Holloway Lodging Corporation

Interim Consolidated Condensed Financial Statements
(Unaudited)
September 30, 2015
(in thousands of Canadian dollars)

November 11, 2015

Management's Report

The accompanying unaudited interim consolidated condensed financial statements of **Holloway Lodging Corporation** (the "Company") have been prepared by the Company's management. The unaudited interim consolidated condensed financial statements have been prepared in accordance with International Financial Reporting Standards and contain estimates based on management's judgment. The unaudited interim consolidated condensed financial statements include some amounts and assumptions based on management's best estimates which have been derived with careful judgment.

In fulfilling its responsibilities, management has developed and maintains a system of internal accounting controls. These controls are designed to ensure that the financial records are reliable for preparation of the unaudited interim consolidated condensed financial statements. The Board of Directors have reviewed and approved these unaudited interim consolidated condensed financial statements.

(signed) *"Felix Seiler"*
Acting Chief Executive Officer

(signed) *"Jane Rafuse"*
Chief Financial Officer

Holloway Lodging Corporation

Interim Consolidated Statements of Financial Position

(Unaudited)

As at September 30, 2015

(in thousands of Canadian dollars)

	September 30, 2015 $	December 31, 2014 $
Assets		
Current assets		
Cash	1,349	3,473
Restricted cash	394	347
Trade and other receivables	5,093	5,697
Inventories	455	597
Prepaid expenses and deposits	3,170	2,258
	10,461	12,372
Non-current assets		
Property and equipment (note 4)	327,503	330,307
Franchise business (note 5)	–	14,700
Minority interest investments in hotel properties	–	190
Capital reserve – restricted	2,733	2,304
Loan receivable (note 6)	5,342	–
Other assets	496	616
Deferred income tax assets	22,724	21,800
Funds held on behalf of franchisees	–	167
	358,798	370,084
Total assets	369,259	382,456
Liabilities		
Current liabilities		
Trade payables and accrued liabilities	14,119	12,210
Accrued interest on convertible debentures	1,367	1,309
Current portion of secured credit facilities	11,061	9,007
Current portion of mortgages and loan payable	11,240	6,248
Share-based payment liability	454	–
	38,241	28,774
Non-current liabilities		
Secured credit facilities	–	18,000
Mortgages and loan payable	119,422	129,510
Convertible debentures	88,781	88,061
Funds to be spent on behalf of franchisees	–	167
	208,203	235,738
Total liabilities	246,444	264,512
Equity		
Equity attributable to shareholders of the Company	120,678	115,913
Non-controlling interest	2,137	2,031
Total equity	122,815	117,944
Total liabilities and equity	369,259	382,456

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

Holloway Lodging Corporation

Interim Consolidated Statements of Income

(Unaudited)

For the three and nine months ended September 30, 2015 and 2014

(in thousands of Canadian dollars)

	For the three months ended		For the nine months ended	
	September 30, 2015 $	September 30, 2014 $	September 30, 2015 $	September 30, 2014 $
Hotel revenues				
Rooms	27,127	31,545	75,583	58,658
Food and beverage	1,891	2,666	7,517	4,644
Franchising	–	763	412	763
Other	1,293	1,112	3,839	1,758
	30,311	36,086	87,351	65,823
Hotel expenses				
Operating expenses	17,854	20,574	55,539	37,284
Property taxes and insurance	1,669	1,654	5,045	3,326
Management fees	–	621	121	1,262
Depreciation and amortization	3,291	4,041	10,438	8,599
	22,814	26,890	71,143	50,471
Income before the following	7,497	9,196	16,208	15,352
Other (income) and expenses				
Interest and accretion on debt	3,901	4,384	12,260	7,958
Corporate and administrative	621	886	2,055	1,787
Share-based payment expense (recovery), net of share based payments	(227)	74	(86)	225
Investment income	(160)	(115)	(309)	(277)
Gain on disposals of property and equipment, franchise business, minority interest investment in hotel property and repurchase of convertible debentures	(3)	(106)	(8,116)	(114)
Fair value adjustment and amounts reclassified to profit and loss on minority interest investments in hotel properties	–	–	–	(689)
Impairment (reversal of impairment) of hotel property	–	–	2,700	(1,217)
Acquisition and redevelopment costs	379	317	514	956
Unrealized foreign exchange gain	(264)	–	(264)	–
	4,247	5,440	8,754	8,629
Income before income taxes	3,250	3,756	7,454	6,723
Provision for (recovery of) deferred income taxes (note 7)	806	(9,924)	(924)	(9,124)
Net income for the period	2,444	13,680	8,378	15,847
Attributable to:				
Shareholders of the Company	2,354	13,562	8,272	15,740
Non-controlling interest	90	118	106	107
	2,444	13,680	8,378	15,847
Basic earnings per share (note 8)	0.12	0.70	0.43	0.86
Diluted earnings per share (note 8)	0.12	0.66	0.43	0.85

