

Holloway Lodging Corporation

Consolidated Financial Statements
December 31, 2018 and 2017

March 6, 2019

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of **Holloway Lodging Corporation** (the "Company") have been prepared by the Company's management. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. When alternative methods of accounting exist, management has chosen those it deems most appropriate in the circumstances. The consolidated financial statements include amounts based on informed judgments and estimates of the expected effects of current events and transactions with appropriate consideration to materiality. In addition, in preparing the consolidated financial statements, management must make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Actual results in the future may differ materially from our present assessment of this information because future events and circumstances may not occur as expected.

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

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

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

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



Independent auditor's report

To the Shareholders of Holloway Lodging Corporation

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Holloway Lodging Corporation and its subsidiaries, (together, the Company) as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

What we have audited

The Company's consolidated financial statements comprise:

- the consolidated statements of financial position as at December 31, 2018 and 2017;
- the consolidated statements of income for the years then ended;
- the consolidated statements of comprehensive income for the years then ended;
- the consolidated statements of changes in equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

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

Independence

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis (MD&A).

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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Responsibilities of management and those charged with governance for the consolidated financial statements

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

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.



- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Gordon Ashe.

(Signed) "PricewaterhouseCoopers LLP"

Chartered Professional Accountants, Licensed Public Accountants

Halifax, Nova Scotia
March 6, 2019

Holloway Lodging Corporation
Consolidated Statements of Financial Position
As at December 31, 2018 and 2017

(in thousands of Canadian dollars)

	2018 \$	2017 \$
Assets		
Current assets		
Cash	32,610	691
Trade, other and insurance proceeds receivable (notes 5 and 9)	3,628	4,385
Inventories	419	490
Prepaid expenses and deposits	1,037	975
Current portion of loans receivable (note 7)	1,000	–
Asset held-for-sale (note 6)	3,206	–
	41,900	6,541
Non-current assets		
Loans receivable (note 7)	7,457	5,018
Property and equipment (notes 8 and 9)	242,775	284,047
Other assets	537	687
Deferred income tax assets (note 19)	19,092	26,116
	269,861	315,868
Total assets	311,761	322,409
Liabilities		
Current liabilities		
Revolving credit facilities (note 10)	15,000	25,339
Trade payables and accrued liabilities (note 11)	8,369	9,389
Accrued interest on convertible debentures	1,290	1,290
Current portion of mortgages payable (note 12)	11,377	6,864
Current portion of convertible debentures (note 14)	40,205	–
Share-based liability (note 13)	902	525
	77,143	43,407
Non-current liabilities		
Mortgages payable (note 12)	67,165	83,723
Convertible debentures (note 14)	50,020	89,460
	117,185	173,183
Total liabilities	194,328	216,590
Equity		
Equity attributable to shareholders of the Company	115,750	104,084
Non-controlling interest	1,683	1,735
Total equity	117,433	105,819
Total liabilities and equity	311,761	322,409
Contingencies and commitments (note 21)		

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

Approved on behalf of the Board of Directors

(signed) “Michael Rapps”
Chairman of the Board

(signed) “David Wood”
Chairman of the Audit Committee

Holloway Lodging Corporation

Consolidated Statements of Income

For the years ended December 31, 2018 and 2017

(in thousands of Canadian dollars, except earnings per share)

	2018	2017
	\$	\$
Revenues		
Hotel: Rooms	91,619	88,924
Food and beverage	9,961	10,541
Rental	1,328	1,232
Other	4,713	4,872
Management services	297	191
	<u>107,918</u>	<u>105,760</u>
Expenses		
Operating expenses	68,471	67,318
Property taxes and insurance	5,868	6,245
Depreciation and amortization	15,652	15,452
	<u>89,991</u>	<u>89,015</u>
Income before the following	<u>17,927</u>	<u>16,745</u>
Other (income) and expenses		
Interest and accretion on debt	13,026	14,278
Corporate and administrative	1,750	2,400
Share-based expense	403	314
Interest income	(658)	(640)
Insurance proceeds, net of clean-up and other costs (note 9)	–	(1,978)
Gain on disposals of property and equipment and repurchase of convertible debentures	(25,813)	(6,581)
Impairment of hotel properties, net (note 9)	1,000	–
Acquisition, disposition and redevelopment costs	73	10
Unrealized foreign exchange (gain) loss	(454)	362
	<u>(10,673)</u>	<u>8,165</u>
Income before income taxes	28,600	8,580
Provision for income taxes (note 19)	7,024	2,056
Net income for the years	<u>21,576</u>	<u>6,524</u>
Attributable to:		
Shareholders of the Company	21,628	6,478
Non-controlling interest	(52)	46
	<u>21,576</u>	<u>6,524</u>
Basic earnings per share (note 16)	1.21	0.34
Diluted earnings per share (note 16)	1.18	0.34

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

Holloway Lodging Corporation
Consolidated Statements of Comprehensive Income
For the years ended December 31, 2018 and 2017

(in thousands of Canadian dollars)

	2018	2017
	\$	\$
Net income for the years	21,576	6,524
Items reclassified to profit or loss		
Cumulative translation adjustments	–	337
Other comprehensive loss	–	337
Comprehensive income for the years	21,576	6,187
Comprehensive income attributable to:		
Shareholders of the Company	21,628	6,141
Non-controlling interest	(52)	46
	21,576	6,187

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

Holloway Lodging Corporation
Consolidated Statements of Changes in Equity
For the years ended December 31, 2018 and 2017

(in thousands of Canadian dollars)

	Common shares \$	Contributed surplus \$	Deficit \$	Accumulated other comprehensive income \$	Equity attributable to shareholders of the Company \$	Non- controlling interest \$	Total equity \$
Balance, January 1, 2017	226,414	2,946	(126,579)	337	103,118	1,887	105,005
Net income for the year	–	–	6,478	–	6,478	46	6,524
Other comprehensive loss for the year	–	–	337	(337)	–	–	–
Comprehensive income for the year	–	–	6,815	(337)	6,478	46	6,524
Dividends paid to shareholders (note 15)	–	–	(2,625)	–	(2,625)	–	(2,625)
Distribution paid to non-controlling interests	–	–	–	–	–	(198)	(198)
Repurchase of common shares (note 15)	(6,288)	3,401	–	–	(2,887)	–	(2,887)
Balance, December 31, 2017	220,126	6,347	(122,389)	–	104,084	1,735	105,819
Balance, January 1, 2018	220,126	6,347	(122,389)	–	104,084	1,735	105,819
Net income and comprehensive income for the year	–	–	21,628	–	21,628	(52)	21,576
Dividends paid to shareholders (note 15)	–	–	(2,505)	–	(2,505)	–	(2,505)
Repurchase of common shares (note 15)	(14,683)	7,226	–	–	(7,457)	–	(7,457)
Balance, December 31, 2018	205,443	13,573	(103,266)	–	115,750	1,683	117,433

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

Holloway Lodging Corporation

Consolidated Statements of Cash Flows

For the years ended December 31, 2018 and 2017

(in thousands of Canadian dollars)

