



Management's Discussion and Analysis  
for the Three Months and Year Ended December 31, 2014

As at March 11, 2015

## Introduction and Forward-Looking Statements

The following management's discussion and analysis ("MD&A") is a discussion of the results of operations and financial condition of Holloway Lodging Corporation ("Holloway" or the "Company") for the three months and year ended December 31, 2014, and should be read in conjunction with the audited consolidated financial statements of the Company and the notes thereto as at and for the year ended December 31, 2014. The financial statements of the Company are prepared in accordance with International Financial Reporting Standards ("IFRS") and are presented in thousands of Canadian dollars, except for share and per share amounts, unless otherwise noted. This MD&A is dated as at March 11, 2015.

This MD&A sets out management's assessment of Holloway's future plans and operations and contains forward-looking statements as defined under applicable Canadian securities legislation. These forward-looking statements often contain words such as "anticipate", "does not anticipate", "believe", "estimate", "forecast", "intend", "expect", "does not expect", "could", "may", "will", "should", "plan" or other similar terms and contain estimates or assumptions about the outcome of future events. These forward-looking statements are provided in the interest of providing readers with information regarding Holloway. Readers are cautioned that management's expectations, estimates and assumptions, although considered reasonable, may prove to be incorrect and readers should not place undue reliance on forward-looking statements which are subject to risks, uncertainties, and other factors that could result in the outcome of these events being materially different from those anticipated in this MD&A. These factors and assumptions include, but are not limited to: general economic conditions, levels of travel in Holloway's key market areas, political conditions and events, competitive pressures, changes in government policy or regulations and lodging industry conditions. Holloway's actual results may differ materially from those expressed in, or implied by these forward-looking statements. The forward-looking information contained in this MD&A is expressly qualified by this cautionary statement. Holloway does not undertake any obligation to update or release any revisions to these forward-looking statements to reflect events or circumstances, unanticipated events or circumstances, or should its estimates or assumptions change, after the date hereof, except as expressly required by law. Additional information relating to Holloway and the risks to which its business is subject is contained in its Annual Information Form, which is available on SEDAR at [www.sedar.com](http://www.sedar.com).

## Business Overview

Holloway owns and operates hotels across Canada and the United States and holds the master franchise rights for the Travelodge® and Thriftlodge® hotel brands in Canada.

**Hotels:** At December 31, 2014, Holloway's portfolio consists of 36 hotels with 4,260 rooms. Subsequent to December 31, 2014, Holloway sold the Ramada® in Trenton, ON and the Travelodge® in Etobicoke, ON and acquired the Ramada® in Whitehorse, YT which is being rebranded as a Days Inn®. At the date of this MD&A, Holloway's portfolio consists of 35 hotels with 3,967 rooms of which 25 hotels are limited service properties and 10 hotels are full service properties. Of the Company's 35 hotels, 31 are operated under internationally recognized hotel brands. Effective January 30, 2015, the Company internalized all of its hotel management.

**Franchise Business:** Holloway holds the master franchise rights for the Travelodge® and Thriftlodge® hotel brands in Canada. There are currently 89 Travelodge® and Thriftlodge® branded hotels in our franchise network.

**Other Assets:** Holloway currently owns three freestanding single tenant properties leased to nationally recognized restaurant chains and eight land parcels that are being held for future development.

## Fourth Quarter Overview and Outlook

Holloway had an excellent fourth quarter and a record 2014. Holloway's base hotel portfolio performed above our expectations. We successfully acquired Royal Host Inc. ("Royal Host") during the third quarter and made material progress integrating its hotels into our operation during the fourth quarter.

The large increases in revenue and operating income during the fourth quarter were driven by the addition of the Royal Host hotels. While operating margins for the Company as a whole declined by 480 basis points in the fourth quarter, this represents an improvement over third quarter operating margins as we continue to apply our operating program to our newly acquired hotels. We expect many of the Royal Host properties will have moderately lower margins than our base portfolio as many of such hotels have large food and beverage operations, which generally carry lower margins. Nonetheless, we expect the Royal Host properties will provide Holloway with attractive returns.

The base portfolio realized an 8.4% increase in revenue, a 20.3% increase in operating income and a 380 basis point increase in operating income margin, in all cases largely due to higher room rates in Western Canada. The newly acquired Royal Host hotels contributed \$31.9 million in revenue, \$7.4 million in operating income and had operating margins of 23%. Included at the end of this MD&A is additional information for the base portfolio of hotels as well as the newly acquired hotels.

	Three Months Ended December 31			Years Ended December 31		
	2014	2013	Variance	2014	2013	Variance
Revenue	\$ 31,715	\$ 14,338	121.2%	\$ 97,537	\$ 59,957	62.7%
Operating income <sup>(1)</sup>	9,269	4,880	89.9%	33,219	21,510	54.4%
Operating income margin	29.2%	34.0%	(4.8 ppt)	34.1%	35.9%	(1.8 ppt)
Net income	11,487	2,862	301.4%	27,333	4,470	511.5%
per basic and diluted share	0.59	0.16	268.8%	1.46	0.25	484.0%
Funds from operations	3,171	2,729	16.2%	16,462	11,606	41.8%
per basic and diluted share	0.16	0.15	6.7%	0.88	0.64	37.5%
Adjusted funds from operations	2,406	2,445	(1.6%)	14,316	10,483	36.6%
per basic and diluted share	0.12	0.14	(14.3%)	0.77	0.58	32.8%
Dividends declared per share	0.035	0.035	-	0.14	0.14	-

(1) Before depreciation and amortization.

During the fourth quarter, substantial progress was achieved integrating Royal Host and Holloway and the financial and administrative integration was largely completed by year-end. We have adjusted our middle management and sales team staffing levels and streamlined our purchasing, capital expenditure and reporting processes. We are beginning to see economies of scale as a result of consolidating several larger suppliers, insurance policies and benefit plans. Subsequent to year end, Holloway internalized the management of the hotels previously managed by a third party, which is expected to result in further annual savings. Management expects the performance of the Royal Host properties to continue to improve in 2015 due to, among other things, labour productivity improvements, energy efficiency upgrades, the implementation of rate management programs and targeted capital investments.

We completed the upgrade of our Super 8<sup>®</sup> in Timmins, ON in December 2014 and the results have been positive to date with ADR increasing approximately 30% on stable occupancy. We opened a new Starbucks<sup>®</sup> location in our Hilton<sup>®</sup> in London, ON in January 2015 and our upgrade of the hotel itself is ongoing. We are presently planning a major upgrade and rebranding of our Chimo<sup>®</sup> hotel in Ottawa, ON, which we anticipate starting in the second half of 2015.

Holloway's balance sheet continues to get stronger. Holloway had a total of \$261.5 million of debt immediately following its acquisition of Royal Host; at year end the Company's debt stood at \$250.8 million and today, the Company's debt stands at \$243.1 million. That represents a 7% reduction in debt while the Company's cash flow continues to increase. We expect debt levels to come down further throughout 2015.

