

---

# **Royal Host Inc.**

(Formerly Royal Host Real Estate Investment Trust)

Interim Consolidated Financial Statements (Unaudited)

June 30, 2011 and 2010

---

**Royal Host Inc.****CONSOLIDATED STATEMENTS OF FINANCIAL POSITION***Unaudited (in thousands of Canadian dollars)*

	<b>June 30, 2011</b>	<b>December 31, 2010</b>
	\$	\$
<b>ASSETS</b>		
<b>Current</b>		
Marketable securities (note 4)	1,875	1,886
Accounts receivable (note 5)	5,395	4,455
Prepaid expenses	2,847	1,431
Inventories (note 6)	2,470	2,366
Assets held for sale (note 7)	24,690	-
	<u>37,277</u>	<u>10,138</u>
<b>Non-current</b>		
Property and equipment (note 8)	174,113	204,799
Intangible assets (note 9)	85	93
Deferred income tax (note 17)	3,993	2,850
Restricted cash	1,674	1,133
<b>Total assets</b>	<u>217,142</u>	<u>219,013</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Bank indebtedness (note 10)	18,100	13,786
Accounts payable and accrued liabilities (note 11)	12,489	11,657
Mortgages (note 12)	12,321	12,477
Interest accrued on convertible debentures	1,245	1,245
Obligations under finance leases (note 13)	71	75
	<u>44,226</u>	<u>39,240</u>
<b>Non-current</b>		
Mortgages (note 12)	31,426	31,834
Convertible debentures (note 14)	145,160	144,552
Obligations under finance leases (note 13)	-	33
Deferred revenue	668	592
Trust units liability (note 2)	-	37,106
Conversion option liability (note 2)	-	2,390
<b>Total liabilities</b>	<u>221,480</u>	<u>255,747</u>
Commitments and provisions (note 22)		
<b>Shareholders' equity</b> (note 15)	<u>(4,338)</u>	<u>(36,734)</u>
<b>Total liabilities and shareholders' equity</b>	<u>217,142</u>	<u>219,013</u>

*See accompanying Notes to the Interim Consolidated Financial Statements*

Approved on behalf of the Board of Directors:

As signed by

Scott McCrea  
Chairman of the Board

As signed by

Blair Cook  
Chairman of the Audit Committee

# Royal Host Inc.

## CONSOLIDATED STATEMENTS OF NET INCOME (LOSS)

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

	Three months ended June 30, 2011 \$	Three months ended June 30, 2010 \$	Six months ended June 30, 2011 \$	Six months ended June 30, 2010 \$
<b>Hospitality revenue</b>				
Rooms	18,962	19,134	36,116	35,286
Food and beverage	3,778	3,843	7,185	7,128
Franchising and management	410	484	746	898
Tenant income	301	306	606	593
Other	569	604	1,069	1,207
	24,020	24,371	45,722	45,112
<b>Hospitality expenses excluding depreciation</b>				
Cost of inventory	1,088	1,135	2,096	2,100
Payroll and benefits	8,120	8,453	16,144	16,242
Property taxes	1,658	1,577	3,273	3,122
Utilities	1,483	1,464	3,563	3,284
Franchise and management fees	1,113	993	2,154	1,588
Other operating expenses (note 16)	5,206	5,768	10,256	10,905
	18,668	19,390	37,486	37,241
<b>Gross Margin</b>	5,352	4,981	8,236	7,871
<b>Investment income (loss)</b>				
Interest income	4	28	5	292
Gain on available-for-sale securities	-	2,065	-	12,746
Unrealized gain (loss) on trust units liability and conversion options	-	6,328	-	(88)
Gain on repurchase of convertible debentures	-	408	-	408
Gain on repurchase of trust units	-	2	-	4
	4	8,831	5	13,362
<b>Finance costs</b>				
Interest and accretion on mortgages and credit facility	965	1,545	1,961	3,282
Interest and accretion on convertible debentures	2,569	2,610	5,131	5,220
Distributions expense	-	1,364	-	2,729
	3,534	5,519	7,092	11,231
<b>Other expenses</b>				
Corporate administration	536	848	1,162	1,626
Depreciation and amortization	3,571	4,286	7,230	8,576
Impairment of intangible assets	-	601	-	601
Remediation of vacant land costs	590	-	590	-
	4,697	5,735	8,982	10,803
<b>Net income (loss) before income taxes</b>	(2,875)	2,558	(7,833)	(801)
Income tax expense (recovery) (note 17)	(1,197)	124	(1,565)	(1,078)
<b>Net income (loss)</b>	(1,678)	2,434	(6,268)	277
<b>Basic income (loss) per share: (CDN) (note 18)</b>				
Net income (loss)	(0.10)	0.13	(0.36)	0.02
<b>Diluted income (loss) per share: (CDN) (note 18)</b>				
Net income (loss)	(0.10)	0.10	(0.36)	0.02