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

Holloway Lodging Corporation

Interim Consolidated Statements of Comprehensive Income

(Unaudited)

For the three and nine months ended September 30, 2015 and 2014

(in thousands of Canadian dollars)

	For the three months ended		For the nine months ended	
	September 30, 2015 $	September 30, 2014 $	September 30, 2015 $	September 30, 2014 $
Net income for the period	2,444	13,680	8,378	15,847
Other comprehensive income (loss)				
Items that may be subsequently reclassified to profit or loss				
Cumulative translation adjustments	149	103	308	107
Fair value adjustments of minority interest investment in hotel properties	–	–	–	80
Items reclassified in the period to profit or loss				
Previously recognized fair value adjustment of minority interest investments in hotel properties	–	–	–	(390)
Other comprehensive income (loss)	149	103	308	(203)
Comprehensive income for the period	2,593	13,783	8,686	15,644
Comprehensive income attributable to:				
Shareholders of the Company	2,503	13,665	8,580	15,537
Non-controlling interest	90	118	106	107
	2,593	13,783	8,686	15,644

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

Holloway Lodging Corporation
Interim Consolidated Statements of Changes in Equity
(Unaudited)
For the nine months ended September 30, 2015 and 2014

(in thousands of Canadian dollars)

	Common shares	Contributed surplus	Deficit	Accumulated other comprehensive income (loss)	Equity attributable to shareholders of the Company	Non-controlling interest	Total equity
	$	$	$	$	$	$	$
Balance, January 1, 2014	223,713	2,327	(140,683)	28	85,385	22	85,407
Net income for the period	–	–	15,740	–	15,740	107	15,847
Other comprehensive income for the period	–	–	–	(203)	(203)	–	(203)
Comprehensive income for the period	–	–	15,740	(203)	15,537	107	15,644
Shares and options issued on acquisition of Royal Host Inc., net of shares acquired and issuance costs	5,691	10	–	–	5,701	–	5,701
Non-controlling interest arising on acquisition of subsidiary	–	–	–	–	–	2,739	2,739
Acquisition of non-controlling interest in subsidiary	–	–	(90)	–	(90)	(11)	(101)
Dividends paid to shareholders	–	–	(1,933)	–	(1,933)	–	(1,933)
Share-based compensation	–	225	–	–	225	–	225
Exercise of stock options	43	(205)	–	–	(162)	–	(162)
Proceeds on sale of common shares	426	–	–	–	426	–	426
Repurchase of common shares	(22)	–	–	–	(22)	–	(22)
Balance, September 30, 2014	229,851	2,267	(126,966)	(175)	105,067	2,857	107,924
Balance, January 1, 2015	229,859	2,544	(116,386)	(104)	115,913	2,031	117,944
Net income for the period	–	–	8,272	–	8,272	106	8,378
Other comprehensive income for the period	–	–	–	308	308	–	308
Comprehensive income for the period	–	–	8,272	308	8,580	106	8,686
Dividends paid to shareholders	–	–	(2,027)	–	(2,027)	–	(2,027)
Share-based compensation	–	119	–	–	119	–	119
Reclassification of share-based compensation from equity-settled to cash-settled liability (note 3)	–	(816)	–	–	(816)	–	(816)
Exercise of stock options	22	(5)	–	–	17	–	17
Repurchase of common shares	(1,108)	–	–	–	(1,108)	–	(1,108)
Balance, September 30, 2015	228,773	1,842	(110,141)	204	120,678	2,137	122,815