Looking forward to 2015, there is considerable uncertainty regarding energy prices and the implications on the Alberta economy. So far in 2015, our Western Canadian hotels have continued to perform well. Several markets have seen revenue declines, such as Whitecourt, AB which has been impacted by unseasonably warm weather that has led to road bans in the area. Other markets, including Grande Prairie, AB and High Level, AB, have performed very strongly. We will not speculate as to how energy markets will perform later in 2015 or which specific markets will be affected. Instead, we will continue to manage our hotels as efficiently as possible.

Outside of Alberta and British Columbia, we expect continued positive performance from our hotels. The weaker Canadian dollar is expected to have a positive impact on the business environment in Southwestern Ontario where we have several hotels and also on leisure markets, including our Maritime hotels and our hotels in Whitehorse, YT and Yellowknife, NT.

We are pleased to have completed the acquisition of Royal Host when we did, as it further diversified our revenue and NOI base outside of oil and gas markets. We will continue to seek hotel acquisitions that are accretive to Holloway on a cash flow and NAV basis.

## **Dividend Declaration**

On March 11, 2015, the Board of Directors declared a quarterly dividend of \$0.035 per share, representing an annual dividend of \$0.14 per share. The dividend is payable on April 15, 2015 to shareholders of record on March 31, 2015.

## Operating Results

The following discussion summarizes Holloway's performance for the three months and year ended December 31, 2014.

### Hotel Performance

	Three Months Ended December 31			Years Ended December 31		
	2014	2013	Variance	2014	2013	Variance
Hotel revenue	\$ 31,206	\$ 14,338	117.6%	\$ 96,265	\$ 59,957	60.6%
Hotel operating income <sup>(1)</sup>	8,950	4,880	83.4%	32,296	21,510	50.1%
Hotel operating income margin	28.7%	34.0%	(5.3 ppt)	33.5%	35.9%	(2.4 ppt)
Hotel operating income per available room <sup>(1)</sup>	\$ 22.91	\$ 29.53	(22.4%)	\$ 29.33	\$ 32.83	(10.7%)

(1) Before depreciation and amortization.

The increases in hotel revenue and hotel operating income are primarily due to the acquisition of Royal Host, which accounted for 90% of the hotel revenue change and 84% of the operating income change. Rooms sold increased 108% compared to the prior year period.

Increases in food and beverage and other revenue are due to the acquisition of Royal Host as the expanded portfolio includes additional full service hotels and hotels with space leased to tenants. Full service hotels generally have lower operating margins than limited service hotels due to restaurant operations resulting in a lower operating income margin for the total portfolio. The Super 8® hotel in Timmins, ON was closed for renovations for most of the quarter and resumed operations in mid-December 2014.

	Three Months Ended December 31			Years Ended December 31		
	2014	2013	Variance	2014	2013	Variance
<b>Occupancy</b>						
Atlantic Canada	52.0%	53.1%	(1.1 ppt)	61.8%	60.4%	1.4 ppt
Western Canada	68.6%	69.0%	(0.4 ppt)	71.5%	71.3%	0.2 ppt
Ontario	50.7%	-	50.7 ppt	58.9%	-	58.9 ppt
United States	47.4%	53.0%	(5.6 ppt)	64.4%	65.6%	(1.2 ppt)
Total	56.8%	64.5%	(7.7 ppt)	65.2%	68.5%	(3.3 ppt)
<b>ADR</b>						
Atlantic Canada	\$ 102.05	\$ 101.04	\$ 1.01	\$ 107.62	\$ 106.91	\$ 0.71
Western Canada	142.23	131.78	10.45	137.80	131.32	6.48
Ontario	98.56	-	98.56	97.31	-	97.31
United States (in USD)	67.74	64.47	3.27	88.81	87.46	1.35
Total	\$ 116.15	\$ 122.91	\$ (6.76)	\$ 118.81	\$ 124.12	\$ (5.31)
<b>RevPAR</b>						
Atlantic Canada	\$ 53.07	\$ 53.65	\$ (0.58)	\$ 66.51	\$ 64.57	\$ 1.94
Western Canada	97.57	90.93	6.64	98.53	93.63	4.90
Ontario	49.97	-	49.97	57.32	-	57.32
United States (in USD)	32.11	34.17	(2.06)	57.19	57.37	(0.18)
Total	\$ 65.97	\$ 79.28	\$ (13.31)	\$ 77.46	\$ 85.02	\$ (7.56)

As most of the Royal Host hotels are located in Ontario, this region accounted for the largest variances compared to the prior year. The strength of the Western Region was driven by strong demand from the oil and gas sector and from infrastructure projects. There was an occupancy decline in Myrtle Beach as a result of a reduction in contracted leisure business. Although a portion of this business was replaced with higher rated corporate clients, that amount was insufficient to prevent a RevPAR decline.

## Franchise Business Performance

	Three Months Ended December 31			Years Ended December 31		
	2014	2013	Variance	2014	2013	Variance
Franchise revenue	\$ 509	\$ -	\$ 509	\$ 1,272	\$ -	\$ 1,272
Franchise operating income <sup>(1)</sup>	319	-	319	923	-	923
Franchise operating income margin	62.7%	-	62.7 ppt	72.6%	-	72.6 ppt
Properties in the franchise network	90	-	90	90	-	90

(1) Before depreciation and amortization.

In the three months and year ended December 31, 2014, the franchise business contributed \$319 thousand and \$923 thousand to operating income. We continue to focus our efforts on adding new franchises to our network, particularly in Eastern and Atlantic Canada.

## Other Expenses

	Three Months Ended December 31			Years Ended December 31		
	2014	2013	Variance	2014	2013	Variance
Interest and accretion on debt	\$ 4,215	\$ 1,815	\$ 2,400	\$ 12,174	\$ 7,546	\$ 4,628
Corporate and administrative	852	364	488	2,657	2,260	397
Acquisition and integration costs	(129)	-	(129)	816	-	816
Share-based compensation	193	75	118	418	378	40
Provision for settlement of management contract and loan receivable	5,828	-	5,828	5,828	-	5,828
Investment income	(33)	(114)	81	(308)	(360)	52
Reversal of impairment of hotel properties, net	(9,040)	(3,450)	(5,590)	(10,258)	(3,450)	(6,808)
Gain on disposal of property and equipment, minority interest investments in hotel properties and repurchase of convertible debentures	-	(14)	14	(114)	(114)	-
Fair value adjustment and amounts reclassified to profit and loss on minority interest investments in hotel properties	-	-	-	(689)	-	(689)
Provision for (recovery of) income taxes	(8,164)	1,113	(9,277)	(17,288)	1,787	(19,075)

In general, other expenses have increased as a result of the acquisition of Royal Host. Corporate and administrative expenses are expected to be lower on an annualized basis in the future due to the realization of synergies, including the elimination of duplicative public company and other costs.