	2018 \$	2017 \$
Cash provided by (used in)		
Operating activities		
Net income for the years	21,576	6,524
Adjustments for non-cash items (note 20)	(1,071)	12,847
	<u>20,505</u>	<u>19,371</u>
Changes in items of working capital (note 20)	268	120
Net cash generated from operating activities	<u>20,773</u>	<u>19,491</u>
Investing activities		
Decrease (increase) in capital reserves and additions to other assets	(72)	3,353
Additions to property and equipment (note 9)	(6,328)	(12,767)
Proceeds from sales of hotel properties and equipment, net of costs (note 8)	50,227	26,097
Net cash provided by investing activities	<u>43,827</u>	<u>16,683</u>
Financing activities		
Proceeds from (repayment of) revolving credit facilities (note 10)	(10,339)	7,709
Proceeds from mortgages, net of deferred financing fees (note 12)	6,156	61,780
Repayment of mortgages payable (note 12)	(18,510)	(98,676)
Settlement of share-based liability	(26)	(498)
Repurchase of convertible debentures	–	(1,271)
Repurchase of common shares (note 15)	(7,457)	(2,887)
Dividends paid to shareholders (note 15)	(2,505)	(2,625)
Distribution paid to non-controlling interests	–	(198)
Net cash used in financing activities	<u>(32,681)</u>	<u>(36,666)</u>
Increase (decrease) in cash during the years	31,919	(492)
Cash – beginning of years	691	1,183
Cash – end of years	<u>32,610</u>	<u>691</u>
Supplemental cash flow information		
Interest paid	11,925	13,296
Interest received	622	644

Cash is comprised of cash on hand and balances with financial institutions.

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

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

(in thousands of Canadian dollars, except shares, share prices and earnings per share)

1 General information

Holloway Lodging Corporation, together with its subsidiaries (the “Company” or “Holloway”) is a hospitality company that owns and operates hotels and provides hotel management services to third parties. As at December 31, 2018, the Company owned and operated 30 hotels and held a 62% interest in another hotel in Canada, with a total of 3,422 guest rooms. One of the hotel properties in Slave Lake, AB has been leased to a third party on a triple net basis. The address of its registered office is 145 Hobsons Lake Drive, Suite 106, Halifax, Nova Scotia.

The results of operations for the year ended December 31, 2018 represent the operations of 31 hotels for the full year and 2 hotels for part of the year as the Company:

- sold the Super 8® in High Level, AB on October 11, 2018; and
- sold the Holiday Inn® in Ottawa, ON on December 17, 2018.

The results of operations for the year ended December 31, 2017 represent the operations of 33 hotels for the full year and 2 hotels for part of the year as the Company:

- sold the Holiday Inn® in Oakville, ON on January 16, 2017; and
- sold the Travelodge® in Belleville, ON on March 17, 2017.

2 Basis of preparation and new accounting standards

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

These consolidated financial statements were approved for issue by the Board of Directors on March 6, 2019.

On January 1, 2018, the Company adopted IFRS 9, *Financial Instruments* (“IFRS 9”) and IFRS 15, *Revenue from Contracts with Customers* (“IFRS 15”). This note explains the impact of the adoption of these standards on the Company’s financial statements and explains how the new accounting policies are different than those applied in prior periods.

IFRS 9, *Financial Instruments*

IFRS 9 replaces the provisions of IAS 39, *Financial Instruments: Recognition and Measurement* (“IAS 39”) that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting. The Company applied this new standard retrospectively, which means this standard was applied to transactions, events and conditions as if it had always been effective.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

(in thousands of Canadian dollars, except shares, share prices and earnings per share)

2 Basis of preparation and new accounting standards (continued)

IFRS 9, *Financial Instruments* (continued)

(a) Classification

The Company classifies its financial instruments in the following categories: fair value through profit and loss (“FVTPL”), fair value through other comprehensive income (“FVTOCI”) or amortized cost. The Company determines the classification of financial assets at their initial recognition. The classification is driven by the Company’s business model for managing financial assets and their contractual cash flow characteristics. Financial liabilities are measured at amortized cost unless they are required to be measured at FVTPL (such as derivatives) or the Company has elected to measure them at FVTPL.

The Company completed a detailed assessment of its financial assets and liabilities as at January 1, 2018 and noted that there were no changes in classification as a result of the transition to IFRS 9. The embedded derivative on the Company’s convertible debentures and the share-based liability are classified as FVTPL. The remainder of the Company’s financial assets and liabilities are classified as amortized cost.

(b) Measurement

Financial assets and liabilities at amortized cost

Financial assets and liabilities carried at amortized cost are initially recorded at fair value and subsequently carried at amortized cost less any impairment.

Financial liabilities at FVTPL

Financial liabilities carried at FVTPL are initially recorded at fair value and transaction costs are expensed in the consolidated statements of income. Financial liabilities that are considered modified during the year are to be accounted for by discounting the revised cash flows at the original effective interest rate. Realized and unrealized gains and losses arising from changes in the fair value of the financial liabilities carried at FVTPL are included in the consolidated statements of income in the period in which they arise. Where management has classified a financial liability at FVTPL, any changes associated with the Company’s own credit risk will be recognized in other comprehensive income.

The Company identified two financial liabilities that had been modified in prior years. The related gains on modification were considered immaterial and consequently, no adjustment was made.

(c) Impairment of financial assets at amortized cost

The new impairment model under IFRS 9 requires the recognition of impairment provisions based on expected credit losses (“ECL”) rather than only incurred credit losses as was the case under IAS 39. Impairment provisions on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the provision decreases and the decrease can be objectively related to an event occurring after the impairment was recognized.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

(in thousands of Canadian dollars, except shares, share prices and earnings per share)

2 Basis of preparation and new accounting standards (continued)

IFRS 9, *Financial Instruments* (continued)

(c) Impairment of financial assets at amortized cost (continued)

The Company's loans receivable and trade, other and insurance proceeds receivable are included in this category. The Company has elected to use the simplified approach to measuring ECL which uses a lifetime expected impairment. To measure the ECL, impairment provisions on trade receivables are based on credit risk characteristics and days past due, while impairment provisions on loans receivable are based on credit risk characteristics and speculative and non-speculative historical default rates. Trade and loans receivable are written off when there is no reasonable expectation of recovery. An indicator that there is no reasonable expectation of recovery is the failure of a debtor to engage in a repayment plan with the Company. The impact of the change in the impairment provision was immaterial and consequently, no adjustment was made.

(d) Derecognition

Financial assets

The Company derecognizes financial assets only when the contractual rights to cash flows from the financial assets expire, or when it transfers the financial assets and substantially all the associated risks and rewards of ownership to another entity. Gains and losses on derecognition are recognized in the consolidated statements of income.

Financial liabilities

The Company derecognizes financial liabilities only when its obligations under the financial liabilities are discharged, cancelled or expired. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable, including any non-cash assets transferred or liabilities assumed, is recognized in the consolidated statements of income.

IFRS 15, *Revenue from Contracts with Customers*

IFRS 15 establishes a new control-based revenue recognition model which replaces IAS 18, *Revenue* and IAS 11, *Construction Contracts*. The underlying principle is that an entity will recognize revenue to depict the transfer of goods and services to customers at an amount the entity expects to be entitled to in exchange for those goods and services. The Company applied this new standard using the modified retrospective approach, which means this standard was applied to transactions, events and conditions as if it had always been effective. The impact on transition was immaterial and consequently, no adjustment was made. This change results in earlier recognition of revenue for external management services contracts that include variable consideration.

Hotel revenue

Hotel revenue is generated primarily from room occupancy, food and beverage services, rental and ancillary services. The Company recognizes revenue when the services are provided to the customer and payment of the transaction price is due, as there are no further performance obligations to be satisfied at this point.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

(in thousands of Canadian dollars, except shares, share prices and earnings per share)

2 Basis of preparation and new accounting standards (continued)

IFRS 15, Revenue from Contracts with Customers (continued)

Management services revenue

Management services revenue is generated from providing hotel management services to third parties. The Company recognizes revenue when the services are rendered to the customer, typically on a monthly basis and payment of the transaction price is due. The total transaction price of certain contracts includes variable consideration based on certain financial measures being achieved.