**Royal Host Inc.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)***Unaudited (in thousands of Canadian dollars)*

	<b>Three months ended June 30, 2011 \$</b>	<b>Three months ended June 30, 2010 \$</b>	<b>Six months ended June 30, 2011 \$</b>	<b>Six months ended June 30, 2010 \$</b>
<b>Net income (loss)</b>	(1,678)	2,434	(6,268)	277
<b>Other comprehensive income (loss)</b>				
Unrealized gain (loss) on available-for-sale securities (net of tax of \$20 for the three and six months ended June 30, 2011)	(105)	(1,118)	(133)	2,380
Gain on available-for-sale securities transferred to net income (loss)	-	(2,065)	-	(12,746)
	(105)	(3,183)	(133)	(10,366)
<b>Comprehensive loss</b>	(1,783)	(749)	(6,401)	(10,089)

*See accompanying Notes to the Interim Consolidated Financial Statements*

**Royal Host Inc.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS’  
EQUITY**

*Unaudited (in thousands of Canadian dollars)*

	Six months ended June 30, 2011 \$	Six months ended June 30, 2010 \$
<b>Common shares</b>		
Balance at beginning of period	-	-
Shares issued pursuant to reorganization	37,106	-
Shares issued pursuant to debenture conversion option	-	-
Shares issued pursuant to a private placement	252	-
Shares repurchased pursuant to normal course issuer bid	(333)	-
Balance at end of period	37,025	-
<b>Equity component of convertible debentures</b>		
Balance at beginning of period	-	-
Balance transferred from long-term liabilities (net of tax \$631)	1,759	-
Convertible debentures repurchased pursuant to normal course issuer	-	-
Balance at end of period	1,759	-
<b>Contributed surplus</b>		
Balance at beginning of period	-	-
Common shares repurchased pursuant to normal course issuer bid	9	-
Compensation expense on stock options granted	4	-
Balance at end of period	13	-
<b>Accumulated income</b>		
Accumulated income (deficit) at beginning of period	(38,746)	58,091
IFRS transitional adjustment (note 2)	-	(90,223)
Balance at beginning of period	(38,746)	(32,132)
Net loss	(6,268)	277
Balance at end of period	(45,014)	(31,855)
<b>Accumulated other comprehensive income (loss)</b>		
Balance at beginning of period	2,012	10,143
Unrealized gains (losses) on available-for-sale securities	(133)	2,380
Realized gains on available-for-sale securities transferred to net loss	-	(12,746)
Balance at end of period	1,879	(223)
<b>Total shareholders’ equity</b>	<b>(4,338)</b>	<b>(32,078)</b>

*See accompanying Notes to the Interim Consolidated Financial Statements*

**Royal Host Inc.****CONSOLIDATED STATEMENTS OF CASH FLOWS***Unaudited (in thousands of Canadian dollars)*

	<b>Six months ended June 30, 2011</b>	<b>Six months ended June 30, 2010</b>
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net income (loss) for the period	(6,268)	277
Adjustments for items not involving cash (note 19)	6,161	(4,276)
Net changes in non-cash working capital (note 19)	(1,552)	(2,204)
	(1,659)	(6,203)
<b>FINANCING ACTIVITIES</b>		
Increase in (repayment of) bank indebtedness	4,314	(935)
Repurchases of convertible debentures pursuant to normal course issuer bids	-	(1,656)
Repurchases of trust units pursuant to normal course issuer bids and substantial issuer bids	-	(320)
Repurchases of common shares pursuant to normal course issuer bids	(324)	-
Principal repayments on mortgages and finance leases	(670)	(25,099)
Payment of mortgage refinancing costs	-	(283)
Proceeds from issuance of common shares	252	-
Proceeds from repayment of employee unit purchase loans	-	6
	3,572	(28,287)
<b>INVESTING ACTIVITIES</b>		
Proceeds on dispositions of marketable securities	-	38,556
Acquisitions of marketable securities	(146)	-
Acquisitions of property and equipment	(1,226)	(782)
Decrease (increase) in restricted cash	(541)	1,102
	(1,913)	38,876
<b>Increase in cash</b>	-	4,386
<b>Cash, beginning of period</b>	-	-
<b>Cash, end of period</b>	-	4,386
Cash interest received	-	41
Cash interest paid		
Mortgages and capital leases	1,690	3,594
Convertible debentures	4,523	4,172
Bank indebtedness	246	-
Total cash interest paid	6,459	7,766