The Company incurred acquisition and integration costs of \$816 thousand in 2014. These costs include legal fees, incremental audit fees related to acquisition accounting and transfer fees related to certain Royal Host assets. We expect minimal additional acquisition related expenses going forward.

In the fourth quarter, the Company recorded a reversal of previously recorded impairments on three hotel properties of \$9.0 million. During the fourth quarter of 2013, the Company recorded a reversal of previously recorded impairments on four hotel properties of \$4.5 million and recorded an impairment of \$1.0 million on one hotel property. The Company also reversed an impairment of \$40 thousand on the sale of a parcel of land at the Holiday Inn® in Grande Prairie, AB.

In the fourth quarter, the Company recorded a provision for settlement of management contract and loan receivable of \$5.8 million relating to the forgiveness of the loan receivable and termination of all management agreements with Pacrim Hospitality Services Inc. ("PHSI").

During 2014, the Company recognized an income tax recovery of \$17.3 million as it expects there will be sufficient taxable income in the foreseeable future to allow the Company to recognize the full amount of its deferred tax assets of \$21.8 million.

## Quarterly Results

	Q4 2014	Q3 2014	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Total revenue	\$ 31,748	\$ 36,201	\$ 14,485	\$ 15,411	\$ 14,451	\$ 16,722	\$ 14,385	\$ 14,758
Operating income <sup>(1)</sup>	9,269	13,237	5,179	5,534	4,880	6,610	4,887	5,135
Net income	11,487	13,680	606	1,559	2,862	1,251	64	294
Funds from operations	3,171	7,508	2,353	3,230	2,729	4,007	2,223	2,648
Adjusted funds from operations	2,406	6,943	2,060	2,903	2,445	3,731	1,949	2,360
Dividends declared	678	678	627	628	628	628	628	652
Per share:								
Net income	\$ 0.59	\$ 0.70	\$ 0.03	\$ 0.09	\$ 0.16	\$ 0.07	\$ -	\$ 0.02
Funds from operations	0.16	0.39	0.13	0.18	0.15	0.15	0.12	0.14
Adjusted funds from operations	0.12	0.36	0.11	0.16	0.14	0.14	0.11	0.13
Dividends declared	0.035	0.035	0.035	0.035	0.035	0.035	0.035	0.035
Occupancy	57%	72%	66%	69%	65%	65%	66%	68%
ADR	\$116.15	\$112.76	\$128.72	\$127.99	\$122.91	\$122.91	\$122.73	\$125.22
RevPAR	\$65.97	\$81.19	\$84.92	\$87.93	\$79.28	\$95.05	\$81.16	\$84.77

(1) Before depreciation and amortization.

The hospitality industry is seasonal in nature and, therefore, the Company's results fluctuate throughout the year. The Company's revenues are generally highest in the third quarter due to increased leisure travel in the summer months. The Company's revenues in the other three quarters are comparable to each other. While certain expenses fluctuate according to occupancy levels, other expenses such as property taxes, insurance and interest are fixed and are incurred evenly throughout the year.

## Cash Flow

	Three Months Ended December 31			Years Ended December 31		
	2014	2013	Variance	2014	2013	Variance
Cash flow provided by / (used in):						
Operating activities	\$ 5,954	\$ 3,165	\$ 2,789	\$ 19,884	\$ 11,908	\$ 7,976
Investing activities	(1,984)	(425)	(1,559)	(22,463)	(2,221)	(20,242)
Financing activities	(2,946)	(2,286)	(660)	5,200	(10,147)	15,347

### Operating Activities

For the three months and year ended December 31, 2014, operating activities generated \$6.0 million and \$19.9 million compared to the same periods in the prior year of \$3.2 million and \$11.9 million. This increase was a result of higher revenues and tight cost controls.

### Investing Activities

For the three months and year ended December 31, 2014, investing activities used \$2.0 million and \$22.5 million compared to the same periods in the prior year of \$425 thousand and \$2.2 million. Among other activities in 2014, the Company sold the Holiday Inn Express® in Kamloops, BC for \$8.9 million, acquired the Days Inn® in Whitecourt, AB for \$8.9 million, used \$16.4 million in cash for the acquisition of Royal Host, acquired a controlling interest in the Super 8® in St. John's, NL for \$2.1 million and made additions and capital improvements at its properties of approximately \$5.5 million during the year.

## Financing Activities

For the three months and year ended December 31, 2014, financing activities used \$2.9 million and generated \$5.2 million compared to the same periods in the prior year that used \$2.3 million and \$10.1 million. This increase in cash was primarily due to the borrowing of \$16.0 million during the second quarter to finance a portion of the Royal Host acquisition, offset in part by the reduction of the secured credit facilities. For the year ended December 31, 2013, the use of cash consisted of common share repurchases, repayments of mortgages and dividends paid to shareholders.

## Liquidity and Capital Structure

The Company uses various forms of debt in the course of its business. The objectives of the Company's debt strategy are to ensure adequate liquidity to fund its business plan and to permit opportunistic acquisitions, minimize its cost of financing and stagger its debt maturities to manage refinancing risks.

The Company's principal sources of liquidity are cash-on-hand, cash deposited in capital expenditure reserve accounts, free cash flow generated throughout the year and its secured credit facilities. In addition, the Company currently has six unencumbered properties which can be mortgaged should circumstances warrant and the terms of the Company's convertible debentures permit the payment of interest and the repayment of principal through the issuance of common shares in lieu of cash.

	December 31, 2014
Cash on hand	\$ 3,473
Capital expenditure reserves <sup>(1)</sup>	2,304
Secured credit facilities availability <sup>(2)</sup>	18,271
<b>Total current liquidity<sup>(3)</sup></b>	<b>\$ 24,048</b>

(1) Contingent on capital expenditures being incurred.

(2) Includes outstanding letters of credit.

(3) Excludes proceeds from financing unencumbered assets.

## Secured Credit Facilities and Mortgages and Loan Payable

	December 31, 2014	December 31, 2013
<b>Secured Credit Facilities</b>		
Principal amount payable	\$ 27,007	\$ 1,004
Weighted average term to maturity	1.2 years	On demand
Weighted average interest rate	6.11%	5.00%
<b>Mortgages and Loan Payable</b>		
Principal amount payable	\$ 136,211	\$ 108,043
Weighted average term to maturity	3.2 years	3.8 years
Weighted average interest rate	6.21%	6.52%

## Chartered Bank Credit Facility

At December 31, 2014, Holloway had a revolving credit facility with a Canadian chartered bank with a maximum borrowing capacity of \$25.0 million. The credit facility is used to manage working capital fluctuations and the seasonal effects of the hospitality industry as well as provide short-term financing in the event of a hotel acquisition or hotel renovation. The credit facility is secured by a registered charge on seven hotels and is currently over-collateralized based on the terms of the credit facility. The interest rate under the credit facility is based on the bank's prime rate plus 1.50%.