The Company determines the total transaction price, including an estimate of any variable consideration, at contract inception and reassesses this estimate at each reporting date using the most likely amount method.

3 Summary of significant accounting policies

To the extent not already disclosed in note 2, the significant accounting policies used in the preparation of these consolidated financial statements are as follows:

Basis of measurement

The financial statements have been prepared on an accrual basis and under the historical cost convention, unless otherwise stated.

Consolidation

These consolidated financial statements include the accounts of the Company and its subsidiary companies. Subsidiaries are those entities which the Company controls by having the power to govern the financial and operating policies. Subsidiaries are fully consolidated from the date on which control is obtained by the Company and are deconsolidated from the date that control ceases. All inter-company transactions and balances have been eliminated in these consolidated financial statements.

Foreign currency translation

The consolidated financial statements are presented in Canadian dollars, the Company's functional currency.

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

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

(in thousands of Canadian dollars, except shares, share prices and earnings per share)

3 Summary of significant accounting policies (continued)

Inventories

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

Property and equipment

Property and equipment are carried at cost, less accumulated depreciation and impairment allowances. Depreciation is provided on a straight-line basis from the date assets are ready to be put into service at rates which will amortize the carrying cost less residual value of the property and equipment over their estimated useful lives. Estimated useful lives and residual values are reviewed at least annually. The estimated useful lives are as follows:

Land lease	Term of the lease
Buildings and components	15 - 60 years
Furniture, fixtures and equipment	2 - 7 years
Paving	10 years
Landscaping	5 years
Signage	10 years
Computer equipment and websites	3 years
Other	3 years

Land is not amortized. Renovations are amortized once they are put into use.

Impairment of non-financial assets and related reversals of impairment

At each reporting date, the Company determines whether there is any indication of impairment of the carrying amount of the Company's property and equipment. If any indication exists, the asset's recoverable amount is estimated. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows (cash-generating unit or "CGU"). The recoverable amount is the higher of the asset's fair value less costs of disposal and value in use. In assessing value in use, the Company uses a discounted cash flow model. The future cash flows are adjusted for risks specific to the asset and are discounted using a pre-tax discount rate. Fair value less costs of disposal utilizes the same cash flows, adjusted for the expected differences in the cash flows of a potential acquirer or market participant, less an estimate of costs to sell. The discount rate reflects the current assessment of the time value of money and the risks specific to the CGU.

IFRS also requires that assets that have previously been impaired, be reviewed at each reporting date to assess if the asset is still impaired. If such an indication exists, the Company calculates the recoverable amount of the asset and if it is greater than the carrying amount then the impairment is reversed up to the asset's recoverable amount. The asset's recoverable amount cannot be greater than the carrying amount that would have existed had no impairment loss been recognized in prior years.

Impairments or reversals of previously recorded impairments on property and equipment are presented as impairment or reversal of impairment of hotel properties, net in the consolidated statements of income.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

(in thousands of Canadian dollars, except shares, share prices and earnings per share)

3 Summary of significant accounting policies (continued)

Leases

Lease payments under operating leases are charged to income on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

Convertible debentures

Convertible debentures are initially recorded at their fair value, net of debt issuance costs using an estimated risk-adjusted discount rate. They are subsequently measured at amortized cost using the effective interest rate method.

Provisions

Provisions for legal or constructive obligations, including termination benefits, are recognized in the consolidated financial statements as liabilities when the following three criteria are met: (i) the Company has a present legal or constructive obligation as a result of a past event; (ii) it is more likely than not that an outflow of resources will be required to settle the obligation; and (iii) the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period and are discounted where the effect is material. The Company does not have any significant provisions recorded at December 31, 2018 and 2017.

Income tax

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

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

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

Deferred income tax is recognized in respect of temporary differences arising between the tax basis of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except, in the case of subsidiaries, where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

(in thousands of Canadian dollars, except shares, share prices and earnings per share)

3 Summary of significant accounting policies (continued)

Income tax (continued)

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

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

Loyalty programs

Loyalty programs administered by third-party hotel brands enable guests to earn credit for points redeemable for free accommodations or other benefits at a later date. The Company effectively acts as an agent for these third party programs. Room revenue is shown net of the cost of these loyalty programs.

Share-based compensation

The Company has a share option plan for certain employees and directors. The Company accounts for share options using the fair value method. The Company has a history of settling share options for cash, and as such, they are treated as a liability and are remeasured at each financial reporting date.

New standard and interpretation not yet adopted

IFRS 16, *Leases*

IFRS 16, *Leases* ("IFRS 16"), will replace IAS 17, *Leases*. The new standard results in substantially all leases being recorded on the consolidated statement of financial position of the lessee. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted. The Company will apply the new standard using the modified retrospective approach from January 1, 2019. The modified retrospective approach measures the lease obligation at the present value of the remaining lease payments, with a practical expedient available to measure the right-of-use asset to equal the value of the lease obligation at January 1, 2019. The Company has evaluated the impact of this new standard and at the application date will record a right-of-use asset and corresponding lease obligation of approximately \$700 on its consolidated statement of financial position related to the Company's head office space lease. The standard is not expected to have a cumulative impact on the Company's opening deficit.

Holloway Lodging Corporation

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4 Critical accounting estimates and judgments

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

a) Valuation of property and equipment

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

For the year ended December 31, 2018, the Company assessed 4 of its hotels or CGUs. The Company prepared internal models to determine the recoverable amount of these hotels and considered comparable hotel sales in the respective regions of these CGUs. In total, the Company recorded a net impairment of \$1,000.

For internal models, the recoverable amount is defined as the higher of the value in use and fair value less costs to sell. In our internal models, the recoverable amount is determined based on the fair value less costs to sell which uses stabilized cash flow projections and a terminal value based on long-term average growth rates for the industry. For periods beyond the initial budget period, cash flows were extrapolated using growth rates determined to be reasonable for the specific CGU and the market in which it operates.

The future cash flows expected from the use and eventual disposition involves assumptions of occupancy rates, room rates, revenues, expenses, the residual or terminal value of the CGU and discount rates. In addition to these estimates, management assesses the effect of new competition in the individual markets and the industry predictions of hotel supply and demand. These estimates and assumptions are subject to change.

Based on this information, management recorded an impairment of \$3,800 on CGUs where the recoverable amount declined and reversed previously recorded impairments of \$2,800 on 2 CGUs where the recoverable amount increased.

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

These are level 3 fair value measurements under the fair value hierarchy (note 22). Key factors of estimation uncertainty included in the internal models for the CGUs tested for impairment or reversal of impairment were:

Pre-tax discount rate	12%
Capitalization rate	10%
Growth rates	Consistent with industry and market/hotel outlook

If the pre-tax discount rate or the capitalization rate had been 1% higher/lower, net income would have changed by approximately \$450 and \$600, respectively. If the value of the comparable hotel sales considered had been 5% higher/lower, net income would have changed by approximately \$475.

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4 Critical accounting estimates and judgments (continued)

b) Depreciation of property and equipment

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

c) Income taxes

Deferred income tax assets and liabilities 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 statements of financial position. Significant estimates and judgments are used in determining the future taxable income, which includes consideration of the history of profitability. 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 Company and the amount of deferred income tax assets that should be recognized. In making its assessment, management considers past operating results, forecasted future operating results and economic conditions in the locations in which it operates.

