

FORM 51-102F4

BUSINESS ACQUISITION REPORT

Item 1 Identity of Corporation

1.1 Name and Address of Corporation

Clarke Inc.
145 Hobsons Lake Drive,
Suite 106, Halifax, NS B3S 0H9

("Clarke" or the "Corporation")

1.2 Executive Officer

The name of the executive officer of the Corporation who is knowledgeable about the significant acquisition and this report is Stephen Cyr, Chief Financial Officer, and his business telephone number is (902) 442-3415.

Item 2 Details of Acquisition

2.1 Nature of Business Acquired

On September 30, 2019, Clarke acquired ownership of 7,383,797 common shares of Holloway Lodging Corporation ("**Holloway**"), representing all of the issued and outstanding common shares in the capital of Holloway (the "**Holloway Shares**") not already owned by Clarke, pursuant to the terms of an arrangement agreement dated August 8, 2019 between Clarke and Holloway (the "**Arrangement Agreement**"). The Holloway Shares were acquired by way of a statutory plan of arrangement pursuant to section 182 of the *Business Corporations Act* (Ontario) (the "**Arrangement**"), which was approved by shareholders of Holloway at a special meeting held on September 25, 2019.

In connection with the Arrangement, Clarke assumed all of the outstanding Series B 6.25% convertible unsecured debentures due February 28, 2023 of Holloway (the "**Holloway Debentures**") effective as of September 30, 2019.

Holloway is a real estate corporation focused on acquiring, adding value to and operating select real estate assets and managing hotels for third parties. Holloway owns 19 hotels with 2,188 rooms across Canada. Prior to the completion of the Arrangement, the Holloway Shares and Holloway Debentures traded on the Toronto Stock Exchange under the trading symbol "HLC" and "HLC.DB", respectively.

2.2 Date of Acquisition

September 30, 2019.

2.3 Consideration

Under the terms of the Arrangement, shareholders of Holloway, other than Clarke, received 0.65 of a common share of Clarke (each whole common share, a "**Clarke Share**") for each Holloway

Share. As consideration for acquiring all of the Holloway Shares, Clarke issued 4,799,455 Clarke Shares.

2.4 Effect on Financial Position

The effect of the Arrangement on the Corporation's financial position is outlined in the Corporation's unaudited *pro forma* financial statements, which are set forth in Schedule C.

2.5 Prior Valuations

No valuation opinion was obtained within the last 12 months by Holloway or Clarke that was required by securities legislation or a Canadian exchange or market to support the consideration paid by Clarke for the Holloway Shares pursuant to the Arrangement.

2.6 Parties to Transaction

The parties to the Arrangement Agreement were Holloway and Clarke. Prior to completion of the Arrangement, Clarke owned 8,037,215 Holloway Shares, representing approximately 52% of the issued and outstanding Holloway Shares, and therefore Holloway was an affiliate of Clarke within the meaning of National Instrument 51-102 – *Continuous Disclosure Obligations* ("NI 51-102").

2.7 Date of Report

December 3, 2019.

Item 3 Financial Statements

The following financial statements are required by Part 8 of NI 51-102 to be included in this report and are set forth in Schedule A, Schedule B and Schedule C, respectively:

- (a) audited consolidated financial statements of Holloway for the years ended December 31, 2018 and December 31, 2017. The auditor, PricewaterhouseCoopers LLP, was not engaged to consent to the inclusion of its auditor's report in this business acquisition report;
- (b) unaudited condensed interim consolidated financial statements of Holloway for the three and six months ended June 30, 2019 and June 30, 2018;
- (c) unaudited *pro forma* consolidated financial statements of Clarke, consisting of (i) the Corporation's unaudited *pro forma* consolidated statement of earnings for the six months ended June 30, 2019; and (ii) the Corporation's unaudited *pro forma* consolidated statement of earnings for the year ended December 31, 2018.

A *pro forma* statement of financial position has not been included as the Arrangement is reflected in the Corporation's unaudited interim condensed consolidated financial statements for the three and nine months ended September 30, 2019 and 2018.

SCHEDULE A

**Audited consolidated financial statements of Holloway for the years ended December 31, 2018 and
December 31, 2017**

[See attached]

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.

PricewaterhouseCoopers LLP
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T: +1 902 491 7400, F: +1 902 422 1166

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



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	—
	<u>41,900</u>	<u>6,541</u>
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
	<u>269,861</u>	<u>315,868</u>
Total assets	<u>311,761</u>	<u>322,409</u>
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
	<u>77,143</u>	<u>43,407</u>
Non-current liabilities		
Mortgages payable (note 12)	67,165	83,723
Convertible debentures (note 14)	50,020	89,460
	<u>117,185</u>	<u>173,183</u>
Total liabilities	<u>194,328</u>	<u>216,590</u>
Equity		
Equity attributable to shareholders of the Company	115,750	104,084
Non-controlling interest	1,683	1,735
Total equity	<u>117,433</u>	<u>105,819</u>
Total liabilities and equity	<u>311,761</u>	<u>322,409</u>
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)	<u>7,024</u>	<u>2,056</u>
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
	20,505	19,371
Changes in items of working capital (note 20)	268	120
Net cash generated from operating activities	20,773	19,491
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	43,827	16,683
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	(32,681)	(36,666)
Increase (decrease) in cash during the years	31,919	(492)
Cash – beginning of years	691	1,183
Cash – end of years	32,610	691
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

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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

Notes to the Consolidated Financial Statements

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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.

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)

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)
Trade receivables – net	3,102	2,924
Receivables from credit card companies	173	587
Other receivables	353	189
Insurance proceeds receivable (note 9)	–	685
	3,628	4,385

Holloway Lodging Corporation

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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.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

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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.

Holloway Lodging Corporation

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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
	284,047	5,789	(27,213)	(15,642)	(3,206)	(1,000)	242,775

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

Holloway Lodging Corporation

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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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For the years ended December 31, 2018 and 2017

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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
	305,624	13,244	(19,385)	(15,436)	284,047

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.

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

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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	15,000	25,339

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
	8,369	9,389

Holloway Lodging Corporation

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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)
	78,542	90,587
Less: Current portion	(11,377)	(6,864)
	67,165	83,723

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

Holloway Lodging Corporation

Notes to the Consolidated Financial Statements

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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	<u>403</u>	<u>314</u>
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)
	90,225	89,460
Less: Current portion	(40,205)	—
	50,020	89,460

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)

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>

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)

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	22,360,662	23,461,075

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.

	For the years ended	
	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

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)

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>

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)

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
	34,906	34,702
Share-based expense	403	314
	35,309	35,016

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
	1,041	1,835

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	7,024	2,056

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.