At December 31, 2014, Holloway had \$6.0 million drawn under this credit facility with an interest rate of 4.50%. The revolving facility matures on December 31, 2015 and the Company expects to renew the facility with similar terms.



### Clarke Inc. Credit Facilities

At December 31, 2014, Holloway had \$16.0 million drawn under its secured credit facility with Clarke Inc. (“Clarke”), which was used to partially fund the Royal Host acquisition. This credit facility was secured by one hotel property, a corporate general security agreement and an assignment of the equity interests of certain subsidiaries. This facility bears interest at 6.50% and does not require any principal repayments until its maturity in March 2016.

The Company had a second secured credit facility with Clarke with a balance of \$3.0 million. This credit facility was secured by one hotel property. This credit facility bore interest at 7.00% and did not require any principal repayments until its maturity in December 2015. The maximum capacity under this credit facility was \$6.0 million and the Company had the ability to draw up to an additional \$3.0 million on this facility in one additional draw. At the date hereof, this facility has been repaid in full.

### Clarke Inc. Master Trust Credit Facility

The Company had a loan with Clarke Inc. Master Trust (the “Clarke Pension Plan”) with a balance and maximum capacity of \$2.0 million. This loan had a maturity date of June 2016 and bore interest at 6.50%. This credit facility was secured two hotel properties. At the date hereof, this facility has been repaid in full.

### **Mortgages and Loan Payable**

The Company has incurred debt under twenty mortgages and one promissory note with a weighted average interest rate of 6.21%. These various debt instruments mature between April 2016 and July 2029. The mortgages are secured with individual first charges on twenty-one hotel properties.

During the fourth quarter, the Company refinanced two mortgages. One mortgage was extended with the same lender from April 2017 to November 2018 with a new blended interest rate of 5.54% compared to 5.99%. The second mortgage was obtained from a new lender and the term was extended from December 2015 to October 2019 with a new interest rate of 4.85% compared to 6.45%.

Subsequent to year end, the Company refinanced a third mortgage with the same lender, extending the maturity date from July 2016 to February 2020 and reducing the interest rate from 6.00% to 4.25%. These refinancings are part of the Company’s strategy to extend its maturity profile and take advantage of the current low interest rate environment.

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

### **Convertible Debentures**

At December 31, 2014, the Company had two series of convertible debentures outstanding. Effective October 31, 2014, the Company consolidated its Series B and Series D convertible debentures into a single series of convertible debentures (known as the Series B convertible debentures and trading under the symbol “HLC.DB”). The combined series of convertible debentures have an aggregate principal amount outstanding of \$52.6 million, bear interest at 6.25%, have interest payment dates of April 30 and October 31 and mature on February 28, 2020. The Series C convertible debentures (trading under the symbol “HLC.DB.A”) have an aggregate principal amount outstanding of \$40.6 million, bear interest at 7.50%, have interest payment dates of March 31 and September 30 and mature on September 30, 2018.

Subject to availability, the Company intends to continue using convertible debentures as a financing source due to the flexible nature of such debt instruments, particularly as the current convertible debentures have no financial covenants and minimal other covenants. In addition, because the convertible debentures are exchange-traded, from time to time the Company has the opportunity to repurchase its debentures at a discount to their face value.

The following table shows the Company's convertible debentures at December 31, 2014:

	Maturity	Interest Rate	December 31, 2014	December 31, 2013
Series B (HLC.DB)	2020	6.25%	\$ 52,621	\$ -
Series C (HLC.DB.A)	2018	7.50%	40,601	-
			\$ 93,222	\$ -
Weighted average term to maturity			4.6 years	-
Weighted average interest rate			6.79%	-

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

On January 13, 2014, Royal Host initiated normal course issuer bids (each, a "NCIB") to repurchase a maximum of \$2.0 million principal amount of the Series B convertible debentures, \$3.4 million principal amount of the Series C convertible debentures and \$2.2 million principal amount of the Series D convertible debentures. At December 31, 2014, Holloway had repurchased \$31 thousand face value of Series B Debentures and \$60 thousand face value of Series C Debentures at a cost of \$86 thousand (average cost of \$94.46 per \$100 face value).

On January 13, 2015, the Company initiated a NCIB to repurchase a maximum of \$4.1 million principal amount of its Series B convertible debentures and \$3.4 million principal amount of its Series C convertible debentures. These NCIBs will be in effect until January 12, 2016 unless terminated earlier by the Company. At the date hereof, Holloway had repurchased \$9 thousand face value of Series B Debentures at a cost of \$8 thousand (average cost of \$89.82 per \$100 face value) and did not repurchase any Series C Debentures.

### Leverage

The Company assesses its leverage in the context of its ability to generate net operating income to service its debt. As a result of the Royal Host acquisition, the Company's leverage has increased since December 31, 2013. The Company anticipates reducing its leverage towards pre-acquisition levels through select sales of non-core assets, the application of cash from operations to debt repayment and by increasing net operating income.

Debt to gross book value is a financial metric historically used by real estate investment trusts. The Company's debt to gross book value is shown below:

	Year Ended December 31, 2014	Year Ended December 31, 2013
Net debt to net operating income	7.4x	5.0x
Debt to gross book value excluding convertible debentures	32.0%	33.1%
Debt to gross book value including convertible debentures	49.3%	33.1%

## Contractual Obligations

The following table shows the Company's contractual obligations as at December 31, 2014:

	2015	2016	2017	2018	2019	Thereafter
Mortgages and loan payable						
Interest <sup>(1)</sup>	\$ 8,092	\$ 7,449	\$ 4,125	\$ 715	\$ 449	\$ 1,052
Principal <sup>(2)</sup>	6,248	14,942	94,073	10,728	5,080	5,140
Secured credit facilities						
Interest <sup>(1)</sup>	1,616	325	-	-	-	-
Principal <sup>(3)</sup>	9,007	18,000	-	-	-	-
Convertible debentures						
Interest	6,334	6,334	6,334	5,573	3,289	548
Principal <sup>(4)</sup>	-	-	-	40,601	-	52,621
Operating leases	699	309	265	97	39	-
Total	\$ 31,996	\$ 47,359	\$ 104,797	\$ 57,714	\$ 8,857	\$ 59,361

(1) Interest on floating rate debt is based on interest rates prevailing at December 31, 2014.

(2) Principal includes regular amortization and repayments at maturity.

(3) Subsequent to year end, a total of \$5,000 of secured credit facilities has been repaid.

(4) Principal represents face value of debentures at maturity.

## Commitments to Capital Spending

At the date of this MD&A, the Company has entered into franchise agreements for the rebranding of two of its properties and has committed to certain renovations in connection with such rebrandings. One of these rebrandings is expected to be completed in 2015 while the other rebranding is expected to be completed in late 2015 or early 2016.

## Common Shares

At December 31, 2014, the Company had 19,373,761 shares outstanding.