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

Holloway Lodging Corporation

Interim Consolidated Statements of Cash Flows

(Unaudited)

For the nine months ended September 30, 2015 and 2014

(in thousands of Canadian dollars)

	For the nine months ended	
	September 30, 2015 $	September 30, 2014 $
Cash provided by (used in)		
Operating activities		
Net income for the period	8,378	15,847
Adjustments for non-cash items (note 9)	5,201	(1,959)
	13,579	13,888
Changes in items of working capital (note 9)	(2,881)	42
Net cash generated from operating activities	10,698	13,930
Investing activities		
Decrease (increase) in capital reserves and restricted cash	(476)	331
Proceeds from sales of property and equipment, net of costs	17,531	9,519
Proceeds from sale of franchise business, net of costs	15,758	–
Proceeds from disposal of minority interest investment in hotel property	155	–
Acquisitions and additions to property and equipment	(20,537)	(12,398)
Acquisition of subsidiaries, net of cash acquired	–	(1,848)
Additions to other assets	(40)	(50)
Acquisition of Royal Host Inc., net of cash acquired	–	(16,033)
Net cash provided by (used in) investing activities	12,391	(20,479)
Financing activities		
Repayment of secured credit facilities	(21,000)	(8,802)
Funds drawn on secured credit facilities	5,054	16,000
Proceeds from mortgages and loan payable, net of deferred financing fees	–	5,826
Repayment of mortgages and loan payable	(5,892)	(3,352)
Proceeds from exercise of options	17	37
Settlement of share-based payment liability	(157)	–
Repurchase of common shares	(1,108)	(22)
Proceeds from sale of common shares, net of costs	–	424
Share issuance costs	–	(32)
Repurchase of convertible debentures	(101)	–
Dividends paid to shareholders	(2,027)	(1,933)
Net cash provided by (used in) financing activities	(25,214)	8,146
Increase (decrease) in cash	(2,124)	1,597
Cash – Beginning of period	3,473	852
Cash – End of period	1,349	2,449
Supplemental cash flow information		
Interest paid	11,299	7,307

Cash is comprised of cash on hand and balances with banks.

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

(in thousands of Canadian dollars)

1 General information

Holloway Lodging Corporation, together with its subsidiaries (the "Company") is a hospitality company that owns and operates hotels. As at September 30, 2015, the Company owned and operated 34 hotels in Canada, one hotel in the United States and a 62% interest in another hotel in Canada, with a total of 4,132 guest rooms. The address of its registered office is 6009 Quinpool Road, 10th Floor, Halifax, Nova Scotia.

The results of operations for the nine months ended September 30, 2015 represent the operations of 34 hotels for the full period and 4 hotels for part of the period as the Company:

- sold the Ramada® in Trenton, ON on January 23, 2015;
- acquired the Days Inn® in Whitehorse, YT on January 30, 2015;
- sold the Travelodge® in Toronto, ON on February 4, 2015; and
- acquired the Days Inn® in Sydney, NS on September 15, 2015.

The results of operations for the nine months ended September 30,2014 represent the operations of 17 hotels for the full period and 20 hotels for part of the period as the Company:

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

The Company's financial results for an individual quarter are not necessarily indicative of results to be expected for the full year. Revenue from hotel operations tends to fluctuate throughout the year. The Company's third quarter revenues are generally the strongest of the year with the other three quarters being comparable to each other.

