
Included in accounts payable and accrued liabilities	32	37
Loan payable	291	—
Geosam Capital Inc., a company in which one director has a significant ownership interest		
Interest expense on loan	127	707
Waiver fee	—	100
Geosam Investments Limited, a company in which a direct relative of one director has a significant ownership interest		
Consulting fees	131	65
Included in accounts payable and accrued liabilities	108	39

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

29 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, 2012	December 31, 2011
	\$	\$
Revenues		
Canada	56,170	75,427
United States	2,203	1,965
	<hr/> 58,373	<hr/> 77,392
	December 31, 2012	December 31, 2011
	\$	\$
Property and equipment		
Canada	175,110	160,882
United States	5,854	6,295
	<hr/> 180,964	<hr/> 167,177

30 Financial instruments and fair values

Measurement categories, fair values, valuation methods and assumptions

As explained in note 3, financial assets and liabilities have been classified into categories that determine their basis of measurement and, for items measured at fair value, whether changes in fair value are recognized in the statement of income (loss) or comprehensive income (loss). 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, 2012 and 2011.

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

	December 31, 2012		December 31, 2011	
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$
Assets				
Loans and receivables				
Cash and cash equivalents	1,312	1,312	2,455	2,455
Restricted cash	253	253	249	249
Capital reserve – internally restricted	318	318	128	128
Capital reserve – restricted	3,976	3,976	3,662	3,662
Trade and other receivables	2,597	2,597	3,974	3,974
Loan receivable	4,879	3,749	4,938	2,256
	13,335	12,205	15,406	12,724
Available-for-sale				
Minority interest investments in hotel properties	861	861	850	850
Liabilities				
Amortized cost				
Line of credit	1,523	1,523	4,822	4,822
Trade payables and accrued liabilities	5,571	5,571	8,545	8,545
Accrued interest on convertible debentures	–	–	1,516	1,516
Mortgages payable	111,683	106,231	139,053	134,797
Loan payable to related party				
Convertible debentures	–	–	46,134	21,930
Obligations under finance leases	10	10	90	90
Loans due to related parties	291	291	14,768	14,768
	119,078	113,626	214,928	186,468
Fair value through profit and loss				
Derivative liability	32	32	10	10
Class B LP units	–	–	9	9
	32	32	19	19

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

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

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

- **Minority interest investments in hotel properties:** The fair value is determined using internal valuation techniques. The Company uses an earnings approach based on the hotel's recent operating performance to determine the value of the investment and deducts the outstanding debt on the hotel property.
- **Mortgages payable, obligations under finance leases and loan due to a related party:** The fair value is determined using internal valuation techniques which incorporate the discounted future cash flows using discount rates that reflect current market conditions for debt instruments with similar interest rates, terms and risk. The fair values do not necessarily represent the amounts the Company might pay in actual market transactions.
- **Convertible debentures:** The fair value was determined based on the closing trading price on the TSX at December 31, 2011.
- **Derivative liability:** The fair value of the conversion option on convertible debentures and warrants is determined using the Black-Scholes option pricing model.
- **Class B LP units:** The fair value was determined based on the closing trading price of the Company's units on the TSX at December 31, 2011, as the Class B LP units were convertible into units.

Fair value hierarchy

The following table classifies financial assets and liabilities that are recognized on 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).

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

Fair value hierarchy (continued)

	December 31, 2012 \$	December 31, 2011 \$
Level 1		
Class B LP units	–	9
Level 2		
Derivative liability	32	10
Level 3		
Minority interest investments in hotel properties	861	850

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 Company has one mortgage with a principal amount of \$6,523 at December 31, 2012 maturing in the next 12 months. The weighted average interest rate on its mortgages payable is 6.63% (December 31, 2011 - 6.68%) with a weighted average maturity of 4.2 years (December 31, 2011 - 4.9 years).

The Company has one mortgage at a floating rate equivalent to the 90 day bankers' acceptance rate plus 501 basis points. The Company's line of credit is at a floating rate. For the year ended December 31, 2012, a 1% change in interest rates would change the net income by \$12 (December 31, 2011 - \$41).

b) Credit risk

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

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

Risk management (continued)

b) Credit risk (continued)

The amount of trade and other receivables disclosed on the balance sheet of \$2,597 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. PHSI is responsible for assessing the creditworthiness of customers requesting credit, prior to submission to Holloway for approval. Listings of trade receivables are reviewed by PHSI and Holloway personnel and discussed with hotel operation personnel on a monthly basis.