*See accompanying Notes to the Interim Consolidated Financial Statements*

# Royal Host Inc.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

### 1. GENERAL INFORMATION

Royal Host Inc. is a diversified hospitality company that delivers shareholder value through hotel ownership, investment and franchising and owns a portfolio of 31 operating hotels, comprising approximately 3,705 guest rooms. The portfolio includes select and full service hotels in the mid-market and economy hospitality segments. All of the hotels are located in Canada. The principal and head office of Royal Host is located at 6009 Quinpool Road, 10th Floor, Halifax, Nova Scotia, B3K 5J7. Royal Host Inc. (the "company") is the successor entity to Royal Host Real Estate Investment Trust following the completion of the conversion from an income trust to a corporation by way of a court-approved plan of arrangement under the Canada Business Corporations Act ("CBCA") effective January 1, 2011 within all provinces of Canada (the "Arrangement"). The Arrangement involved the exchange of the units of the REIT for Common Shares of Royal Host on a one-for-one basis and the dissolution of Royal Host Commercial Trust and the REIT in accordance with their respective declarations of trust. Effective January 4, 2011, the common shares of Royal Host began trading on the Toronto Stock Exchange (TSX) under the symbol RYL. These financial statements have been approved for release by the Board of Directors on August 8, 2011.

### 2. TRANSITION TO IFRS

Effective January 1, 2011, the company adopted International Financial Reporting Standards (IFRS). Prior to the adoption of IFRS, the company prepared its financial statements in accordance with Canadian generally accepted accounting principles (CGAAP). The company's financial statements for the year ending December 31, 2011 will be the first annual financial statements that comply with IFRS. Accordingly, the company will make an unreserved statement of compliance with IFRS beginning with its 2011 annual financial statements. These financial statements (including both current period and comparative period balances) are prepared in accordance with the significant accounting policies summarized in Note 3. At the date of transition, all adjustments to previously reported balances were recorded within accumulated income.

#### a) Elective exemptions from full retrospective application

In preparing these consolidated financial statements in accordance with IFRS 1 First Time Adoption of International Financial Reporting Standards (IFRS 1), the company has applied certain of the optional exemptions from full retrospective application of IFRS. The optional exemptions applied are as described below:

##### i) Fair Value or Revaluation as Deemed Cost

The company has elected to measure certain items of property and equipment at fair value as of the date of transition to IFRS and use that fair value as deemed cost for those classes of assets in future periods.

##### ii) Leases

Based on the transitional provisions of IFRIC 4, the company has elected to only apply section IAS 17 Leases to those arrangements existing at the transition date.

##### iii) Business combinations

The company has elected to not apply IFRS 3 retrospectively to past business combinations. Accordingly, the company has not restated business combinations that took place prior to the transition date.

#### b) Mandatory exemptions to full retrospective application

In preparing these consolidated financial statements in accordance with IFRS 1, the company has applied certain mandatory exemptions from full retrospective application of IFRS, as described below:

##### i) Estimates

Hindsight was not used to create or revise estimates and accordingly, the estimates previously made by the company under CGAAP are consistent with their application under IFRS.

# Royal Host Inc.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

### c) Reconciliation of equity as reported under CGAAP to IFRS

The following is a reconciliation of the company's equity reported in accordance with CGAAP to its equity in accordance with IFRS as at June 30, 2010:

	Note	Trust Units	Equity Component of Convertible Debentures	Contributed Surplus	Accumulated Distributions	Accumulated Income (Incl. IFRS Trans. Balance)	Accumulated Other Comprehensive Income	Total Shareholders' Equity
As reported under CGAAP – June 30, 2010		142,505	3,115	35,242	(225,155)	63,413	(223)	18,897
Property and equipment revaluation	(i)	-	-	-	-	(5,815)	-	(5,815)
Conversion feature of convertible debentures	(ii)	-	(3,115)	-	-	(1,262)	-	(4,377)
Reclassification of trust units	(iii)	(142,505)	-	(575)	-	98,020	-	(45,060)
Reclassification of contributed surplus and distributions	(iv)	-	-	(34,667)	225,155	(187,758)	-	2,730
Deferred income tax adjustment	(v)	-	-	-	-	6,592	-	6,592
Overall change to 2010 net loss	(vi)	-	-	-	-	(5,045)	-	(5,045)
<b>As reported under IFRS – June 30, 2010</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(31,855)</b>	<b>(223)</b>	<b>(32,078)</b>