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)

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	26,116	(7,024)	19,092

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	6,979	6,243

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	9,157

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)

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
	(1,071)	12,847

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)
	268	120

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.

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)

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

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)

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

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)

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.

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)

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.

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)

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.

	For the years ended	
	December 31, 2018	December 31, 2017
	\$	\$
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.

SCHEDULE B

**Unaudited condensed interim consolidated financial statements of Holloway for the three
and six months ended June 30, 2019 and June 30, 2018**

[See attached]

Holloway Lodging Corporation

Interim Condensed Consolidated Financial Statements
(Unaudited)

June 30, 2019

(in thousands of Canadian dollars)

August 9, 2019

Management's Report

The accompanying unaudited interim condensed consolidated financial statements of **Holloway Lodging Corporation** (the "Company") have been prepared by the Company's management. The unaudited interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and contain estimates based on management's judgment. The unaudited interim condensed consolidated 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 condensed consolidated financial statements. The Board of Directors have reviewed and approved these unaudited interim condensed consolidated financial statements.

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

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

Holloway Lodging Corporation

Interim Condensed Consolidated Statements of Financial Position

(Unaudited)

As at June 30, 2019

(in thousands of Canadian dollars)

	June 30, 2019	December 31, 2018 Restated (note 2)
	\$	\$
Assets		
Current assets		
Cash	1,245	32,610
Trade and other receivables	5,224	3,628
Inventories	369	419
Prepaid expenses and deposits	1,703	1,037
Current portion of loans receivable (note 4)	2,200	1,000
Asset held-for-sale (note 3)	-	3,206
	10,741	41,900
Non-current assets		
Loans receivable (note 4)	4,720	7,457
Property and equipment (notes 2, 3 and 5)	251,438	241,150
Investment property (notes 2 and 6)	19,545	2,525
Other assets	477	537
Deferred income tax assets (note 2)	10,533	18,892
	286,713	270,561
Total assets	297,454	312,461
Liabilities		
Current liabilities		
Revolving credit facilities (note 3)	28,477	15,000
Trade payables and accrued liabilities	9,835	8,369
Accrued interest on convertible debentures	530	1,290
Current portion of mortgages payable	10,357	11,377
Current portion of convertible debentures (note 7)	-	40,205
Share-based liability (note 8)	-	902
	49,199	77,143
Non-current liabilities		
Mortgages payable	54,738	67,165
Convertible debentures (note 7)	48,710	50,020
Lease obligation (note 2)	624	-
	104,072	117,185
Total liabilities	153,271	194,328
Equity		
Equity attributable to shareholders of the Company	142,532	116,450
Non-controlling interest	1,651	1,683
Total equity	144,183	118,133
Total liabilities and equity	297,454	312,461

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

Holloway Lodging Corporation

Interim Condensed Consolidated Statements of Income (Loss)

(Unaudited)

For the three and six months ended June 30, 2019 and 2018

(in thousands of Canadian dollars)

	For the three months ended		For the six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
				Restated (note 2)
	\$	\$	\$	\$
Revenues				
Hotel: Rooms	17,520	22,613	34,138	42,319
Food and beverage	2,091	2,536	4,255	4,900
Rental	219	328	470	647
Other	1,000	1,158	2,055	2,205
Management services	264	27	463	90
	21,094	26,662	41,381	50,161
Expenses				
Operating expenses	14,378	16,982	29,346	33,608
Property taxes and insurance	1,226	1,395	2,497	2,915
Depreciation and amortization	3,360	3,926	6,956	7,849
	18,964	22,303	38,799	44,372
Income before the following	2,130	4,359	2,582	5,789
Other (income) and expenses				
Interest and accretion on debt	2,306	3,260	4,734	6,506
Corporate and administrative	592	444	1,192	1,497
Share-based expense (note 8)	-	18	202	317
Interest income	(135)	(163)	(343)	(315)
Insurance proceeds, net of clean-up and other costs (note 5)	(949)	-	(949)	-
Loss (gain) on disposals of assets (notes 3 and 4)	523	71	(2,956)	75
Gain on debenture extension (note 7)	(1,600)	-	(1,600)	-
Selling costs on property and equipment sales (note 3)	337	-	1,217	-
Revaluation of hotel properties (notes 2 and 5)	(200)	-	6,400	-
Fair value change of investment property (notes 2 and 6)	-	-	-	(900)
Write-off of deferred financing fees and discount on debenture redemption	-	-	362	-
Unrealized foreign exchange (gain) loss	(5)	(113)	108	(258)
	869	3,517	8,367	6,922
Income (loss) before income taxes	1,261	842	(5,785)	(1,133)
Provision for (recovery of) income taxes (notes 2 and 9)	(2,714)	410	(4,895)	(80)
Net income (loss) for the period	3,975	432	(890)	(1,053)
Attributable to:				
Shareholders of the Company	3,993	429	(820)	(1,004)
Non-controlling interest	(18)	3	(70)	(49)
	3,975	432	(890)	(1,053)
Basic earnings (loss) per share (notes 2 and 10)	0.26	0.02	(0.05)	(0.05)
Diluted earnings (loss) per share (notes 2 and 10)	0.18	0.02	(0.05)	(0.05)

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

Holloway Lodging Corporation

Interim Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

For the three and six months ended June 30, 2019 and 2018

(in thousands of Canadian dollars)

	For the three months ended June 30, 2019	June 30, 2018	For the six months ended June 30, 2019	June 30, 2018 Restated (note 2)
	\$	\$	\$	\$
Net income (loss) for the period	3,975	432	(890)	(1,053)
Items that will not be reclassified to profit or loss				
Revaluation surplus (notes 2 and 5)	(940)	-	52,060	-
Income taxes	240	-	(13,351)	-
	(700)	-	38,709	-
Items that will be reclassified to profit or loss				
Cumulative translation adjustments (note 6)	(334)	-	(334)	-
Income taxes	92	-	92	-
	(242)	-	(242)	-
Other comprehensive income (loss)	(942)	-	38,467	-
Comprehensive income (loss) for the period	3,033	432	37,577	(1,053)
Comprehensive income (loss) attributable to:				
Shareholders of the Company	3,051	429	37,647	(1,004)
Non-controlling interest	(18)	3	(70)	(49)
	3,033	432	37,577	(1,053)

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

Holloway Lodging Corporation

Interim Condensed Consolidated Statements of Changes in Equity (Unaudited)

For the six months ended June 30, 2019 and 2018

(in thousands of Canadian dollars)