On August 13, 2014, the Company initiated a NCIB to repurchase up to 978,628 of its outstanding common shares. During the fourth quarter, no shares were repurchased under the Company's NCIB. At the date hereof, Holloway had repurchased and cancelled 23,700 shares at a cost of \$124 thousand (average price of \$5.25 per share).

## Dividends

The Company currently pays dividends on a quarterly basis at the discretion of the Company's Board of Directors, which reviews the Company's dividend policy on a regular basis. At the present time, the Board of Directors believes in paying a modest dividend to shareholders while allocating the majority of the Company's free cash flow to other uses that offer higher returns to shareholders and result in the compounding of shareholder capital over time. These alternative uses include acquisitions, upgrades and/or expansions of existing hotels, share repurchases and discounted convertible debenture repurchases and/or regular debt repayment.

The following table shows the Company's payout ratio based on various earnings metrics. The payout ratio for the year may not be indicative of the Company's run-rate payout ratio as it includes the results of the base portfolio of hotels for the full year and the results of the newly acquired hotels for only the six-month period.

	Three Months Ended December 31, 2014		Year Ended December 31, 2014	
Dividends declared	\$	678	\$	2,611
Net income		11,487		27,333
Payout ratio		5.9%		9.6%
Funds from operations		3,171		16,462
Payout ratio		21.4%		15.9%
Adjusted funds from operations		2,406		14,316
Payout ratio		28.2%		18.2%

## Other Information

### Same Store Results

The following tables summarize the performance of Holloway's base portfolio of hotels for the three months and year ended December 31, 2014 compared to the same period in the prior year, along with the performance of hotels acquired and/or sold during the same time periods. The base portfolio includes the 17 hotels owned by Holloway throughout all periods and acquired/sold hotels include the 17 Royal Host hotels, the Holiday Inn Express® in Kamloops, BC, the Days Inn® in Whitecourt, AB and the Super 8® in St. John's, NL which is now consolidated as Holloway owns 62% at December 31, 2014.

	Three Months Ended December 31						
	Base Portfolio			Acquired/Sold Hotels		Total	
	2014	2013	Variance	2014	2013	2014	2013
Hotel revenue	\$ 15,004	\$ 13,846	8.4%	\$ 16,202	\$ 492	\$ 31,206	\$ 14,338
Hotel operating income <sup>(1)</sup>	5,768	4,796	20.3%	3,182	84	8,950	4,880
Hotel operating income margin	38.4%	34.6%	3.8 ppt	19.6%	17.1%	28.7%	34.0%

(1) Before depreciation and amortization.

	Years Ended December 31						
	Base Portfolio			Acquired/Sold Hotels		Total	
	2014	2013	Variance	2014	2013	2014	2013
Hotel revenue	\$ 60,974	\$ 57,433	6.2%	\$ 35,291	\$ 2,524	\$ 96,265	\$ 59,957
Hotel operating income <sup>(1)</sup>	23,580	20,744	13.7%	8,716	766	32,296	21,510
Hotel operating income margin	38.7%	36.1%	2.6 ppt	24.7%	30.3%	33.5%	35.9%

(1) Before depreciation and amortization.

Base portfolio revenue for the year increased 6.2% while operating income increased 13.7%. The operating income increased to a greater extent than revenue due to strong room rate growth in Western Canada. The revenue increases are a result of higher room rates as opposed to higher occupancy and as a result generate better margins than occupancy-driven growth. The base portfolio achieved higher margins than the acquired hotels due to the higher rates achieved in Western Canada and the number of full service hotels in Ontario. Full service hotels generally have lower margins than limited service hotels.

Three Months Ended December 31

	Base Portfolio			Acquired/Sold Hotels		Total	
	2014	2013	Variance	2014	2013	2014	2013
<b>Occupancy</b>							
Atlantic Canada	53.8%	53.1%	0.7 ppt	50.0%	-	52.0%	53.1%
Western Canada	69.7%	69.0%	0.7 ppt	62.0%	56.7%	68.6%	69.0%
Ontario	-	-	-	50.7%	-	50.7%	-
United States	47.4%	53.0%	(5.6 ppt)	-	-	47.4%	53.0%
Total	64.6%	64.5%	0.1 ppt	51.5%	56.7%	56.8%	64.5%
<b>ADR</b>							
Atlantic Canada	\$ 105.34	\$ 101.04	\$ 4.30	\$ 98.10	\$ -	\$ 102.05	\$ 101.04
Western Canada	142.10	131.78	10.32	143.12	117.56	142.23	131.78
Ontario	-	-	-	98.56	-	98.56	-
United States (in USD)	67.74	64.47	3.27	-	-	67.74	64.47
Total	\$ 131.93	\$ 122.91	\$ 9.02	\$ 102.72	\$ 117.56	\$ 116.15	\$ 122.91
<b>RevPAR</b>							
Atlantic Canada	\$ 56.67	\$ 53.65	\$ 3.02	\$ 49.05	\$ -	\$ 53.07	\$ 53.65
Western Canada	99.04	90.93	8.11	88.73	66.66	97.57	90.93
Ontario	-	-	-	49.97	-	49.97	-
United States (in USD)	32.11	34.17	(2.06)	-	-	32.11	34.17
Total	\$ 85.23	\$ 79.28	\$ 5.95	\$ 52.90	\$ 66.66	\$ 65.97	\$ 79.28

Years Ended December 31

	Base Portfolio			Acquired/Sold Hotels		Total	
	2014	2013	Variance	2014	2013	2014	2013
<b>Occupancy</b>							
Atlantic Canada	60.4%	60.4%	-	64.8%	-	61.8%	60.4%
Western Canada	73.3%	71.3%	2.0 ppt	54.7%	71.0%	71.5%	71.3%
Ontario	-	-	-	58.9%	-	58.9%	-
United States	64.4%	65.6%	(1.2 ppt)	-	-	64.4%	65.6%
Total	69.7%	68.4%	1.3 ppt	59.3%	71.0%	65.2%	68.5%
<b>ADR</b>							
Atlantic Canada	\$ 109.68	\$ 106.91	\$ 2.77	\$ 103.39	\$ -	\$ 107.62	\$ 106.91
Western Canada	137.72	131.86	5.86	138.79	123.07	137.80	131.32
Ontario	-	-	-	97.31	-	97.31	-
United States (in USD)	88.81	87.46	1.35	-	-	88.81	87.46
Total	\$ 129.71	\$ 124.17	\$ 5.54	\$ 101.87	\$ 123.07	\$ 118.81	\$ 124.12
<b>RevPAR</b>							
Atlantic Canada	\$ 66.25	\$ 64.57	\$ 1.68	\$ 67.00	\$ -	\$ 66.51	\$ 64.57
Western Canada	100.95	94.02	6.93	75.92	87.38	98.53	93.63
Ontario	-	-	-	57.32	-	57.32	-
United States (in USD)	57.19	57.37	(0.18)	-	-	57.19	57.37
Total	\$ 90.41	\$ 84.93	\$ 5.48	\$ 60.41	\$ 87.38	\$ 77.46	\$ 85.02

Occupancy, ADR, and RevPAR for the base portfolio remains strong. The addition of hotels in Ontario represents an opportunity to further diversify the Company's portfolio. The Yellowknife Inn, a hotel acquired in the Western region in the above table, experienced business declines due to forest fires in the area resulting in reduced travel to Yellowknife.