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

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

	December 31, 2012	December 31, 2011
	\$	\$
Trade and other receivables under 30 days aged	1,840	854
Trade and other receivables over 30 days aged	859	3,286
Less: Allowance for doubtful accounts	(102)	(166)
	<u>2,597</u>	<u>3,974</u>

The Company is exposed to credit risk on its loan receivable (note 10).

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 fluctuations as a result of foreign exchange rate variations. 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 \$17 (year ended December 31, 2011 - \$18).

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

Risk management (continued)

d) Liquidity risk

The Company's objective is to have sufficient liquidity to meet liabilities when due, as well as to maintain compliance with 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 one mortgage with a principal amount of \$6,523 at December 31, 2012, maturing in the next 12 months. The Company expects to refinance its maturing mortgage at similar or better terms with the existing or another lender.

The Company monitors and forecasts its cash balances and cash flows generated from operations to meet its required obligations. At December 31, 2012, the Company had drawn \$1,523 (December 31, 2011 - \$4,822) from its available line of credit of \$5,000.

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

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

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

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

Risk management (continued)

d) Liquidity risk (continued)

	December 31, 2011			
	Less than 3 months	3 months to 1 year	2 to 5 years	Over 5 years
Line of credit	4,822	–	–	–
Trade payables and accrued liabilities	8,545	–	–	–
Accrued interest on convertible debentures	1,516	–	–	–
Mortgages payable	842	13,501	26,589	75,528
Convertible debentures	46,134	–	–	–
Obligations under finance leases	20	60	10	–
Mortgages on assets held-for-sale	23,156	–	–	–
Loan due to a related party	–	–	14,768	–

31 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 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 and/or issue or redeem shares or sell assets to reduce debt.

Holloway Lodging Corporation
Notes to the Consolidated Financial Statements
For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

31 Capital management (continued)

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

- a debt to gross book value (“Debt to GBV”) ratio defined as line of credit, mortgages payable, loans due to related parties, obligations under finance leases, the face value of convertible debentures, derivative liability and Class B LP units (“Debt”) divided by total assets plus accumulated impairments, depreciation and amortization (“GBV”). The Company’s by-laws state that the Company’s Debt to GBV should not exceed 60%; and
- a debt service coverage ratio defined as earnings before interest, income taxes, depreciation, amortization, non-cash accretion, fair value adjustments for Class B LP units and derivative liability, gains or losses on the repurchase of convertible debentures and share/unit-based compensation (“earnings base”) to the sum of the annual principal and interest payments on mortgages, debentures, loans due to related parties, promissory notes and finance leases (“debt service”).

	December 31, 2012 \$	December 31, 2011 \$
Capital structure		
Line of credit	1,523	4,822
Derivative liability	32	10
Class B LP units	–	9
Obligations under finance leases	10	90
Mortgages payable	111,683	115,897
Mortgages on assets held-for-sale	–	23,156
Loans due to related parties	291	14,768
Convertible debentures	–	46,134
Total debt	113,539	204,886
Equity	85,511	20,282
Total capital	199,050	225,168
Ratios		
Total debt	113,539	204,886
Adjustment of convertible debentures to face value	–	526
Debt	113,539	205,412
Gross book value	328,121	382,599
Debt to GBV	34.6%	53.7%
For the years ended		
	December 31, 2012 \$	December 31, 2011 \$
Earnings base	17,343	20,269
Debt service	11,884	20,625
Debt service coverage ratio	1.46	0.98

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars)

31 Capital management (continued)

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

At December 31, 2012, the mortgage on the Holiday Inn Express in Stellarton, NS was in violation of its covenants. This mortgage matures within the next twelve months and is included in current liabilities. The carrying amount of this mortgage is \$6,523 (December 31, 2011 - \$nil).

As a result of a discussion with the lender and receipt of a waiver on the covenant breach subsequent to December 31, 2012, management believes the mortgages will not be called prior to maturity.

At December 31, 2011 covenants on certain mortgages were in violation. These mortgages all matured in 2011 and were included in current liabilities at December 31, 2011. The carrying amount of the mortgages was \$11,259.