	Common shares \$	Contributed surplus \$	Deficit \$	Revaluation surplus (note 2) \$	Accumulated other comprehensive loss \$	Equity attributable to shareholders of the Company \$	Non- controlling interest \$	Total equity \$
Balance, January 1, 2018	220,126	6,347	(122,389)	-	-	104,084	1,735	105,819
Net loss and comprehensive loss for the period	-	-	(1,004)	-	-	(1,004)	(49)	(1,053)
Dividends paid to shareholders	-	-	(1,279)	-	-	(1,279)	-	(1,279)
Repurchase of common shares (note 10)	(2,359)	1,202	-	-	-	(1,157)	-	(1,157)
Balance, June 30, 2018 – restated (note 2)	217,767	7,549	(124,672)	-	-	100,644	1,686	102,330
Balance, January 1, 2019 – restated (note 2)	205,443	13,573	(102,566)	-	-	116,450	1,683	118,133
Net loss for the period	-	-	(820)	-	-	(820)	(70)	(890)
Other comprehensive income for the period	-	-	-	38,709	(242)	38,467	-	38,467
Comprehensive income for the period	-	-	(820)	38,709	(242)	37,647	(70)	37,577
Transfer upon sale of properties (note 3)	-	-	8,037	(8,037)	-	-	-	-
Contributions from non- controlling interests	-	-	-	-	-	-	38	38
Exercise of options	24	-	-	-	-	24	-	24
Dividends paid to shareholders	-	-	(1,091)	-	-	(1,091)	-	(1,091)
Repurchase of common shares (note 10)	(19,051)	8,553	-	-	-	(10,498)	-	(10,498)
Balance, June 30, 2019	186,416	22,126	(96,440)	30,672	(242)	142,532	1,651	144,183

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

Holloway Lodging Corporation

Interim Condensed Consolidated Statements of Cash Flows (Unaudited)

For the six months ended June 30, 2019 and 2018

(in thousands of Canadian dollars)

	For the six months ended June 30, 2019	June 30, 2018 Restated (note 2)
	\$	\$
Cash provided by (used in)		
Operating activities		
Net loss for the period	(890)	(1,053)
Adjustments for non-cash items (note 11)	6,303	7,572
	5,413	6,519
Changes in items of working capital (note 11)	(2,812)	(1,255)
Net cash generated from operating activities	2,601	5,264
Investing activities		
Additions to property and equipment and change in other assets	(2,389)	(3,182)
Additions of investment property	(17,458)	-
Proceeds from sales of assets and property and equipment, net of costs (note 3)	34,790	-
Proceeds from sale of loan receivable (note 4)	4,513	-
Net cash (used in) provided by investing activities	19,456	(3,182)
Financing activities		
Proceeds from (repayment of) revolving credit facilities	13,477	(1,796)
Proceeds from mortgages, net of deferred financing fees	-	4,980
Repayment of mortgages payable	(13,664)	(2,179)
Repurchase of common shares	(10,498)	(1,157)
Redemption of convertible debentures	(40,565)	-
Dividends paid to shareholders	(1,091)	(1,279)
Settlement of share-based liability	(1,080)	-
Contributions from non-controlling interests	38	-
Financing fees on convertible debentures	(39)	-
Net cash used in financing activities	(53,422)	(1,431)
(Decrease) increase in cash	(31,365)	651
Cash – beginning of period	32,610	691
Cash – end of period	1,245	1,342
Supplemental cash flow information		
Interest paid	4,976	5,923
Interest received	438	171

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

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

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited)

For the three and six months ended June 30, 2019 and 2018

(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, provides hotel management services to third parties and owns three commercial office buildings in Houston, TX. As at June 30, 2019, the Company owned and operated 24 hotels and held a 62% interest in another hotel in Canada, with a total of 2,890 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 six months ended June 30, 2019 represent the results of 25 hotels for the full period and 6 hotels for part of the period as the Company:

- sold the Travelodge® in Dartmouth, NS on January 15, 2019;
- sold the Travelodge® in Moncton, NB on March 6, 2019;
- sold the Days Inn® in Moncton, NB on March 6, 2019;
- sold the Super 8® in Windsor, NS on March 28, 2019;
- sold the Super 8® in Timmins, ON on June 18, 2019; and
- sold the Travelodge® in Timmins, ON on June 18, 2019.

The results of operations for the six months ended June 30, 2018 represent the operations of 33 hotels for the full period.

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 highest of the year.

2 Basis of preparation, changes in accounting policies and new accounting standard

These unaudited interim condensed consolidated financial statements (“condensed 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, and in accordance with IAS 34, *Interim Financial Reporting*. These condensed financial statements should be read in conjunction with the Company’s audited annual financial statements for the year ended December 31, 2018. 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, 2018, except as discussed below.

These condensed consolidated financial statements were approved for issue by the Board of Directors on August 8, 2019.

Foreign currency translation

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

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

2 Basis of preparation, changes in accounting policies and new accounting standard (continued)

Changes in accounting policies

On January 1, 2019, the Company adopted the revaluation model for measurement after recognition for certain assets classified under IAS 16, *Property, Plant and Equipment* ("IAS 16") and adopted the fair value model for measurement after recognition under IAS 40, *Investment Property* ("IAS 40"). This note explains the impact of these accounting policy changes on the Company's financial statements.

IAS 16, *Property, Plant and Equipment*

Effective January 1, 2019, the Company changed its accounting policy for measurement after recognition of certain asset classes of its property and equipment from the cost model to the revaluation model. The change in accounting policy is accounted for prospectively as required by IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

The policy choice is by asset class, and as such, the Company has elected to change its land and buildings and components asset classes to the revaluation model. All other asset classes will continue to be accounted for under the cost model. This accounting policy change will provide consistent carrying values of our property and equipment with our controlling shareholder's purchase price allocation on their acquisition of control. Under the revaluation model, land and buildings and components are carried at fair value at the date of revaluation and subsequently depreciated until the next revaluation.

The Company has elected the net method for adjustment upon revaluation. The net method eliminates accumulated depreciation and accumulated impairment against the carrying amount of the asset and then revalues the net carrying amount. Depreciation on the carrying amount is charged to profit and loss.

Land and buildings and components are revalued on a sufficiently regular basis using third party offers, internal models or external appraisals, when available, so that the carrying value of an asset does not materially differ from its fair value at each reporting date. The Company has established a methodology to evaluate when circumstances indicate that the carrying amount may differ materially from its fair value, which includes significant changes in operating performance, economic activity, regional development opportunities and new competition in the markets in which each hotel operates.

On transition to the revaluation model, initial increases in fair value are recorded in other comprehensive income and accumulated within equity in revaluation surplus. Initial decreases in fair value are recorded in profit and loss. Subsequently, increases in fair value are recorded in other comprehensive income and accumulated in revaluation surplus, except to the extent that they reverse a revaluation decrease previously charged to profit and loss, in which case the reversal is recorded in profit and loss. Decreases in fair value are charged against other comprehensive income and the revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset, and thereafter are recorded in profit and loss.