5 Trade, other and insurance proceeds receivable

	December 31, 2018 \$	December 31, 2017 \$
Trade receivables	3,203	2,964
Less: allowance for doubtful accounts	(101)	(40)
	<hr/>	<hr/>
Trade receivables – net	3,102	2,924
Receivables from credit card companies	173	587
Other receivables	353	189
Insurance proceeds receivable (note 9)	–	685
	<hr/>	<hr/>
	3,628	4,385
	<hr/>	<hr/>

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6 Asset held-for-sale

A non-current asset is classified as an asset held-for-sale when its carrying amount is expected to be recovered principally through a sale transaction and a sale is considered highly probable. The asset is stated at the lower of its carrying value and fair value less costs to sell. IFRS 5, *Non-current Assets Held-for-Sale and Discontinued Operations* requires that the property and equipment be measured based on the guidance in IAS 36, *Impairment of Assets*, prior to being classified as an asset held-for-sale.

Prior to December 31, 2018, the Company entered into an agreement to sell the Travelodge® hotel in Dartmouth, NS, which closed on January 15, 2019 (note 25). Based on the recoverable amount, no adjustment to the carrying value of the asset was required upon classification as an asset held-for-sale.

	As at December 31, 2018		
	Cost	Accumulated depreciation	Net
	\$	\$	\$
Land	1,761	–	1,761
Buildings	1,428	(221)	1,207
Furniture, fixtures and other equipment	518	(301)	217
Signage	7	–	7
Computer equipment	41	(27)	14
	3,755	(549)	3,206

7 Loans receivable

	2018	2017
	\$	\$
Senior secured loan	5,457	5,018
Vendor take-back loan (note 8)	3,000	–
	8,457	5,018
Less: Current portion	(1,000)	–
	7,457	5,018

The senior secured loan is denominated in US dollars (US \$4,000) and bears interest at 12.0%. Interest payments are due semi-annually. The maturity date of the loan is April 30, 2027.

The vendor take-back loan has a two-year term and bears interest at 5.0% with interest payable monthly. A principal payment of \$1,000 is due on December 17, 2019 with the balance due on the loan's maturity date of December 17, 2020.

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8 Disposals of property and equipment

2018

Super 8®, High Level, AB

On October 11, 2018, the Company sold the Super 8® hotel in High Level, AB for gross proceeds of \$4,750. After closing costs, the net cash proceeds were \$4,582. The Company recognized a loss on disposal of property and equipment of \$411 in the consolidated statements of income.

Holiday Inn®, Ottawa, ON

On December 17, 2018, the Company sold the Holiday Inn® hotel in Ottawa, ON for gross proceeds of \$50,000. After closing costs and a vendor take-back loan receivable of \$3,000 (note 7), the net cash proceeds before debt repayment was \$45,645. Concurrent with the sale, the Company repaid \$14,250 of its \$47,371 mortgage payable (note 12) and reduced its revolving credit facility availability from \$30,000 to \$21,000 (note 10). The Company recognized a gain on disposal of property and equipment of \$26,309 in the consolidated statements of income.

2017

Holiday Inn®, Oakville, ON

On January 16, 2017, the Company sold the Holiday Inn® hotel in Oakville, ON for gross proceeds of \$19,438. After closing costs, the net cash proceeds were \$19,196. The Company recognized a gain on disposal of property and equipment of \$7,832 in the consolidated statements of income.

Travelodge®, Belleville, ON

On March 17, 2017, the Company sold the Travelodge® hotel in Belleville, ON for gross proceeds of \$7,000. After repayment of the existing mortgage and closing costs, the net cash proceeds were \$3,453. The Company recognized a loss on disposal of property and equipment of \$144 in the consolidated statements of income.

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9 Property and equipment

	For the year ended December 31, 2018						
	Opening net book value \$	Additions \$	Disposals \$	Depreciation 2018 \$	Reclassified as held-for- sale \$	Impairment, net \$	Closing net book value \$
Land	43,053	19	(6,003)	—	(1,761)	(460)	34,848
Land lease	364	—	—	(12)	—	—	352
Buildings and components	213,215	754	(17,239)	(9,346)	(1,207)	(460)	185,717
Renovations in progress	1,067	929	—	—	—	—	1,996
Furniture, fixtures and equipment	24,539	3,521	(3,644)	(5,645)	(217)	(80)	18,474
Paving	351	54	(8)	(52)	—	—	345
Landscaping	208	17	(114)	(50)	—	—	61
Signage	606	17	(118)	(95)	(7)	—	403
Computer equipment and websites	580	443	(87)	(398)	(14)	—	524
Other	64	35	—	(44)	—	—	55
	<u>284,047</u>	<u>5,789</u>	<u>(27,213)</u>	<u>(15,642)</u>	<u>(3,206)</u>	<u>(1,000)</u>	<u>242,775</u>

Disposals consist primarily of two sold hotels in the year (note 8).

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9 Property and equipment (continued)

	As at December 31, 2018			
	Cost	Accumulated impairment losses	Accumulated depreciation	Net book value
	\$	\$	\$	\$
Land	44,770	(9,922)	–	34,848
Land lease	500	(15)	(133)	352
Buildings and components	311,267	(59,784)	(65,766)	185,717
Renovations in progress	1,996	–	–	1,996
Furniture, fixtures and equipment	51,849	(3,989)	(29,386)	18,474
Paving	2,508	(411)	(1,752)	345
Landscaping	90	–	(29)	61
Signage	1,130	–	(727)	403
Computer equipment and websites	2,139	–	(1,615)	524
Other	308	–	(253)	55
	416,557	(74,121)	(99,661)	242,775

During 2018, the Company recognized net impairment losses of \$1,000 (2017 - \$nil) in respect to various CGUs.

On January 26, 2018, the Company entered into a lease arrangement with a third party where the Company leased on a triple net basis, our former Travelodge® hotel in Slave Lake, AB. The lease expires on January 15, 2021 and includes an option for the lessee to acquire the hotel at any time during the lease period. The investment property is accounted for using the cost model and its components are amortized on a straight-line basis over a period of 3-60 years. The carrying value of the property is \$1,625 (December 31, 2017 - \$1,765), net of accumulated depreciation and impairment losses of \$1,994 and \$8,764, respectively (December 31, 2017 - \$1,876 and \$8,764, respectively).

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9 Property and equipment (continued)

	For the year ended December 31, 2017				
	Opening net book value \$	Additions, acquisitions and transfers \$	Disposals \$	Depreciation \$	Closing net book value \$
Land	50,836	–	(7,783)	–	43,053
Land lease	375	–	–	(11)	364
Buildings and components	229,016	3,995	(10,404)	(9,392)	213,215
Renovations in progress	657	416	(6)	–	1,067
Furniture, fixtures and equipment	22,557	8,342	(1,114)	(5,246)	24,539
Paving	409	64	(2)	(120)	351
Landscaping	230	26	–	(48)	208
Signage	619	101	–	(114)	606
Computer equipment and websites	834	294	(76)	(472)	580
Other	91	6	–	(33)	64
	<u>305,624</u>	<u>13,244</u>	<u>(19,385)</u>	<u>(15,436)</u>	<u>284,047</u>

Disposals consist primarily of two sold hotels in the year (note 8) and the derecognized property and equipment of the Super 8® in Grande Prairie, AB as a result of the flood.