## Selected Financial Information

The following table provides certain financial information for the past three years:

	2014	2013	2012
Total revenues	\$ 97,845	\$ 60,317	\$ 58,660
Net income	27,333	4,470	19,736
per basic and diluted share	1.46	0.25	1.11
Dividends paid per share	0.14	0.14	0.065
Total assets	\$ 382,456	\$ 199,408	\$ 204,621
Total long-term financial liabilities	241,986	107,906	112,016

## Balance Sheet

The following table outlines significant balances or changes in the consolidated balance sheet from December 31, 2013 to December 31, 2014. The increase in all balance sheet items is primarily a result of the acquisition of Royal Host in addition to items noted in the table.

	December 31, 2014	December 31, 2013	Increase (Decrease)	Explanation
<b>Assets</b>				
Cash	\$ 3,473	\$ 852	2,621	Refer to the "Cash Flow" section.
Trade and other receivables	5,697	2,394	3,303	The balance is primarily comprised of \$5,073 from billed customers and hotel guests at the end of the year, \$297 from credit card companies and \$327 in other receivables.
Prepaid expenses and deposits	2,258	1,820	438	Property tax reserve balances held by lenders increased.
Property and equipment	330,307	179,937	150,370	Due to the acquisition of Royal Host, the Days Inn® in Whitecourt, AB and acquiring a controlling interest in the Super 8® St. John's, NL and the reversal of impairment on three properties, offset by the sale of the Holiday Inn Express® in Kamloops, BC and depreciation.
Franchise business	14,700	-	14,700	Represents the Travelodge® and Thriftlodge® franchise business.
Deferred income tax assets	21,800	5,295	16,505	Due to the acquisition of Royal Host and planned reorganization of the Company, some previously unrecognized tax losses have been recognized resulting in an increase to the deferred income tax assets balance.
<b>Liabilities</b>				
Trade payables and accrued liabilities	12,210	5,091	7,119	Higher accrued payroll, vacation pay and property taxes due to the acquisition of Royal Host. In addition, the balance includes an accrual of \$1,000 for the termination payment of the management contract with PHSI and a deposit of \$750.
Accrued interest on convertible debentures	1,309	-	1,309	Interest accrued to the end of December 31, 2014.
Current portion of secured credit facilities	9,007	-	9,007	Refer to secured credit facilities in the "Liquidity and Capital Structure" section.
Current portion of mortgages and loan payable	6,248	4,261	1,987	Current portion of mortgages increased due to the inclusion of three mortgages related to acquired hotels.
Convertible debentures	88,061	-	88,061	Refer to convertible debentures in the "Liquidity and Capital Structure" section.
Secured credit facilities	18,000	-	18,000	Refer to secured credit facilities in the "Liquidity and Capital Structure" section.
Mortgages and loan payable	129,510	103,338	26,172	The acquisition of Royal Host, Days Inn® in Whitecourt, AB and Super 8® in St. John's, NL.
<b>Equity</b>				
Equity attributable to shareholders of the Company	115,913	85,385	30,528	Increase primarily represents comprehensive income, net of dividends paid, as well as the issuance of common shares on the acquisition of Royal Host.
Non-controlling interest	2,031	22	2,009	Increase represents non-controlling interest arising on consolidation of the Super 8® in St. John's, NL.

## Portfolio of Hotels

The following table details the hotels in which the Company had an interest at December 31, 2014. The Company had a majority ownership interest in 36 hotels (with 4,260 rooms) and had a minority ownership interest in two hotels (with 177 rooms).

Property	Location	No. of Rooms	Interest
<b>Alberta</b>			
Best Western®	Grande Prairie	100	100%
Days Inn®	Whitecourt	79	100%
Holiday Inn®	Grande Prairie	145	100%
Holloway Inn and Suites	Grande Prairie	152	100%
Super 8®	Drayton Valley	60	100%
Super 8®	Grande Prairie	149	100%
Super 8®	High Level	81	100%
Super 8®	Slave Lake	58	100%
Super 8®	Whitecourt	59	100%
Travelodge®	Slave Lake	99	100%
		<b>982</b>	
<b>British Columbia</b>			
Super 8®	Fort Nelson	142	100%
Super 8®	Fort St. John	101	100%
		<b>243</b>	
<b>New Brunswick</b>			
Holiday Inn Express® and Suites	Moncton	151	100%
Super 8®	Dieppe	85	6%
Travelodge® (Note 1)	Moncton	75	100%
Travelodge® (Note 1)	Saint John	59	100%
		<b>370</b>	
<b>Newfoundland and Labrador</b>			
Super 8®	St. John's	81	62%
<b>Northwest Territories</b>			
Super 8®	Yellowknife	66	100%
Yellowknife Inn (Note 1)	Yellowknife	129	100%
		<b>195</b>	
<b>Nova Scotia</b>			
Holiday Inn Express®	Stellarton	125	100%
Super 8®	Truro	50	100%
Super 8®	Windsor	66	100%
Travelodge® (Note 1)	Dartmouth	75	100%
Travelodge® (Note 1)	New Glasgow	64	100%
		<b>380</b>	
<b>Ontario</b>			
Airline (Note 1)	Thunder Bay	153	100%
Chimo (Note 1)	Ottawa	256	100%
Hilton® (Note 1)	London	323	100%
Holiday Inn® (Note 1)	Oakville	147	100%
Ramada® (Note 1)	Trenton	109	100%
Super 8® (Note 1)	Timmins	74	100%
Super 8® (Note 2)	Toronto	92	19%
Travelodge® (Note 1)	Barrie	130	100%
Travelodge® (Note 1)	Belleville	124	100%
Travelodge® (Note 1)	Etobicoke	283	100%
Travelodge® (Note 1)	Ottawa	196	100%
Travelodge® (Note 1)	Thunder Bay	93	100%
Travelodge® (Note 1)	Timmins	92	100%
		<b>2,072</b>	
<b>South Carolina – USA</b>			
Holiday Inn Express®	Myrtle Beach	114	100%
<b>Total Rooms</b>		<b>4,437</b>	

Note 1: This hotel was acquired during the year as a result of the Royal Host acquisition.

Note 2: The Company's economic interest in this property has been diluted to a nominal amount.