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

2 Basis of preparation, changes in accounting policies and new accounting standard (continued)

IAS 16, *Property, Plant and Equipment* (continued)

To determine the fair value at January 1, 2019, the Company used a capitalized income internal model and considered hotel sales in comparable markets. The fair value models were prepared internally. Capitalization rates used were obtained from an independent third party. In the Company's internal models, each hotel's recent historical operating income was normalized for any unusual and non-recurring events and reduced by a capital expenditure reserve of 4% of revenues. A 4% capital expenditure reserve may not reflect actual capital expenditures for a particular hotel.

A capitalization rate specific to the market in which each hotel operates was applied to the operating income. In situations where the capitalized income value resulted in a fair value which differed significantly from the price per room metrics in recent market transactions, the Company used comparable hotel sales prices, professional judgement and management expertise to determine the fair value. The fair value may not reflect the realizable value in the event a particular hotel is sold by the Company.

On January 1, 2019, the Company recorded a revaluation surplus of \$53,000 on 20 hotels where the fair value exceeded the carrying value and a revaluation expense of \$6,600 on 8 hotels where the carrying value exceeded the fair value. One hotel's fair value equaled its carrying value.

These are level 3 fair value measurements under the fair value hierarchy. A key factor of estimation uncertainty used in the internal models was the capitalization rate, which ranged from 9.0% - 11.0%. If the capitalization rate had been 0.25% higher/lower, the estimated fair value under the capitalized income approach would have changed the value of property and equipment by \$4,500. If the value of the comparable hotel sales had been 5% higher/lower, the estimated fair value would have changed the value of property and equipment by \$2,800.

On June 30, 2019, the Company revalued 4 hotels based on third party offers. The value of 2 hotels increased by a total of \$2,130, and the value of 2 hotels decreased by a total of \$2,870. The increases in fair value were recorded in other comprehensive income and accumulated in revaluation surplus except for 1 hotel where the increase was partially recorded in the statement of income (loss) as it reversed a \$200 revaluation decrease previously charged to profit and loss. The decreases in fair value were charged against other comprehensive income.

IAS 40, *Investment Property*

Effective January 1, 2019, the Company changed its accounting policy for measurement after recognition of its investment property from the cost model to the fair value model. The change in policy was applied retrospectively, which means the policy was applied to transactions, events and conditions as if it had always been in effect. This accounting policy change will provide consistent carrying values of our investment property with our controlling shareholder's purchase price allocation on their acquisition of control.

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements (Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

2 Basis of preparation and new accounting standards (continued)

IAS 40, *Investment Property* (continued)

Investment property is held either to earn rental income, for capital appreciation (including future re-development) or both, but not for sale in the ordinary course of business.

Investment property is initially measured at cost, including transaction costs, and subsequently measured at fair value at each reporting date. The difference between the fair value at the reporting date and the carrying value is recognized in profit and loss. Under the fair value model, investment property is not depreciated.

Selected adjusted financial statement information reflecting the change in accounting policy is presented below. The accounting policy change did not impact the results of the Company for the three months ended June 30, 2018.

Interim Condensed Consolidated Statement of Financial Position As at December 31, 2018

	As originally presented \$	Accounting policy change \$	As restated \$
Investment property (previously included in property and equipment)	1,625	900	2,525
Deferred income tax assets	19,092	(200)	18,892
Equity attributable to shareholders of the Company	115,750	700	116,450

Interim Condensed Consolidated Statement of Loss and Comprehensive Loss For the six months ended June 30, 2018

	As originally presented \$	Accounting policy change \$	As restated \$
Fair value change of investment property	-	(900)	(900)
Loss before income taxes	(2,033)	900	(1,133)
Recovery of income taxes	(280)	200	(80)
Net loss and comprehensive loss for the period	(1,753)	700	(1,053)
Attributable to:			
Shareholders of the Company	(1,704)	700	(1,004)
Non-controlling interest	(49)	-	(49)
	(1,753)	700	(1,053)
Basic and diluted loss per share	(0.09)	0.04	(0.05)

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

2 Basis of preparation and new accounting standards (continued)

New accounting standard

IFRS 16, *Leases*

IFRS 16, *Leases* replaces IAS 17, *Leases*. The new standard results in substantially all leases being recorded on the consolidated statement of financial position of the lessee. The Company has selected the modified retrospective approach without the use of practical expedients as its transition method for this standard. The Company elected to apply exemptions for low value and short-term leases upon transition. The Company evaluated the impact of this new standard and at January 1, 2019, recorded a right-of-use asset and corresponding lease obligation of \$738 on its interim condensed consolidated statement of financial position related to the Company's head office space lease. The right-of-use asset is presented in property and equipment. The current portion of the lease obligation is presented in trade payables and accrued liabilities. The standard did not have an impact on the Company's opening deficit.

A reconciliation of operating lease commitments disclosed at December 31, 2018 and the right-of-use asset is presented below.

	\$
Operating lease commitments disclosed at December 31, 2018	544
Commitments on low value and short-term leases	(71)
Commitments in excess of five years, not disclosed	470
Discount	<u>(205)</u>
Right-of-use asset	<u>738</u>

3 Disposals of asset held-for-sale and property and equipment

Travelodge®, Dartmouth, NS

On January 15, 2019, the Company sold the Travelodge® hotel in Dartmouth, NS, for gross proceeds of \$6,900 and recorded a gain on sale of \$3,478 in the consolidated statement of income (loss). This property was accounted for as an asset held-for-sale at December 31, 2018. It was not subject to the revaluation model and accordingly, the gain on sale was recorded in the consolidated statement of loss. The Company received net cash proceeds of \$3,199 after selling costs, the repayment of a \$2,823 mortgage secured by the property and the provision of a \$700 vendor take-back second mortgage.

Days Inn®, Moncton, NB

On March 6, 2019, the Company sold the Days Inn® hotel in Moncton, NB, for gross proceeds of \$9,000. The Company received net cash proceeds of \$4,056 after selling costs, the repayment of a \$3,624 mortgage secured by the property and the provision of a \$1,000 vendor take-back second mortgage. On January 1, 2019, a revaluation adjustment of \$2,000 on this property was recognized in other comprehensive income. Upon disposition, this revaluation surplus was transferred to deficit within equity.

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements (Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

3 Disposals of asset held-for-sale and property and equipment (continued)

Travelodge®, Moncton, NB

On March 6, 2019, the Company sold the Travelodge® hotel in Moncton, NB, for gross proceeds of \$5,000. The Company received net cash proceeds of \$1,790 after selling costs and the repayment of a \$3,028 mortgage secured by the property. On January 1, 2019, a revaluation adjustment of \$1,000 on this property was recognized in other comprehensive income. Upon disposition, this revaluation surplus was transferred to deficit within equity.