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9 Property and equipment (continued)

	As at December 31, 2017			
	Cost	Accumulated impairment losses	Accumulated depreciation	Net book value
	\$	\$	\$	\$
Land	52,793	(9,740)	–	43,053
Land lease	500	(15)	(121)	364
Buildings and components	338,436	(63,695)	(61,526)	213,215
Renovations in progress	1,067	–	–	1,067
Furniture, fixtures and equipment	56,921	(4,103)	(28,279)	24,539
Paving	2,627	(457)	(1,819)	351
Landscaping	289	–	(81)	208
Signage	1,358	–	(752)	606
Computer equipment and websites	2,191	–	(1,611)	580
Other	302	–	(238)	64
	456,484	(78,010)	(94,427)	284,047

On March 17, 2017, the Super 8® in Grande Prairie, AB was damaged due to a significant release of water into the hotel. This event resulted in an insurance claim under the Company's insurance policy. The hotel reopened on October 1, 2017.

In 2017, the Company spent \$1,839 on capital improvements to the hotel and recorded \$767 in business interruption insurance (included in other revenues) and \$1,978 in property and contents insurance proceeds, net of clean-up and other costs. The Company recorded a loss on disposal of \$1,045 on the derecognized portion of the building components and equipment that were damaged. The Company had \$685 of insurance proceeds receivable at December 31, 2017, which was received in 2018.

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10 Revolving credit facilities

	December 31, 2018	December 31, 2017
	\$	\$
Revolving credit facilities	<u>15,000</u>	<u>25,339</u>

The Company has revolving credit facilities with two Canadian chartered banks. The first credit facility has a maximum borrowing capacity of \$45,000 (December 31, 2017 - \$45,000). This credit facility's availability is determined by a borrowing base calculation and bears interest at prime plus 1.25% or based on a spread to banker's acceptance. At December 31, 2018, the balance on this facility was \$nil (December 31, 2017 - \$20,839). This facility is secured by a registered charge on nine hotel properties, is subject to an annual review and has no set expiry.

The second credit facility has a maximum borrowing capacity of \$21,000 (December 31, 2017 - \$30,000) and was obtained in 2017 (note 12). This credit facility bears interest at prime plus 1.50%. At December 31, 2018, the Company had drawn \$15,000 (December 31, 2017 - \$4,500) on this facility. This facility is secured by a registered charge on nine hotel properties (December 31, 2017 - ten hotel properties), is subject to an annual review and matures in May 2022. Each individual draw must be repaid within one year.

At December 31, 2018, the credit facilities had a weighted average interest rate of 5.45% (December 31, 2017 - 4.49%) and a total available to be drawn of \$51,000 (December 31, 2017 - \$49,661).

11 Trade payables and accrued liabilities

	December 31, 2018	December 31, 2017
	\$	\$
Trade payables	2,565	3,929
Accrued liabilities	5,804	5,460
	<u>8,369</u>	<u>9,389</u>

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12 Mortgages payable

	December 31, 2018 \$	December 31, 2017 \$
Mortgages payable, bearing interest at a weighted average rate of 4.83% (December 31, 2017 - 4.57%) and maturing on various dates from October 2019 to September 2029. Individual first charges on 20 hotel properties (December 31, 2017 - 21 hotel properties) with a net book value of \$173,418 (December 31, 2017 - \$204,015) have been pledged as security for individual mortgages	79,383	91,672
Less: Deferred financing fees	(841)	(1,085)
	<u>78,542</u>	<u>90,587</u>
Less: Current portion	(11,377)	(6,864)
	<u>67,165</u>	<u>83,723</u>

In December 2018, the Company repaid \$14,250 on its \$47,371 mortgage payable using proceeds from the sale of the Holiday Inn® hotel in Ottawa, ON as this hotel was security for this mortgage.

In November 2018, the Company refinanced a maturing mortgage on one of its hotels, increasing the principal balance to \$3,700 from \$2,480. The interest rate was reduced from 5.54% to 4.15%. The mortgage has an amortization period of ten years and a three-year term.

In June 2018, the Company drew the remaining \$5,000 available on an existing mortgage with a maximum principal amount of \$17,500, secured by two hotels. The mortgage bears interest at 4.55%, has an amortization period of fifteen years and matures in July 2022. The Company obtained this mortgage in July 2017 of which \$6,866 was drawn in July 2017 and \$5,634 was drawn in October 2017.

In October 2017, the Company extended a mortgage on one of its hotels with a principal amount of \$4,902 which was to mature in April 2018. The interest rate was reduced from 4.81% to 4.29%. The mortgage has an amortization period of fifteen years and a five-year term.

In May 2017, the Company repaid eleven mortgages totaling \$90,385 which were to mature in May and July 2017. The Company secured financing with a new lender through a loan consisting of a \$50,000 mortgage and a \$30,000 revolving credit facility (note 10). The mortgage bears interest at prime plus 1.50%, has an option to convert the interest to a fixed rate, an amortization period of seventeen years and a five-year term. The loan is secured by a registered charge on nine hotel properties.

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

	\$
Year ending December 31, 2019	11,416
2020	6,358
2021	11,261
2022	46,888
2023	560
Thereafter	2,900

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12 Mortgages payable (continued)

The following table summarizes significant changes in mortgages payable for the years ended December 31, 2018 and 2017:

	2018	2017
	\$	\$
Beginning balance	90,587	127,296
Proceeds from new mortgages	6,220	62,500
Repayment of mortgages	(18,510)	(98,676)
Additions to deferred financing fees	(64)	(920)
Write-off of deferred financing fees on mortgages repaid during the year	–	107
Amortization of deferred financing fees	309	280
Ending balance	<u>78,542</u>	<u>90,587</u>

13 Share-based liability

The Company issues options to purchase common shares to its directors and certain employees. The change in fair value of the share-based liability is recognized in share-based expense in the consolidated statements of income.

The following table summarizes the changes in the share-based liability for the years ended December 31, 2018 and 2017:

	2018	2017
	\$	\$
Beginning balance	525	709
Options exercised	(26)	(498)
Change in fair value of share-based liability	403	314
Ending balance	<u>902</u>	<u>525</u>

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13 Share-based liability (continued)

At December 31, 2018, the fair value of the options were measured using the Black-Scholes option pricing model with the following assumptions (not in thousands):

	Option grant		
	March 2017	March 2016	November 2014
Exercise price	\$5.36	\$4.80	\$6.37
Closing price at December 31, 2018	\$6.35	\$6.35	\$6.35
Volatility	29.9%	29.9%	21.7%
Annual dividend yield	2.2%	2.2%	2.2%
Expected remaining option life	5 years	4 years	1 year
Annual risk-free interest rate	1.9%	1.9%	1.9%
Fair value per option	\$1.84	\$2.02	\$0.49

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

	2018		2017	
	Weighted average exercise price in \$ per share	Options	Weighted average exercise price in \$ per share	Options
At January 1	5.62	810,000	5.11	770,000
Granted	—	—	5.36	285,000
Exercised	4.93	(21,667)	3.70	(245,000)
Forfeited	5.67	(33,333)	—	—
At December 31	5.64	<u>755,000</u>	5.62	<u>810,000</u>

Of the 755,000 outstanding options (December 31, 2017 - 810,000), 516,667 options are exercisable (December 31, 2017 - 391,667).