## Related Party Transactions

At December 31, 2014, Clarke owned or exercised control or direction over 7,874,815 common shares of Holloway, representing approximately 41% of the Company's issued and outstanding shares; accordingly, Clarke is considered a related party of Holloway. During the three months and year ended December 31, 2014, the Company incurred IT fees of \$45 thousand and \$83 thousand supplied by Clarke. As of December 31, 2014, \$1 thousand was owing in respect of these fees. The Company has borrowed money from Clarke pursuant to two secured credit facilities. During the three months and year ended December 31, 2014, the Company incurred interest under these facilities of \$316 thousand and \$642 thousand. As of December 31, 2014, accrued interest of \$276 thousand was owing.

The Clarke Pension Plan is considered a related party of Holloway due to its affiliation with Clarke. The Company has borrowed money from the Clarke Pension Plan pursuant to a secured credit facility and a mortgage. During the three months and year ended December 31, 2014, the Company incurred interest and fees under these facilities of \$79 thousand and \$157 thousand. As of December 31, 2014, accrued interest of \$42 thousand was owing. Subsequent to year end, Holloway repaid \$5.1 million of the secured credit facilities and mortgage owing to Clarke at December 31, 2014.

## Non-IFRS Financial Measures

### Funds from Operations ("FFO")

FFO is a common measure of performance for publicly-traded real estate companies. FFO assumes that the value of real estate investments does not necessarily decrease on a systematic basis over time, an assumption inherent in IFRS, and it adjusts for items included in net income that do not necessarily provide the best indicator of operating performance, such as gains or losses on the sale of assets, provisions for impairment (and impairment reversals) of assets and depreciation and amortization of real estate assets which may not necessarily occur and is based on historical cost accounting. The Real Property Association of Canada defines FFO as net income excluding depreciation and amortization on real property, extraordinary items, gains or losses on the sale of assets, provisions for impairment and deferred income taxes. The Company calculates FFO in accordance with this definition. Other entities may calculate FFO differently. FFO should not be considered a substitute for net income or cash flow from operating activities determined in accordance with IFRS. The Company believes the best metric of its performance is free cash flow.

	Three Months Ended December 31		Years Ended December 31	
	2014	2013	2014	2013
Net income	\$ 11,487	\$ 2,862	\$ 27,333	\$ 4,470
Add / (deduct):				
Depreciation and amortization of real estate assets	4,060	2,218	12,650	8,913
Provision for settlement of management contract and loan receivable (non-cash portion)	4,828	-	4,828	-
Reversal of impairment of hotel properties, net	(9,040)	(3,450)	(10,258)	(3,450)
Gain on disposal of property and equipment, minority interest investments in hotel properties and repurchase of convertible debentures	-	(14)	(114)	(114)
Fair value adjustment and amounts reclassified to profit and loss on minority interest investments in hotel properties	-	-	(689)	-
Provision for (recovery of) income taxes	(8,164)	1,113	(17,288)	1,787
FFO	\$ 3,171	\$ 2,729	\$ 16,462	\$ 11,606
per basic share	0.16	0.15	0.88	0.64

## Adjusted Funds from Operations (“AFFO”)

AFFO is another common measure of performance for publicly-traded real estate companies. AFFO is generally considered reflective of the Company’s ability to earn income and pay cash dividends to shareholders. The Company calculates AFFO as FFO adjusted for: share-based compensation, depreciation and amortization of corporate assets, accretion on debt, and reserve for replacement of FF&E. Other entities may calculate AFFO differently. AFFO should not be considered a substitute for net income or cash flow from operating activities determined in accordance with IFRS. The Company believes the best metric of its performance is free cash flow.

	Three Months Ended December 31		Years Ended December 31	
	2014	2013	2014	2013
FFO	\$ 3,171	\$ 2,729	\$ 16,462	\$ 11,606
Add / (deduct):				
Share-based compensation	193	75	418	378
Depreciation and amortization of corporate assets	21	37	82	123
Change in fair value of embedded derivative	(265)	-	(265)	-
Accretion on debt	242	42	552	207
FF&E reserve	(956)	(438)	(2,933)	(1,831)
AFFO	\$ 2,406	\$ 2,445	\$ 14,316	\$ 10,483
per basic share	0.12	0.14	0.77	0.58

## Other Non-IFRS Metrics

Throughout this MD&A, the Company refers to the following metrics that do not have a standardized meaning under IFRS but that are commonly used by hospitality companies.

**Occupancy:** Occupancy represents the number of rooms sold in a hotel compared to the total number of rooms available for sale in the hotel.

**Average daily rate or “ADR”:** ADR is defined as room revenue divided by the number of rooms occupied or sold.

**Revenue per available room or “RevPAR”:** RevPAR is defined as total room revenue divided by the total number of rooms in the hotel multiplied by the number of days in the period. RevPAR is the most commonly used indicator of market performance for hotels and represents the combination of the ADR and the average occupancy rate achieved during a period. RevPAR does not include food and beverage or other ancillary revenues generated by a hotel.

**Hotel operating income before depreciation:** Hotel operating income before depreciation is defined as hotel revenue less hotel expenses. Hotel operating income measures hotel results before interest, depreciation and amortization.

## Legal Proceedings

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

## Changes in Accounting Policies

The following standard has been adopted by the Company for the financial year which began on January 1, 2014:

### **IFRIC 21, Levies**

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

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning on or after January 1, 2015, and have not been applied in preparing the December 31, 2014 consolidated financial statements. None of these new standards and amendments is expected to have a significant effect on the consolidated financial statements of Holloway, except for the following:

### **IFRS 9, Financial Instruments**

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

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

IFRS 9 was amended in November 2013 to (i) include guidance on hedge accounting, (ii) allow entities to early adopt the requirement to recognize changes in fair value attributable to changes in an entity's own credit risk, from financial liabilities designated under the fair value option, in OCI, without having to adopt the remainder of IFRS 9.

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

### **IFRS 15, Revenue from Contracts and Customers**

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

## Critical Accounting Estimates and Judgments

The discussion and analysis of Holloway's financial position and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with IFRS. The preparation of financial statements requires management to use judgment in applying its accounting policies and make 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. Actual results may differ from management's estimates and expectations. The following discusses the most significant judgments and estimates that the Company has made in the preparation of its financial statements.

### Valuation of Property and Equipment

The Company is required to test for impairment when there is an indication that the carrying value of a cash generating unit ("CGU") may not be recoverable or when a previously recorded impairment could be reversed. Property and equipment is reviewed at the individual hotel level, the lowest level for which identifiable cash flows are largely independent when testing and measuring for impairment or reversal of impairment. The fair value is determined based on the discounted future cash flows expected to be received from the property. The amount of the impairment loss is the amount by which the hotel property's carrying value exceeds its recoverable amount.

The Company has established a methodology for identifying indicators of impairment which includes looking at changes in operating performance, occupancy levels, room rates, revenues, expenses and other factors for each CGU. Additional factors including oil and gas or other business and economic market activity, regional development opportunities and new competition in the markets in which each CGU operates are also considered in the review methodology. These indicators determine whether the Company tests for impairment or reversal of previously recorded impairments at each balance sheet date. The Company values its properties using a discounted cash flow analysis, starting with a base year's financial results and applying certain growth assumptions for a term certain and a terminal capitalization rate at the end of such term. These estimates and assumptions, including the discount rates involve significant judgment and are subject to change.