Single tenant property, Timmins, ON

On March 18, 2019, the Company sold its single tenant property located in Timmins, ON, for gross proceeds of \$1,725. The Company received net cash proceeds of \$1,648 after selling costs. On January 1, 2019, a revaluation adjustment of \$614 on this property was recognized in other comprehensive income. Upon disposition, this revaluation surplus was transferred to deficit within equity.

Super 8®, Windsor, NS

On March 28, 2019, the Company sold the Super 8® hotel in Windsor, NS, for gross proceeds of \$5,300. The Company received net cash proceeds of \$2,452 after selling costs, the repayment of a \$2,157 mortgage secured by the property and the provision of a \$500 vendor take-back second mortgage. On January 1, 2019, a revaluation adjustment of \$2,900 on this property was recognized in other comprehensive income. Upon disposition, this revaluation surplus was transferred to deficit within equity.

Super 8®, Timmins, ON

On June 18, 2019, the Company sold the Super 8® hotel in Timmins, ON, for gross proceeds of \$6,500. The Company received net cash proceeds of \$5,279 after selling costs and the provision of a \$1,000 vendor take-back second mortgage. On January 1, 2019, a revaluation adjustment of \$2,900 on this property was recognized in other comprehensive income. Upon disposition, this revaluation surplus was transferred to deficit within equity.

Travelodge®, Timmins, ON

On June 18, 2019, the Company sold the Travelodge® hotel in Timmins, ON, for gross proceeds of \$4,900. The Company received net cash proceeds of \$4,734 after selling costs. On January 1, 2019, a revaluation adjustment of \$1,386 on this property was recognized in other comprehensive income. Upon disposition, this revaluation surplus was transferred to deficit within equity.

The two hotels in Timmins, ON had provided security on one of the Company's revolving credit facilities, which has a maximum borrowing capacity of \$45,000, determined by a borrowing base calculation. At June 30, 2019, the maximum borrowing capacity of this credit facility was \$40,650.

4 Loans receivable

On April 30, 2019, the Company sold US\$3,450 principal amount of its US\$4,000 loan receivable for net proceeds of \$4,513. The loss on sale of \$116 was recorded in the three months ended June 30, 2019.

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

5 Property and equipment

	For the six months ended June 30, 2019							
	Opening net book value	Additions	Transfers	Disposals	Depreciation	Revaluation through other comprehensive income	Revaluation through profit and loss	Closing net book value
	\$	\$	\$	\$	\$	\$	\$	\$
Land	34,250	936	1,978	(6,854)	-	9,689	(960)	39,039
Buildings and components	184,793	395	-	(24,346)	(4,628)	42,371	(5,440)	193,145
Furniture, fixtures, equipment and other	20,111	1,452	-	(1,512)	(2,290)	-	-	17,761
Right-of-use asset	-	738	-	-	(38)	-	-	700
Renovations in progress	1,996	775	(1,978)	-	-	-	-	793
	241,150	4,296	-	(32,712)	(6,956)	52,060	(6,400)	251,438

Disposals consist primarily of five hotels and one single tenant property sold during the period (note 3).

	As at June 30, 2019				
	Valuation	Cost	Accumulated impairment losses	Accumulated depreciation	Net book value
	\$	\$	\$	\$	\$
Land	39,039	-	-	-	39,039
Buildings and components	197,564	-	-	(4,419)	193,145
Furniture, fixtures, equipment and other	-	52,347	(3,951)	(30,635)	17,761
Right-of-use asset	-	738	-	(38)	700
Renovations in progress	-	793	-	-	793
	236,603	53,878	(3,951)	(35,092)	251,438

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

5 Property and equipment (continued)

The Super 8® in Yellowknife, NT and the Travelodge® in Sydney, NS were damaged due to a release of water into the hotels. These events resulted in insurance claims under the Company's insurance policy. The Company has incurred \$900 on capital improvements to the hotels and has recorded \$107 and \$219 in business interruption insurance (included in other revenues) in the three and six months ended June 30, 2019, respectively and \$949 in property and contents insurance, net of clean-up and other costs in the three and six months ended June 30, 2019. The Company recorded a loss on disposal of \$400 on the write-off of the building components that were damaged.

6 Investment property

	\$
Beginning balance, January 1, 2019 (note 2)	2,525
Additions through acquisition	17,458
Foreign exchange	(438)
Ending balance, June 30, 2019	19,545

On May 24, 2019, the Company acquired two office buildings in Houston, TX, for US \$8,275. 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 building. The functional currency of these foreign operations is the US dollar.

On January 26, 2018, the Company entered into a lease arrangement with a third party where the Company leased on a triple net basis, its 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. On January 1, 2019, the Company changed its accounting policy and retroactively restated the asset from property and equipment to investment property and recorded a fair value adjustment of \$900.

7 Convertible debentures

At December 31, 2018, the Company had two series of convertible debentures outstanding. 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 principal amount (amounts not in thousands), representing the principal amount of \$1,000 and accrued and unpaid interest of \$19.52.

On April 26, 2019, at a meeting of the holders of the Series B Debentures, the Company obtained approval to amend the Series B Debentures as follows: (1) extending the maturity date by three years to February 28, 2023; (2) amending the conversion price to \$12.50 per common share being a conversion rate of 80 common shares per \$1,000 principal amount of the debentures; and (3) amending the redemption provision to, among other things, prohibit the Company from redeeming the debentures until June 1, 2020, except in connection with a change in control of the Company resulting in the acquisition of 100% of the voting or equity interests in the Company and except, for the 60 days following the effective date of the debenture amendments, to allow the Company to redeem up to 10% of the aggregate principal amount, being approximately \$5,087 aggregate principal amount, of the debentures at a price equal to the principal amount thereof, plus accrued and unpaid interest. A gain of \$1,600 was recognized in the three months ended June 30, 2019 based on the present value of the modified contractual cash flows as a result of extending the maturity date.

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

7 Convertible debentures (continued)

The following table summarizes the significant changes in the convertible debentures for the six months ended June 30, 2019:

	\$
Beginning balance, January 1, 2019	90,225
Accretion of discount and amortization of deferred financing fees	329
Deferred financing fees	(39)
Gain on debenture extension	(1,600)
Carrying value of fully redeemed debentures	<u>(40,205)</u>
Ending balance, June 30, 2019	<u>48,710</u>

8 Share-based liability

The Company issues options to purchase common shares to its directors and certain employees which can be settled for cash.

On January 24, 2019, a change of control occurred which resulted in all unvested options vesting immediately and, subject to limited exceptions, all options not exercised within 90 days expired. At December 31, 2018, there were 755,000 options outstanding. During the six months ended June 30, 2019, 740,000 options were exercised and settled with cash and 15,000 options were exercised and settled with the issuance of 3,514 common shares.