2 Basis of preparation

These unaudited interim consolidated condensed financial statements ("condensed financial statements") have been prepared in accordance with generally accepted accounting principles in Canada ("GAAP") as set out in the CPA Canada Handbook – Accounting – Part 1 ("CPA Canada Handbook") which incorporates International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), and in accordance with IAS 34 – *"Interim Financial Reporting"*.

These condensed financial statements were approved by the Board of Directors on November 11, 2015.

3 Significant accounting policies and critical accounting estimates

Significant accounting polices

The accounting policies followed in these condensed financial statements are the same as those applied in the Company's audited annual financial statements for the year ended December 31, 2014 except as noted below. These condensed financial statements should be read in conjunction with the Company's audited annual financial statements for the year ended December 31, 2014.

(in thousands of Canadian dollars)

3 Significant accounting policies and critical accounting estimates (continued)

Cash-settled options

In the second quarter of 2015, the Company settled stock options for cash. As a result, effective May 29, 2015, the stock option obligation changed from an equity settled obligation to a cash settled obligation and was recognized in the consolidated statement of financial position. The share-based payment liability is remeasured to fair value based on the number of options expected to vest at each reporting date up to and including the settlement date. Changes to the share-based payment liability are included in share-based payment expense (recovery) in the consolidated statement of income.

Critical accounting estimates

Property and equipment

On June 30, 2015, the Company decreased the carrying value of one cash generating unit ("CGU") by $2,700. The fair value of the CGU was based on its value in use and was determined by an internal model. For the period ended September 30, 2015, the Company assessed six CGU's which had indicators of potential impairment for which a fair value was calculated at period end. The fair value of each of the six CGU's exceeded their carrying value and no impairment has been recorded. 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 higher of value in use ("VIU"), which is based on discounted future cash flows expected to be received from the CGU, or value in use, which can be based on discounted future cash flows expected to be received from the CGU or comparable market transactions. When the fair values have been determined using cash flow projections and a capitalized terminal value calculation and made maximum use of observable inputs and outputs. For periods beyond the initial budget period for VIU, cash flows were extrapolated using growth rates determined to be reasonable for the specific CGU and the market in which it operates and does not exceed the anticipated long-term average growth rates for the Company's portfolio. Key factors of estimation uncertainty include:

Pre-tax discount rate	11.75%
Capitalization rate	10.50%
Growth rates	Consistent with industry and market/hotel outlook for VIU
Determining comparable market transactions	

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 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 the discount rate. In addition to these estimates, management assesses the effect of new competition in the individual markets and the hotel industry predictions of hotel demand and supply. These estimates and assumptions are subject to change. Based on this information, management estimated that the range of reasonably possible values for the asset would be between $6,836 and $8,344 for the CGU that was decreased in value using an internal model. The final value for the CGU decreased in value was $7,530. Management estimated that the range of reasonably possible values for the assets that are not impaired would be between $49,675 and $55,865. The carrying values for those CGU's was $52,990.

(in thousands of Canadian dollars)

4 Acquisitions and disposals of property and equipment

Royal Host Inc.

The Company has finalized the purchase price allocation to the assets acquired and liabilities assumed. There have been no changes to the purchase price allocation since December 31, 2014.

Ramada®, Trenton, ON

On January 23, 2015, the Company sold the Ramada® in Trenton, ON for gross proceeds of $3,950. After closing costs, the net cash proceeds were $3,760. A portion of the proceeds were used to fully repay a $3,000 secured credit facility. The Company recognized a gain on disposal of property and equipment of $116 in the consolidated statement of income.

Days Inn®, Whitehorse, YT

On January 30, 2015, the Company acquired the Ramada® in Whitehorse, YT for a gross purchase price of $8,228 which was paid in cash. The property has been rebranded as a Days Inn®.

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

	$
Assets acquired	
Land	2,470
Building and components	4,372
Furniture, fixtures and equipment	1,250
Paving	100
Signage	11
Computer equipment	25
	8,228

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

Included in the condensed financial statements at September 30, 2015 is revenue of $2,051 and a net income of $607. Costs of acquisition of $140 were recognized in the consolidated statement of income.