On December 31, 2014, the Company increased the carrying value of 3 CGUs by reversing previously recorded impairments by \$9.0 million. Key factors of estimation uncertainty include:

Pre-tax discount rates	12.00% to 12.25%
Capitalization rate	10.25%
Growth rates	Consistent with industry and market/hotel outlook

Based on this information, management estimated that the range of reasonably possible values for the assets would be between \$62.6 million and \$68.9 million for the 3 CGUs that were increased in value using internal models. The final value for the 3 CGUs increased in value was \$65.6 million.

### Valuation of Minority Interest Investments in Hotel Properties

At December 31, 2014, the Company's minority interest investments in hotel properties were not traded in an active market and their fair value is estimated using internal valuation models. Valuations for these investments require the use of inputs and capitalization rates that cannot be derived from current market prices but are based on management estimates. The carrying amount of the Company's minority interest investments in hotel properties would be between \$59 thousand and \$350 thousand if the capitalization rate used in the valuation differed by plus or minus 1% from management's estimates.

## **Valuation of 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 judgement and uncertainty.

## **Depreciation of Property and Equipment and Franchise Business**

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

## **Income Taxes**

Deferred income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in the consolidated statement of income, other comprehensive income, or directly in equity, as applicable, in the year that includes the date of enactment or substantive enactment. The carrying amount of deferred income tax assets is reviewed at the end of each reporting period and increased or decreased based on the estimated taxable earnings that will be available to allow all or part of the asset to be recovered.

Deferred income tax assets and liabilities recorded require management's judgment in determining the amounts to be recognized. In particular, judgment is used when assessing the extent to which deferred income tax assets should be recognized with respect to estimated future taxable income, which impacts the amount of deferred income tax assets recorded related to differences on the tax basis of assets and available non-capital losses. The estimates of future taxable income, the years when the temporary differences are expected to reverse and the tax rates in those years have an impact on the deferred income tax assets recorded in the consolidated statement of financial position. Significant estimates and judgments are used in determining the future consolidated taxable income, which includes consideration of the history of profitability, forecasting expected revenues and expenses as a result of the Royal Host acquisition and the impact of internalizing its hotel management previously performed by PHSI. Actual results will differ from the amounts estimated for future taxable income. Management considers both favourable and unfavourable evidence in determining whether or not it is probable that the future economic benefits will flow to the entity and the amount of deferred income tax assets that should be recognized. In making its assessment, management considers past operating results, forecasted future results and economic conditions of the locations in which it operates. If total future forecasted taxable income used to determine the amount of the deferred income tax assets recorded decreased by \$10.0 million, the deferred income tax assets recorded would decrease by \$2.6 million with a corresponding decrease to net income. There would be no impact on deferred tax assets recorded and net income if forecasted future taxable income increased.

## **Business Combinations**

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

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

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

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

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

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

## Financial Instruments and Risk Management

### Financial Instruments

The Company's financial instruments consist of cash, restricted cash, capital reserve – internally restricted, trade and other receivables, loan receivable, capital reserve – restricted, funds held on behalf of franchisees, minority interest investments in hotel properties, trade payables and accrued liabilities, accrued interest on convertible debentures, secured credit facilities, mortgages and loan payable, convertible debentures, loan due to a related party and funds to be spent on behalf of franchisees.

The following financial instruments have fair values that differ from their carrying value:

- Secured credit facilities: At December 31, 2014, the secured credit facilities had a fair value of \$27.0 million compared to a carrying value of \$27.0 million. 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.
- Mortgages and loan payable: At December 31, 2014, the mortgages and loan payable had a fair value of \$126.0 million compared to a carrying value of \$135.8 million. 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: At December 31, 2014, the convertible debentures had a fair value of \$86.2 million compared to a carrying value of \$88.1 million and face value of \$93.2 million. The fair value is based on the quoted market price for the convertible debentures.

The minority interest investments in hotel properties are measured at fair value 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.

## **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.

### Interest Rate Risk

The Company is exposed to interest rate risk on its lending and borrowing activities. It manages its exposure to interest rate risk by primarily using fixed rate debt so cash flow is not impacted significantly by a change in interest rates. The weighted average interest rate on its mortgages payable is 6.21% with a weighted average maturity of 3.2 years.

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

### Credit Risk

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

The amount of trade and other receivables disclosed on the consolidated statement of financial position of \$5.7 million is net of an allowance for doubtful accounts, estimated by management based on prior experience and their assessment of the current economic environment.

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

Trade receivables are due within 30 days; therefore amounts over 30 days and considered overdue. The allowance for doubtful accounts is generally recorded for trade receivable balances outstanding for more than 120 days. Amounts charged to the allowance are generally written off when there is no expectation of recovering additional cash.

### Currency Risk

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

In addition, the Company is exposed to some currency risk as it pays certain franchise and royalty payments in US dollars. A \$0.01 change in the US dollar exchange rate will change the foreign exchange gain or loss recognized in the statement of income by \$32 thousand.

## Liquidity Risk

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

## **Controls and Procedures**

Management is responsible for establishing and maintaining internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. In addition, the Company maintains disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in reports filed or submitted under applicable securities legislation is accumulated and communicated to management, including the acting Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), as appropriate to allow timely decisions regarding required public disclosure.

During 2014, the Company's management evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings), under the supervision of, and with the participation of those acting as CEO and CFO. As at December 31, 2014, based on the evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures were appropriately designed and were operating effectively.

During 2014, the Company's management also evaluated the design and operating effectiveness of the internal controls over financial reporting (as defined in National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings), using the Committee of Sponsoring Organizations Internal Control – Integrated Framework, under the supervision of, and with the participation of the those acting as CEO and CFO. As at December 31, 2014, based on the evaluation, those acting as CEO and CFO have concluded that the Company's internal controls over financial reporting were appropriately designed and were operating effectively.

It is important to note that all systems of internal controls and procedures can only provide reasonable, rather than absolute assurance that all control issues will be detected. Misstatement and errors may not be detected and controls can be circumvented by collusion among individuals or management override. In addition, the design of any system of control is also based upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future events.

The Company continually reviews its controls and updates its documentation of its disclosure controls and procedures, including its internal controls over financial reporting so as to enhance the effectiveness of its systems of controls and procedures.

## **Risks**

There are a number of risk factors associated with the Company. These include risks related to real property ownership, risks related to the business of the Company, including the hotel industry, competition, customer concentration, franchised hotels, availability of additional capital, and debt financing and risks relating to the structure of the Company. Information on these risks and uncertainties are described under "Risk Factors" in the Company's Annual Information Form dated March 11, 2015 which is available on Holloway's profile on the SEDAR website at [www.sedar.com](http://www.sedar.com).