The following table summarizes the changes in the share-based liability for the six months ended June 2019.

	\$
Beginning balance, January 1, 2019	902
Options exercised	(1,104)
Change in fair value of share-based liability	<u>202</u>
Ending balance, June 30, 2019	<u>-</u>

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

9 Income taxes

The following table is a reconciliation of the expected income tax recovery at the statutory rate to the amounts recognized in the condensed consolidated statements of income (loss):

	For the three months ended		For the six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018 Restated (note 2)
	\$	\$	\$	\$
Income (loss) before income taxes	1,261	842	(5,785)	(1,053)
Combined statutory income tax rate	27.60%	27.51%	27.60%	27.51%
Income tax at the combined statutory income tax rate	348	232	(1,597)	(290)
Non-taxable portion of gains	(269)	(16)	(576)	(35)
Non-deductible expenses	5	11	65	98
Adjustment on change of control	(2,862)	-	(2,862)	-
Change in tax rates	-	-	-	28
Other	64	183	75	119
Provision for (recovery of) income taxes	(2,714)	410	(4,895)	(80)

The statutory tax rate was 27.60% for the six months ended June 30, 2019 (for the six months ended June 30, 2018 - 27.51%).

The Company was subject to an acquisition of control on January 24, 2019 which resulted in the realization of certain tax attributes which were not recognized by the Company prior to that date. The recognition of these tax attributes upon filing of income tax compliance, resulted in a \$2,862 deferred income tax asset and income tax recovery. The Company expects to realize the deferred income tax asset in the future.

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements (Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

10 Share capital and earnings (loss) per share

Basic

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

	<u>For the three months ended</u>		<u>For the six months ended</u>	
	<u>June 30,</u>	<u>June 30,</u>	<u>June 30,</u>	<u>June 30,</u>
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
				<u>Restated</u>
				<u>(note 2)</u>
				<u>\$</u>
Net income (loss) attributable to shareholders of the Company	\$ 3,993	\$ 429	\$ (820)	\$ (1,004)
Weighted average number of shares outstanding	15,579,273	18,259,844	15,781,541	18,275,855
Basic earnings (loss) per share	0.26	0.02	(0.05)	(0.05)

Diluted

Diluted earnings (loss) 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 six months ended June 30, 2019, the Company had one potentially dilutive instrument, convertible debentures. During the six months ended June 30, 2018, the Company had both 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 three months ended June 30, 2018 and the six months ended June 30, 2019 and 2018, the potentially dilutive instruments were antidilutive.

Diluted earnings per share for the three months ended June 30, 2019 is presented below:

	<u>Three months ended</u>
	<u>June 30,</u>
	<u>2019</u>
	<u>\$</u>
Diluted income attributable to shareholders of the Company	3,470
Weighted average number of diluted shares	19,648,553
Diluted earnings per share	0.18

At June 30, 2019, there were 15,559,112 common shares outstanding. During the six months ended June 30, 2019, the Company repurchased and cancelled 1,589,955 shares at a cost of \$10,498 (average price of \$6.60 per share). During the six months ended June 30, 2018, the Company repurchased and cancelled 196,900 shares at a cost of \$1,157 (average price of \$5.88 per share).

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

11 Supplemental cash flow information

Adjustments for non-cash items:

	For the six months ended	
	June 30, 2019	June 30, 2018 Restated (note 2)
	\$	\$
Revaluation of hotel properties	6,400	-
Depreciation and amortization	6,977	7,868
Accretion on debt and foreign exchange changes	601	292
Share-based expense	202	317
Fair value change of investment property	-	(900)
(Gain) loss on disposal of assets	(2,956)	75
Gain on debenture extension	(1,600)	-
Selling costs on property and equipment sales	1,217	-
Write-off of deferred financing fees and discount on debenture redemption	362	-
Recovery of income taxes	(4,900)	(80)
	6,303	7,572

Changes in items of working capital:

	For the six months ended	
	June 30, 2019	June 30, 2018
	\$	\$
Trade and other receivables	(1,596)	(746)
Inventories	50	35
Prepaid expenses and deposits	(666)	(1,669)
Trade payables and accrued liabilities	160	1,125
Accrued interest on convertible debentures	(760)	-
	(2,812)	(1,255)

12 Financial instruments and fair values

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

	June 30, 2019		December 31, 2018	
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$
Mortgages payable	65,095	65,012	78,542	79,900
Convertible debentures	48,710	51,375	90,225	90,627

The methods and assumptions used in estimating the fair values are consistent with those applied in the Company's audited annual financial statements for the year ended December 31, 2018.

Holloway Lodging Corporation

Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited)

For the three and six months ended June 30, 2019 and 2018

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

13 Related party transactions

The Company's controlling shareholder as of January 24, 2019 is Clarke Inc. ("Clarke"), which is a public company listed on the Toronto Stock Exchange. Clarke and companies owned or partially owned by Clarke's Executive Chairman and his immediate family member are considered related parties of the Company. During the three and six months ended June 30, 2019, the Company paid rent, IT support fees and tax services of \$80 and \$150, respectively to companies owned or partially owned by Clarke's Executive Chairman and his immediate family member.

14 Subsequent events

On July 25, 2019, the Company sold the Travelodge® hotel in Sydney, NS for gross proceeds of \$5,050. After repayment of the existing mortgage and closing costs, the net cash proceeds were \$1,820. The hotel property has been revalued in the six months ended June 30, 2019 to reflect its fair value.

On August 6, 2019, the Company sold its leasehold interest in the Super 8® hotel in Truro, NS for gross proceeds of \$3,000. After repayment of the existing mortgage and closing costs, the net cash proceeds were \$1,070. The hotel property has been revalued in the six months ended June 30, 2019 to reflect its fair value.

On August 8, 2019, the Company entered into a definitive agreement (the "Arrangement Agreement") pursuant to which Clarke agreed to acquire all outstanding common shares of the Company by way of a statutory plan of arrangement under the Ontario Business Corporations Act. Under the terms of the Arrangement Agreement, Holloway shareholders, other than Clarke, will receive 0.65 common shares of Clarke for each Holloway common share they own. The acquisition is valued at approximately \$132 million on an equity value basis as of the announcement date on August 9, 2019. As of August 9, 2019, Clarke owned 7,952,715 common shares of Holloway, representing approximately 51% of the outstanding Holloway common shares.

The transaction, which is subject to approval by both Holloway and Clarke shareholders, and other customary conditions and approvals, is expected to close in the third quarter of 2019. Upon closing, Holloway will become a wholly-owned subsidiary of Clarke.

SCHEDULE C

Unaudited Pro Forma Consolidated Financial Statements of Clarke

[See attached]

Clarke Inc.