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

Expiry date	Exercise price per share	December 31, 2018	December 31, 2017
	\$	\$	\$
November 2019	6.37	310,000	310,000
December 2019	6.37	—	15,000
March 2023	4.80	175,000	200,000
March 2024	5.36	270,000	285,000
		<u>755,000</u>	<u>810,000</u>

On March 29, 2017, the Company granted a total of 285,000 options to purchase common shares to directors and certain employees with an exercise price of \$5.36 per share. The options vest equally over three years commencing on March 29, 2018 and expire after seven years. Subsequent to December 31, 2018, as a result of the acquisition of control, the unvested common share options immediately vested (note 25).

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14 Convertible debentures

At December 31, 2018, the Company had two series of convertible debentures outstanding. The Series B Debentures (HLC.DB) have a maturity date of February 28, 2020, bear interest at 6.25% payable semi-annually on April 30 and October 31 and have a face value of \$50,866 (December 31, 2017 - \$50,866). The Series C Debentures (HLC.DB.A) had a maturity date of September 30, 2021, bear interest at 7.50% payable semi-annually on March 31 and September 30 and have a face value of \$40,565 (December 31, 2017 - \$40,565).

On January 3, 2019, the Company fully redeemed the Series C Debentures. The Company paid the holders of the Series C Debentures \$1,019.52 per \$1,000 (amounts not in thousands) principal amount, representing the principal amount of \$1,000 and accrued and unpaid interest of \$19.52. At December 31, 2018, the Series C Debentures are presented as current in the consolidated statements of financial position.

In August 2017, the Company obtained approval to amend the Series B and C Debentures to provide holders with the option to exchange their Debentures upon receiving an exchange notice from the Company. The Company also extended the Series C Debentures to September 30, 2021 and amended the conversion price.

With the amendment noted above, the Series C Debentures were convertible at the option of the holder for 80 common shares at \$12.50 per share of the Company for each \$1,000 principal amount of debentures outstanding (amount not in thousands). The Series B Debentures can be converted at the option of the holder for \$285 in cash and 28 common shares of the Company for each \$1,000 principal amount of debentures outstanding (amounts not in thousands). The Company has the option to repay the principal amount of the debentures, in whole or in part, at maturity or redeem the debentures in whole or in part, at or prior to maturity, in cash or by issuing the number of equivalent common shares of the Company (the "Redemption Option"). The number of common shares to be issued is calculated by dividing the aggregate principal amount by 95% of the current market price of the common shares (calculated in accordance with the indenture).

The Redemption Option is required to be accounted for as an embedded derivative financial instrument. On initial recognition, the Redemption Option was recorded at its calculated fair value and grouped with the debentures. The Redemption Option is adjusted to its fair value at each reporting date and any change in the fair value is included in interest and accretion on debt in the consolidated statements of income. On initial recognition, the carrying value of the liability portion of the debentures was increased by the amount of the debt premium arising from the Redemption Option, which is amortized over the term of the debentures.

	December 31, 2018	December 31, 2017
	\$	\$
Face value of convertible debentures	91,431	91,431
Discount and embedded derivative	(1,148)	(1,919)
Deferred financing fees	(58)	(52)
	<u>90,225</u>	<u>89,460</u>
Less: Current portion	<u>(40,205)</u>	<u>—</u>
	<u>50,020</u>	<u>89,460</u>

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14 Convertible debentures (continued)

The following table summarizes the significant changes in the convertible debentures for the years ended December 31, 2018 and 2017:

	2018	2017
	\$	\$
Beginning balance	89,460	89,815
Accretion of discount and amortization of deferred financing fees	740	929
Change in fair value of embedded derivative	25	–
Carrying value of debentures repurchased under NCIB	–	(1,284)
Ending balance	<u>90,225</u>	<u>89,460</u>

On January 15, 2018, the Company initiated 12 month Normal Course Issuer Bids (“NCIBs”) to repurchase a maximum of \$4,962 principal amount of its Series B Debentures and \$3,411 principal amount of its Series C Debentures. The Series B Debentures NCIB expired on January 14, 2019. The Series C Debentures NCIB was terminated on January 3, 2019 as a result of the redemption of the debentures. No purchases under the NCIBs were made in 2018.

On January 13, 2017, the Company initiated 12 month NCIBs to repurchase up to \$4,526 of its issued and outstanding Series B Debentures and \$3,411 of its issued and outstanding Series C Debentures. These NCIBs were in effect until January 12, 2018. During 2017, the Company repurchased and cancelled Series B Debentures with a \$1,321 face value for \$1,264 (average cost of \$95.69 per \$100 face value - prices not in thousands) and Series C Debentures with a \$7 face value for \$7 (average cost of \$98.99 per \$100 face value - prices not in thousands) pursuant to this NCIB. The Company recorded a gain on the repurchase of the debentures of \$13 which represents the difference between the book value at the time of repurchase and the amount paid.

15 Shareholders’ equity

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

Issued and outstanding common shares

The following table summarizes the number of common shares issued and outstanding and the related carrying values as at December 31, 2018 and 2017:

	Shares issued and outstanding #	Carrying value \$
Balance – January 1, 2017	18,889,066	226,414
Repurchase of common shares under NCIB	(518,100)	(6,288)
Balance – December 31, 2017	<u>18,370,966</u>	<u>220,126</u>
Repurchase of common shares under NCIB	(1,225,413)	(14,683)
Balance – December 31, 2018	<u>17,145,553</u>	<u>205,443</u>

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15 Shareholders' equity (continued)

On August 17, 2018, the Company initiated a 12 month NCIB to repurchase up to 893,682 of its issued and outstanding shares. On August 17, 2017, the Company initiated a 12 month NCIB to repurchase up to 943,713 of its issued and outstanding shares. On August 17, 2016, the Company initiated a 12 month NCIB to repurchase up to 944,453 of its issued and outstanding shares.

For the year ended December 31, 2018, the Company repurchased and cancelled 1,225,413 shares at a cost of \$7,457 (average price of \$6.09 per share). For the year ended December 31, 2017, the Company repurchased and cancelled 518,100 shares at a cost of \$2,887 (average price of \$5.57 per share).

On December 18, 2018, the Company announced the commencement of a substantial issuer bid ("SIB") to purchase up to 1,200,000 of its outstanding common shares (or such greater number of common shares that the Company may determine it will take up and pay for) at a purchase price of \$6.50 per share. On January 23, 2019, the Company announced that a total of 1,553,755 common shares were deposited pursuant to the SIB, resulting in a cash outlay of \$10,099.

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

	December 31, 2018	December 31, 2017
Common shares outstanding	17,145,553	18,370,966
Conversion of convertible debentures	4,698,442	4,698,442
Options outstanding and exercisable	516,667	391,667
Total common shares reflecting exercise and conversion	<u>22,360,662</u>	<u>23,461,075</u>

The Board of Directors declared a quarterly dividend of \$0.035 per share in each quarter of 2018, representing an annual dividend of \$0.14 per share. The Company declared and paid \$2,505 in dividends for the year ended December 31, 2018 (December 31, 2017 - \$2,625).

16 Basic and diluted 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 years.

	<u>For the years ended</u>	
	December 31, 2018	December 31, 2017
	\$	\$
Net income attributable to shareholders of the Company	21,628	6,478
Weighted average number of shares outstanding	17,908,914	18,792,951
Basic earnings per share	1.21	0.34

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16 Basic and diluted earnings per share (continued)

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. During the years ended December 31, 2018 and 2017, the Company had two categories of potentially dilutive instruments – convertible debentures and options. This calculation is done to determine the number of shares that could have been acquired at fair value based on the subscription rights of the convertible debentures and options. For the year ended December 31, 2017, the options and convertible debentures were anti-dilutive.