Travelodge®, Toronto, ON

On February 4, 2015, the Company sold the Travelodge® in Toronto, ON for gross proceeds of $13,000. A portion of the proceeds were used to fully repay a $2,000 secured credit facility. After closing costs, the net cash proceeds were $12,715. The Company recorded a gain on disposal of property and equipment of $1,672 in the consolidated statement of income.

Land, Orillia, ON

On April 15, 2015, the Company sold a vacant parcel of land in Orillia, ON for gross proceeds of $1,084. After closing costs, the net cash proceeds were $1,048. The Company recorded a gain on disposal of property and equipment of $88 in the consolidated statement of income.

(in thousands of Canadian dollars)

4 Acquisitions and disposals of property and equipment (continued)

Days Inn®, Sydney, NS

On March 25, 2015, the Company acquired the first and second mortgages receivable in the amount of $1,919 on the Days Inn® in Sydney, NS. The mortgages were in default due to non-payment of principal, interest and property taxes. During the foreclosure period, the Company recorded management income of $122 in other revenue, representing the net profit of the hotel for this period. The Company has concluded foreclosure proceedings against the borrower and obtained ownership of the property on September 15, 2015.

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

	$
Assets acquired	
Land	576
Building and components	1,324
Furniture, fixtures and equipment	19
	1,919

The fair values and allocation to the various assets was based on management estimates.

Included in the condensed financial statements at September 30, 2015 is revenue of $66 and a net loss of $10. Costs of acquisition of $6 were recognized in the consolidated statement of income.

5 Disposal of franchise business

On March 31, 2015, the Company sold the franchise business which owned the master franchise rights to the Travelodge® and Thriftlodge® hotel brands in Canada for gross proceeds of $21,030. The purchase price was satisfied with the issuance of a $4,000 USD senior secured loan (note 6) and a cash payment of $15,758, net of closing costs, which was applied to a $16,000 secured credit facility which has been repaid in full. The Company recognized a gain on disposal of franchise business of $6,260 in the consolidated statement of income.

6 Loan receivable

The senior secured loan receivable is denominated in US dollars (US$4,000) and bears interest at 12.0%. Interest and principal payments are due semi-annually. The maturity date of the note is April 30, 2027 although the anticipated amortization period for the principal amount of the note is approximately eight years.

(in thousands of Canadian dollars)

7 Income taxes

The following table is a reconciliation of the expected deferred income tax provision (recovery) at the statutory rate to the amounts recognized in the consolidated statement of income for the three and nine months ended September 30, 2015 and 2014:

	For the three months ended		For the nine months ended	
	September 30, 2015 $	September 30, 2014 $	September 30, 2015 $	September 30, 2014 $
Income before income taxes	3,250	3,756	7,454	6,723
Combined statutory income tax rate	26.76%	25.98%	26.76%	25.93%
Income tax expense at the combined statutory income tax rate	869	976	1,995	1,743
Non-taxable portion of gains	66	121	(2,624)	(57)
Non-deductible share-based payment expense	(61)	19	(23)	58
Non-deductible expenses	–	3	40	171
Benefit of recording previously unrecognized deferred tax assets	–	(11,067)	–	(11,067)
Change in tax rates	(9)	–	(478)	–
Other	(59)	24	166	28
Provision for (recovery of) deferred income taxes	806	(9,924)	(924)	(9,124)

The statutory tax rate was 26.76% for the three and nine months ended September 30, 2015 (for the three and nine months ended September 30, 2014 – 25.98% and 25.93%, respectively).