For the Six Months Ended June 30, 2019 and
the Year Ended December 31, 2018

Clarke Inc.
PRO FORMA CONSOLIDATED STATEMENT OF EARNINGS
Unaudited (in thousands of Canadian dollars, except per share amounts)

For the six months ended June 30, 2019

	Clarke Inc. (including consolidation of Holloway from January 23, 2019) \$	Notes	Pro forma adjustments \$	Pro forma statement of earnings \$
Revenue and other income				
Hotel and management services	36,923	3(i)	4,458	41,381
Provision of services	2,216		—	2,216
Bargain purchase	22,108		—	22,108
Investment and other income	14,736	3(i)	50	14,786
	75,983		4,508	80,491
Expenses				
Hotel operating expenses	25,487	3(i)	3,798	29,285
Cost of services provided	2,032		—	2,032
General and administrative expenses	1,568	3(i)	270	1,838
Property taxes and insurance	2,176	3(i)	321	2,497
Selling costs on property and equipment sales	1,217		—	1,217
Loss on disposal of assets	527		—	527
Insurance proceeds, net of clean-up and other costs	(949)		—	(949)
Share-based payment expense	445	3(i)	102	547
Depreciation	6,338	3(i)	856	7,370
		3(iii)	176	
Interest expense	4,237	3(i)	608	4,862
		3(iii)	17	
	43,078		6,148	49,226
Income before income taxes	32,905		(1,640)	31,265
Recovery of income taxes	(3,924)	3(v)	(468)	(4,392)
Net income	36,829		(1,172)	35,657
Attributable to:				
Equity holders of the Company	35,508	3(ii)	1,391	35,727
			(1,172)	
Non-controlling interest	1,321	3(ii)	(1,391)	(70)
	36,829		(1,172)	35,657
Basic earnings per share attributable to equity holders of the Company:				
(in dollars) (note 4)	2.93			2.11
Diluted earnings per share attributable to equity holders of the Company:				
(in dollars) (note 4)	2.91			1.87

See accompanying notes to the unaudited pro forma condensed consolidated financial statements

Clarke Inc.
PRO FORMA CONSOLIDATED STATEMENT OF EARNINGS
Unaudited (in thousands of Canadian dollars, except per share amounts)

For the year ended December 31, 2018

	Clarke Inc. \$	Holloway Lodging Corporation \$	Change in accounting policy (note 5) \$	Notes	Pro forma adjustments \$	Pro forma statement of earnings \$
Revenue and other income						
Hotel and management services	—	107,918	—		—	107,918
Provision of services	7,395	—	—		—	7,395
Investment and other income (loss)	(945)	26,852	—	3(iv)	(5,885)	20,022
	6,450	134,770	—		(5,885)	135,335
Expenses						
Hotel operating expenses	—	68,471	—		—	68,471
Cost of services provided	4,228	—	—		—	4,228
General and administrative expenses	1,814	1,750	—		—	3,564
Property taxes and insurance	—	5,868	—		—	5,868
Impairment of hotel properties	—	1,000	—	3(iii)	(1,000)	—
Fair value change of investment property	—	—	(900)	3(iii)	900	—
Share-based payment expense	—	403	—		—	403
Depreciation	331	15,652	—	3(iii)	2,791	18,774
Interest expense	129	13,026	—	3(iii)	(488)	12,667
	6,502	106,170	(900)		2,203	113,975
Income (loss) before income taxes	(52)	28,600	900		(8,088)	21,360
Provision for (recovery of) income taxes	512	7,024	200	3(v)	(1,310)	6,426
Net income (loss)	(564)	21,576	700		(6,778)	14,934
Attributable to:						
Equity holders of the Company	(564)	21,628	700		(6,778)	14,986
Non-controlling interest	—	(52)	—		—	(52)
	(564)	21,576	700		(6,778)	14,934
Basic earnings (loss) per share attributable to equity holders of the Company:						
(in dollars) (note 4)	(0.04)					0.86
Diluted earnings (loss) per share attributable to equity holders of the Company:						
(in dollars) (note 4)	(0.04)					0.86

See accompanying notes to the unaudited pro forma condensed consolidated financial statements

Clarke Inc.

NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the six months ended June 30, 2019 and year ended December 31, 2018

Unaudited (in thousands of Canadian dollars, except per share amounts)

1. BASIS OF PRESENTATION

The unaudited pro forma consolidated statements of earnings of Clarke Inc. ("Clarke" or the "Company") for the six months ended June 30, 2019 and the year ended December 31, 2018, have been prepared by management of Clarke for illustrative purposes only and give effect to the transactions and the proposed acquisition pursuant a plan of arrangement under the Business Corporations Act (Ontario) (the "Acquisition") of the remaining outstanding shares of Holloway Lodging Corp. ("Holloway") not already owned by Clarke. The Agreement (as defined herein) provides that Clarke would acquire all the remaining outstanding shares of Holloway not owned by Clarke. The pro forma financial statements have been prepared on the basis of the assumptions and adjustments described below and in note 3.

In the opinion of management, the unaudited pro forma consolidated statements of earnings for the six months ended June 30, 2019 and the year ended December 31, 2018, include all adjustments necessary for the presentation of the transaction on a basis consistent with Clarke's accounting policies applied in its audited consolidated financial statements for the year ended December 31, 2018 and in its unaudited interim condensed consolidated financial statements for the three and six months ended June 30, 2019.

The unaudited pro forma condensed consolidated financial statements may not be indicative of the financial position that would have prevailed and operating results that would have been obtained if the transactions had taken place on the dates indicated or of the financial position or operating results which may be obtained in the future. The unaudited pro forma condensed consolidated financial statements are not a forecast or projection of future results. The actual financial position and results of operations of the Company for any period following the closing of the Acquisition will vary from the amounts set forth in the unaudited pro forma condensed consolidated financial statements and such variations may be material.

The unaudited pro forma condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of Clarke as at and for the year ended December 31, 2018, the unaudited interim condensed consolidated financial statements of Clarke as at and for the three and six months ended June 30, 2019, the audited consolidated financial statements of Holloway as at and for the year ended December 31, 2018 and the unaudited interim condensed consolidated financial statements of Holloway as at and for the three and six months ended June 30, 2019, all of which were prepared in accordance with International Reporting Standards ("IFRS").

The unaudited pro forma consolidated statement of earnings for the six months ended June 30, 2019, has been prepared using information from the unaudited interim consolidated statement of earnings of Clarke for the six months ended June 30, 2019 and the unaudited interim consolidated statement of income (loss) of Holloway for the six months ended June 30, 2019. The unaudited pro forma consolidated statement of earnings for the six months ended June 30, 2019 gives effect to the Acquisition as if it had occurred on January 1, 2018.