Diluted earnings per share for the year ended December 31, 2018 is presented below:

	<u>For the year ended</u> <u>December 31,</u> <u>2018</u> \$
Diluted income attributable to shareholders of the Company	26,832
Weighted average number of diluted shares	22,671,453
Diluted earnings per share	1.18

17 Expenses by nature

A summary of operating expenses, property taxes and insurance and corporate and administrative expenses is presented below:

	<u>For the years ended</u>	
	<u>December 31,</u> <u>2018</u> \$	<u>December 31,</u> <u>2017</u> \$
Salaries, wages and employee benefits	34,906	34,702
Materials, supplies, repairs and utilities	19,378	19,328
Food, beverage and service costs	5,637	5,708
Royalty and franchise fees	5,630	5,152
Property taxes	5,099	5,374
Other	2,462	2,431
Legal, audit and other professional consulting fees	1,108	1,273
Information technology and support	1,056	1,094
Insurance	769	871
Depreciation of corporate assets	44	30
	<u>76,089</u>	<u>75,963</u>

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18 Salaries, wages and employee benefits

	For the years ended	
	December 31, 2018 \$	December 31, 2017 \$
Salaries and wages	31,185	31,105
Benefits	3,410	3,301
RRSP and pension expense	51	56
Directors fees	228	230
Termination benefits	32	10
	<u>34,906</u>	<u>34,702</u>
Share-based expense	403	314
	<u>35,309</u>	<u>35,016</u>

Compensation of key management

Key management includes the Company's directors and officers. Compensation awarded to key management included:

	For the years ended	
	December 31, 2018 \$	December 31, 2017 \$
Salaries and benefits	752	848
Consulting fees	25	250
Share-based expense – cash	26	507
Directors fees	238	230
	<u>1,041</u>	<u>1,835</u>

19 Income taxes

The following table is a reconciliation of the expected income tax recovery at the statutory rate to the amounts recognized in the consolidated statements of income for the years ended December 31, 2018 and 2017:

	For the years ended	
	December 31, 2018 \$	December 31, 2017 \$
Income before income taxes	28,600	8,580
Combined statutory income tax rate	27.60%	27.54%
Income tax expense at the combined statutory income tax rate	7,894	2,363
Non-taxable portion of gains	(1,120)	(478)
Non-deductible expenses	134	108
Change in tax rates	(58)	(13)
Other	174	76
Provision for income taxes	<u>7,024</u>	<u>2,056</u>

The statutory tax rate was 27.60% for the year ended December 31, 2018 (December 31, 2017 - 27.54%). The income tax provision will not require an outlay of cash due to available non-capital loss carry forwards.

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19 Income taxes (continued)

Deferred income taxes

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

	December 31, 2017 \$	Recognized in net income \$	December 31, 2018 \$
Deferred income tax assets			
Property and equipment	22,563	(5,849)	16,714
Non-capital losses	3,879	(1,351)	2,528
Other assets	227	(26)	201
Deferred income tax liabilities			
Convertible debentures	(543)	210	(333)
Deferred financing fees	(10)	(8)	(18)
Net deferred income tax assets	<u>26,116</u>	<u>(7,024)</u>	<u>19,092</u>

The Company's US subsidiary has non-capital loss carry forwards of US \$5,115, which expire between the years 2028 and 2037. The US subsidiaries sold the majority of its assets during 2015 and the Company has no plans to utilize or otherwise benefit from these loss carry forwards at the present time. Deductible temporary differences and unused US tax losses for which no deferred income tax assets have been recognized are attributable to the following:

	December 31, 2018 \$	December 31, 2017 \$
Non-capital losses	<u>6,979</u>	<u>6,243</u>

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

Year of expiry	Loss \$
2032	582
2033	4,397
2034	4,095
2035	64
2037	18
2038	1
Total	<u>9,157</u>

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20 Supplemental cash flow information

Adjustments for non-cash items:

	For the years ended	
	December 31, 2018	December 31, 2017
	\$	\$
Depreciation and amortization	15,696	15,481
Accretion on debt and unrealized foreign exchange gain	619	1,577
Share-based expense	403	314
Gain on disposals of property and equipment and repurchase of convertible debentures	(25,813)	(6,581)
Impairment of hotel properties, net	1,000	—
Provision for income taxes	7,024	2,056
	<u>(1,071)</u>	<u>12,847</u>

Changes in items of working capital:

	For the years ended	
	December 31, 2018	December 31, 2017
	\$	\$
Trade, other and insurance proceeds receivable	757	(805)
Inventories	71	43
Prepaid expenses and deposits	(62)	1,644
Trade payables and accrued liabilities	(498)	(748)
Accrued interest on convertible debentures	—	(14)
	<u>268</u>	<u>120</u>

21 Contingencies and commitments

Contingencies

In the course of the Company's ordinary activities, the Company is involved in administrative proceedings, litigations and claims. In September 2015, the Company was served with a personal injury claim in the Alberta Court of Queen's Bench seeking over \$10,000 in damages. The Company believes the claims are without merit, there are valid defences to any actions or the outcomes will not have a material impact on the Company's consolidated statements of financial position or results of operations. The Company intends to fully defend its interests and take all other action available to it. The outcome of the claims is subject to future court proceedings, and it is not practicable to determine an estimate of the possible financial effect, if any, at this time with sufficient reliability. Accordingly, no amounts have been recorded in the accounts of the Company related to these claims.

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21 Contingencies and commitments (continued)

Commitments

Franchise agreements

Under the terms of the hotel franchise agreements expiring at various dates through the year 2036, franchise fees (including royalty fees, reservation and marketing assessments) are due to franchise companies on 29 of the 31 hotels owned by the Company at December 31, 2018 (December 31, 2017 - 32 of 33 hotels). The franchise fees paid to franchisors for all but one hotel are calculated based on a percentage of revenue, with one hotel's fees being based on an annual membership fee.

Operating leases

The Company leases office space and has various equipment operating leases. The minimum annual lease payments over the next five years are as follows:

	\$
Year ending December 31, 2019	126
2020	111
2021	106
2022	102
2023	99

22 Financial instruments and fair values

The following table shows the carrying values of assets and liabilities by category at December 31, 2018 and 2017:

	December 31, 2018		December 31, 2017	
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$
Assets				
Amortized cost				
Cash	32,610	32,610	691	691
Trade, other and insurance proceeds receivable	3,628	3,628	4,385	4,385
Loans receivable	8,457	8,457	5,018	5,018
	<u>44,695</u>	<u>44,695</u>	<u>10,094</u>	<u>10,094</u>
Liabilities				
Amortized cost				
Trade payables and accrued liabilities	8,369	8,369	9,389	9,389
Accrued interest on convertible debentures	1,290	1,290	1,290	1,290
Revolving credit facilities	15,000	15,000	25,339	25,339
Mortgages payable	78,542	79,900	90,587	91,107
Convertible debentures	90,225	90,627	89,460	89,651
	<u>193,426</u>	<u>195,186</u>	<u>216,065</u>	<u>216,776</u>
Fair value through profit and loss				
Share-based liability	902	902	525	525

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22 Financial instruments and fair values (continued)

The carrying value of the following items approximate their fair value due to the immediate or short-term maturities of these financial instruments: cash, trade, other and insurance proceeds receivable, trade payables and accrued liabilities, accrued interest on convertible debentures and the revolving credit facilities. Loans receivable approximate their fair value due to their insignificant expected credit losses.