(in thousands of Canadian dollars, except share amounts)

8 Earnings per share

Basic

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

	For the three months ended		For the nine months ended	
	September 30, 2015 $	September 30, 2014 $	September 30, 2015 $	September 30, 2014 $
Net income attributable to shareholders of the Company	2,354	13,562	8,272	15,740
Weighted average number of shares outstanding	19,269,202	19,350,729	19,327,143	18,408,064
Basic earnings per share	0.12	0.70	0.43	0.86

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of shares outstanding to assume conversion of all potentially dilutive instruments convertible into shares. This calculation is done to determine the number of shares that could have been acquired at fair value based on the subscription rights of the convertible debentures, options and warrants. During the three and nine months ended September 30, 2015, the Company had two categories of potentially dilutive instruments – convertible debentures and options. During the three and nine months ended September 30, 2014, the Company had three categories of potentially dilutive instruments – convertible debentures, options and warrants. For the three and nine months ended September 30, 2015, the convertible debentures are anti-dilutive. For the three and nine months ended September 30, 2014, the convertible debentures and warrants were anti-dilutive.

Diluted earnings per share for the three and nine months ended September 30, 2015 and September 30, 2014 is presented below:

	For the three months ended		For the nine months ended	
	September 30, 2015 $	September 30, 2014 $	September 30, 2015 $	September 30, 2014 $
Diluted income attributable to shareholders of the Company	2,354	14,504	8,272	15,740
Weighted average number of diluted shares	19,338,177	22,096,919	19,405,356	18,468,299
Diluted earnings per share	0.12	0.66	0.43	0.85

At September 30, 2015, there were 19,163,666 common shares outstanding. During the nine months ended September 30, 2015, the Company repurchased and cancelled 216,300 shares at a cost of $1,108 (average price of $5.12 per share).

(in thousands of Canadian dollars)

9 Supplemental cash flow information

Adjustments for non-cash items:

	For the nine months ended	
	September 30, 2015 $	September 30, 2014 $
Accretion on debt, change in fair value of embedded derivative and unrealized foreign exchange gain	805	309
Share-based payment expense (recovery)	(86)	225
Depreciation and amortization	10,552	8,651
Gain on disposals of property and equipment, franchise business, minority interest investment in hotel property and repurchase of convertible debentures	(8,116)	(114)
Fair value adjustment and amounts reclassified to profit and loss on minority interest investments in hotel properties	–	(689)
Impairment (reversal of impairment) of hotel property	2,700	(1,217)
Write-off of acquisition and redevelopment costs	270	–
Provision for (recovery of) deferred income taxes	(924)	(9,124)
	5,201	(1,959)

Changes in items of working capital:

	For the nine months ended	
	September 30, 2015 $	September 30, 2014 $
Trade and other receivables	556	(973)
Inventories	142	(34)
Prepaid expenses and deposits	(912)	112
Funds held on behalf of franchisees	167	(101)
Trade payables and accrued liabilities	(2,725)	877
Accrued interest on convertible debentures	58	60
Funds to be spent on behalf of franchisees	(167)	101
	(2,881)	42

(in thousands of Canadian dollars)

10 Financial instruments and fair values

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 consolidated statement of income or comprehensive income. Those categories are: fair value through profit or loss; loans and receivables; available-for-sale assets; and for liabilities, amortized cost. With the exception of the items noted below, all financial instruments have fair values that approximate their carrying values due to their short-term nature.

The Company's financial instruments consist of cash, restricted cash, trade and other receivables, capital reserve – restricted, loan receivable, trade payables and accrued liabilities, accrued interest on convertible debentures, secured credit facilities, mortgages and loan payable and convertible debentures.

The following table shows the financial instruments which have fair values that differ from their carrying values:

	September 30, 2015	
	Carrying value $	Fair value $
Mortgages and loan payable	130,662	124,456
Convertible debentures	88,781	85,163

The methods and assumptions used in estimating the fair values are as follows:

Loan receivable, secured credit facilities and mortgages and loan payable: The fair values are determined using internal valuation techniques which incorporate the discounted future cash flows using discount rates that reflect current market conditions for instruments with similar interest rates, terms and risk. The fair values do not necessarily represent the amounts the Company might pay or receive in actual market transactions.

Convertible debentures: The fair value of the convertible debentures is based on the quoted market price for the debentures.