The unaudited pro forma consolidated statement of earnings for the year ended December 31, 2018, has been prepared using information from the audited consolidated statement of earnings of Clarke for the year ended December 31, 2018, and the audited consolidated statement of income of Holloway for the year ended December 31, 2018. The unaudited pro forma consolidated statement of earnings for the year ended December 31, 2018 gives effect to the Acquisition as it had occurred on January 1, 2018.

On January 23, 2019, Clarke acquired control of Holloway through its ownership of a 51% controlling interest in Holloway.

Clarke is considered the legal and accounting acquirer and applied the acquisition method of accounting in the preparation of Clarke's unaudited interim consolidated financial statements for the three and six months ended June 30, 2019 ("historical acquisition accounting"). As a result:

Clarke Inc.

NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the six months ended June 30, 2019 and year ended December 31, 2018

Unaudited (in thousands of Canadian dollars, except per share amounts)

1. BASIS OF PRESENTATION (CONT'D)

- The statement of earnings for Clarke for the three and six months ended June 30, 2019 already includes the results of operations of Holloway from January 23, 2019, based on the historical acquisition accounting. The unaudited pro forma statements of earnings for the six months ended June 30, 2019 and the twelve months ended December 31, 2018 have been adjusted to reflect the incremental impact of the acquisition of Holloway as if the Acquisition Agreement had occurred on January 1, 2018, using the accounting values of the assets and liabilities acquired as per the historical acquisition accounting.
- Certain reclassifications have been made to Holloway's historical financial statements in preparation of the pro forma condensed consolidated financial statements to conform to the financial statement presentation currently adopted by Clarke.

There were no material transactions between Clarke and Holloway during the periods presented in the unaudited pro forma condensed consolidated financial statements that would need to be eliminated other than Clarke's investment in Holloway prior to obtaining control and dividend income earned by Clarke from Holloway.

Management has determined that no material adjustments to the Holloway financial statements are required to comply with the accounting policies used by Clarke in the preparation of its consolidated financial statements.

On July 25, 2019, Holloway sold the Travelodge® hotel in Sydney, NS for gross proceeds of \$5,050. On August 6, 2019, Holloway sold the Super 8® hotel in Truro, NS for gross proceeds of \$3,000. These transactions were not directly related to the Acquisition; accordingly, no adjustment has been recorded in the unaudited condensed consolidated pro forma financial statements as at June 30, 2019 or for the six months then ended to reflect these transactions.

The unaudited pro forma consolidated statements of earnings do not reflect any cost savings that the combined company may achieve as a result of the Acquisition, or the costs necessary to achieve these cost savings.

Acquisition-related transaction costs, such as advisory, legal and other professional fees, are not included as a component of consideration transferred but will be accounted for as expenses in the periods during which the costs are incurred. Total acquisition-related transaction costs expected to be incurred by Clarke and Holloway on a combined basis in connection with the Acquisition Agreement are estimated to be approximately \$725.

The transaction costs have not resulted in a pro forma adjustment to the pro forma consolidated statement of earnings since these costs are a non-recurring item directly attributable to the Acquisition.

2. ACQUISITION OF THE REMAINING SHARES OF HOLLOWAY

On August 8, 2019, Clarke entered into an arrangement agreement with Holloway for the acquisition of all the issued and outstanding shares of Holloway not already owned by Clarke (the "Agreement"). The Agreement provided that Clarke would acquire the outstanding shares of Holloway not already owned by Clarke for 0.65 of a Clarke common share per Holloway common share. The value of Clarke's shares in the final purchase price allocation of \$12.50 was based on Clarke's share price on September 30, 2019, the date the Acquisition closed.

Clarke Inc.**NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

For the six months ended June 30, 2019 and year ended December 31, 2018

*Unaudited (in thousands of Canadian dollars, except per share amounts)***3. PRO FORMA ADJUSTMENTS**

- i. Reflects the Holloway operational activity from the incremental period of January 1, 2019 through January 23, 2019 where Clarke did not control Holloway and consolidate their results.
- ii. Reflects the movement of net income from non-controlling interest to equity holders of the Company.
- iii. Reflects the adjustments to depreciation expense related to the fair value adjustments on the historical acquisition accounting to hotel properties over estimated remaining useful lives of 15 years and the adjustment to interest expense on the historical acquisition accounting to the convertible debentures and mortgages payable of Holloway.
- iv. Reflects the elimination of dividend income received from Holloway and the unrealized gain on Holloway shares.
- v. Reflects the adjustments to income tax expense arising from the aforementioned pro forma adjustments recorded in the unaudited pro forma consolidated statement of income (loss).

4. CLARKE PRO FORMA COMMON SHARES OUTSTANDING AND NET INCOME PER SHARE

For the six months ended June 30, 2019, the average number of shares used in the computation of pro forma basic and diluted net income per share has been determined as follows:

	Six months ended June 30, 2019
Historical weighted average number of Clarke common shares issued and outstanding – basic	12,128,395
Common shares issued pursuant to the Acquisition	4,819,033
Pro forma weighted average common shares outstanding of Clarke – basic	16,947,428
Pro forma net income per share – basic	2.11
Historical weighted average number of Clarke common shares issued and outstanding – diluted	12,220,287
Common shares issued on assumed conversion of convertible debentures	2,645,032
Common shares issued pursuant to the Acquisition	4,819,033
Pro forma weighted average common shares outstanding of Clarke – diluted	19,684,352
Pro forma net income per share – diluted	1.87

For the year ended December 31, 2018, the average number of shares used in the computation of pro forma basic and diluted net income per share has been determined as follows:

	Year ended December 31, 2018
Historical weighted average number of Clarke common shares issued and outstanding – basic	12,630,188
Common shares issued pursuant to the Acquisition	4,819,033
Pro forma weighted average common shares outstanding of Clarke – basic	17,449,221
Pro forma net income per share – basic	0.86
Historical weighted average number of Clarke common shares issued and outstanding – diluted	12,695,061
Common shares issued on assumed conversion of convertible debentures	2,645,032
Common shares issued pursuant to the Acquisition	4,819,033
Pro forma weighted average common shares outstanding of Clarke – diluted	20,159,126
Pro forma net income per share – diluted	0.86

Clarke Inc.

NOTES TO PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the six months ended June 30, 2019 and year ended December 31, 2018

Unaudited (in thousands of Canadian dollars, except per share amounts)

5. CHANGE IN ACCOUNTING POLICY

IAS 40, Investment Property

Effective January 1, 2019, the Company changed its accounting policy for measurement after recognition of its investment property from the cost model to the fair value model. The change in policy was applied retrospectively, which means the policy was applied to transactions, events and conditions as if it had always been in effect.