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

- **Mortgages payable:** The fair value is determined using internal valuation techniques which incorporate the discounted future cash flows using discount rates that reflect current market conditions for debt instruments with similar interest rates, terms and risk. The fair values do not necessarily represent the amounts the Company might pay in actual market transactions.
- **Convertible debentures:** The convertible debentures have two components of value: the conventional debentures and the Redemption Option (note 14). The fair value of the convertible debentures is based on the quoted market price for the debentures. The Redemption Option has been accounted for as an embedded derivative that is required to be bifurcated from the underlying debentures, valued using an option pricing model and accounted for as a financial asset with the amount of any Redemption Option being added to the carrying value of the convertible debentures. Any change in the fair value of the Redemption Option is recorded in interest and accretion on debt in the consolidated statements of income.
- **Share-based liability:** The fair value is determined using the quoted market price for the shares, the Black-Scholes option pricing model and internal valuation techniques which incorporate the share price in calculating volatility. Volatility is calculated using the Company's specific volatility bases on the historical share price.

Fair value hierarchy

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

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices); and
- Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

	December 31, 2018 \$	December 31, 2017 \$
Level 2		
Redemption Option	—	25
Share-based liability	902	525

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23 Risk management

The Company's activities expose it to interest rate risk, credit risk, currency risk and liquidity risk. Senior management is responsible for setting acceptable levels of risk and reviewing risk management activities as necessary. The Company's overall risk management program seeks to minimize potential adverse effects on the Company's financial performance.

a) Interest rate risk

The Company is exposed to interest rate risk on its lending and borrowing activities. It manages its exposure to interest rate risk by using fixed rate debt or debt with a fixed-rate option, so cash flows are not impacted significantly by a change in interest rates. The weighted average interest rate on its mortgages payable is 4.83% (December 31, 2017 - 4.57%) with a weighted average maturity of 3.5 years (December 31, 2017 - 4.5 years).

The Company has one mortgage (December 31, 2017 - one mortgage) and its revolving credit facilities at floating rates. For the year ended December 31, 2018, if interest rates on the Company's floating rate debt had been 1% higher/lower, net income would have changed by approximately \$700 (December 31, 2017 - \$500).

b) Credit risk

The amount of trade, other and insurance proceeds receivable presented on the consolidated statements of financial position of \$3,628 is net of an allowance for doubtful accounts. The Company also has two loans receivable in the amount of \$8,457 obtained through the respective sales of previously owned assets. There is no impairment provision recorded on the loans receivable.

Historically, there have been no significant trade receivable 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.

c) Currency risk

The Company is exposed to currency risk as it pays certain franchise and royalty payments and receives interest income on a loan receivable denominated in US dollars (note 7). A \$0.01 change in the US dollar exchange rate would have an impact on net income of approximately \$15 (December 31, 2017 - \$19).

d) Liquidity risk

The Company's objective is to have sufficient liquidity to meet its liabilities when due, as well as to maintain compliance with various covenants in its financing agreements and its capital management requirements and objectives. The Company monitors and forecasts its cash balances and cash flows generated from operations to meet its required obligations. Cash flow forecasting is performed at the hotel level and aggregated in head office.

The Company has two revolving credit facilities with a total available to be drawn of \$51,000 (note 10).

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

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24 Risk management (continued)

d) Liquidity risk (continued)

The tables below analyzes the Company's non-derivative financial liabilities by relevant maturity groupings based on the remaining period from the statement of financial position date to the contractual maturity date. The amounts below are the contractual undiscounted cash flows.

	December 31, 2018			
	Less than 3 months \$	3 months to 1 year \$	1 to 5 years \$	Over 5 years \$
Trade payables and accrued liabilities	8,369	–	–	–
Convertible debentures (face value)	40,565	–	50,866	–
Convertible debentures interest	792	3,179	1,060	–
Revolving credit facilities	–	15,000	–	–
Revolving credit facilities interest	264	758	–	–
Mortgages payable	3,949	7,467	65,067	2,900
Mortgage interest	883	2,648	7,433	295

	December 31, 2017			
	Less than 3 months \$	3 months to 1 year \$	1 to 5 years \$	Over 5 years \$
Trade payables and accrued liabilities	9,389	–	–	–
Convertible debentures (face value)	–	–	91,431	–
Convertible debentures interest	1,521	4,700	12,076	–
Revolving credit facilities	–	25,339	–	–
Revolving credit facilities interest	285	848	–	–
Mortgages payable	1,103	5,768	81,342	3,459
Mortgage interest	1,021	3,063	10,956	419

24 Capital management

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

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

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24 Capital management (continued)

The Company monitors capital using certain financial metrics, including (but not limited to) a debt service coverage ratio defined as earnings before interest, income taxes, depreciation, amortization, non-cash accretion and share-based expense to the sum of the annual principal and interest payments on its revolving credit facilities, mortgages and convertible debentures (“debt service”). The Company’s covenants require the debt service coverage ratio (“DSCR”) to exceed various levels ranging from 1.25 - 1.40, with certain DSCR tests to be met on a property-specific basis.

	<u>For the years ended</u>	
	<u>December 31,</u> <u>2018</u>	<u>December 31,</u> <u>2017</u>
	\$	\$
Earnings base	32,963	32,039
Debt service	16,122	17,862
Debt service coverage ratio	2.04	1.79

The Company is also subject to financial covenants on certain of its mortgages payable and revolving credit facilities, which include customary terms and conditions for borrowings of this nature. At December 31, 2018, all covenants measured on an annual basis were in compliance except one mortgage for which a waiver was obtained from the lender. This mortgage matures in 2019 and is presented as current on the consolidated statements of financial position as at December 31, 2018. At December 31, 2017, all covenants measured on an annual basis were in compliance.

25 Subsequent events

On January 3, 2019, the Company fully redeemed its Series C Debentures, resulting in a cash outlay of \$41,357 (note 14).

On January 15, 2019, the Company sold the Travelodge® hotel in Dartmouth, NS for gross proceeds of \$6,900. After repayment of the existing mortgage, closing costs and a vendor take-back loan receivable of \$700, the net cash proceeds were \$3,199. The Company expects to record a gain on disposal of property and equipment of approximately \$3,486 in the first quarter of 2019.

On January 24, 2019, the Company, pursuant to an SIB, repurchased 1,553,755 of its common shares. As a result, a shareholder acquired control of the Company and owns approximately 51% of the common shares. Also as a result, a change of control was triggered under the Company's option plan. Accordingly, all unvested options vested immediately and, subject to limited exceptions, all options that are not exercised will be terminated 90 days following the change of control.

On January 25, 2019, the Company initiated a 12 month NCIB to repurchase a maximum of \$4,920 principal amount of its issued and outstanding Series B Debentures. The NCIB will be in effect until January 24, 2020 or such earlier time as the bid is completed or terminated at the option of the Company.

On January 30, 2019, the Company purchased a non-performing US dollar loan receivable, secured by an office building, for US \$4,800. On March 5, 2019, the Company foreclosed on the office property.

On March 6, 2019, the Company sold the Days Inn® and Travelodge® hotels in Moncton, NB for gross proceeds of \$14,000. After repayment of the existing mortgages, closing costs and a vendor take-back loan receivable of \$1,000, the net cash proceeds were \$5,859. The Company expects to record a gain on disposal of property and equipment of approximately \$2,500 in the first quarter of 2019