The following is a reconciliation of the company's equity reported in accordance with CGAAP to its equity in accordance with IFRS as at December 31, 2010:

	Note	Trust Units	Equity Component of Convertible Debentures	Contributed Surplus	Accumulated Distributions	Accumulated Income (Incl. IFRS Trans. Balance)	Accumulated Other Comprehensive Income	Total Shareholders' Equity
As reported under CGAAP – December 31, 2010		138,164	3,061	38,210	(227,845)	55,362	-	6,952
Property and equipment revaluation	(i)	-	-	-	-	(5,815)	-	(5,815)
Conversion feature of convertible debentures	(ii)	-	(3,061)	-	-	(1,262)	-	(4,323)
Reclassification of trust units	(iii)	(138,164)	-	(3,543)	-	98,020	-	(43,687)
Reclassification of contributed surplus and accumulated distributions	(iv)	-	-	(34,667)	227,845	(187,758)	-	5,420
Deferred income tax adjustments	(v)	-	-	-	-	6,592	2,012	8,604
Overall change to 2010 net loss	(vi)	-	-	-	-	(3,885)	-	(3,885)
<b>As reported under IFRS – December 31, 2010</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(38,746)</b>	<b>2,012</b>	<b>(36,734)</b>

## Royal Host Inc.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

### Explanatory notes:

i) Property and equipment fair value as deemed cost:

The following items of property and equipment were adjusted to fair value as of the transition date: land, building, and building components (roof, HVAC, and interior finishings). The use of fair value as “deemed cost” is permitted through an election available within IFRS 1; however, this election is only available at the transition date. For all subsequent periods, the company uses the cost method to record subsequent additions and changes in depreciation expenses. The fair value of the land assets for all 33 Royal Host properties (31 operating hotels and 2 non-operating sites) was determined using market-based evidence sourced from valuation work performed by independent professionally qualified valuers. The fair value for six of the buildings (and building components) was based on appraisals done by qualified valuation specialists, using discounted cash flow and market comparable valuation techniques. The buildings at another 20 of the Royal Host properties were valued internally using consistent discounted cash flow methodology, while the remaining five buildings were valued internally using market-based evidence. On a property by property basis, the fair values determined were allocated among the building and building components by first deducting the following amounts: (1) the value of the land and (2) the carrying value of the furniture, fixtures & equipment and the computer hardware and software. The residual amount was allocated to (1) building; (2) roof; (3) HVAC and (4) interior finishing based on engineering estimates of the relative cost to replace each type of component. The election to use fair value as deemed cost was not applied to the company’s furniture, fixtures and equipment, computer hardware and software and intangible assets. As a result, the basic cost method was used and the carrying value at the date of transition was not adjusted.

ii) Conversion feature of convertible debentures

Under IAS 32, paragraph 29, the convertible debentures issued by Royal Host qualify as a compound financial instrument because they represent a financial instrument that creates a financial liability of the entity as well as an option to the holder of the instrument to convert the liability into trust units. Under CGAAP, the two parts were classified separately as a liability and equity for the conversion option; however, because IFRS dictates that Royal Host’s trust units were a liability in substance, the equity portion of the convertible debentures will also be classified as a liability. The conversion feature has been measured at fair value upon the IFRS transition date using the binomial method. The conversion feature will be re-valued at each reporting date with changes reported in the consolidated statements of net income (loss) and comprehensive income (loss). Following the conversion of Royal Host from a Trust to a Corporation on January 1, 2011, the company’s shares were classified as equity and the conversion feature of the convertible debentures was classified as equity.

iii) Reclassification of trust units

The trust units were reclassified to long-term liabilities for the year ended December 31, 2010 because they did not qualify to be reported as equity under IFRS. IAS 32 paragraph 16 specifies that in order to qualify as equity, financial instruments cannot include a contractual obligation to deliver cash or another financial asset to another entity. Prior to January 1, 2011, the company’s Declaration of Trust included a puttable option on the units as well as a mandatory requirement to distribute all taxable income as distributions to the unitholders, constituting a contractual obligation. For the comparative period ended December 31, 2010, the trust units are presented as a financial liability, with measurement based on the units’ closing ask price on the Toronto stock exchange (TSX) and the number of units outstanding at the reporting date. As IFRS 1 allows the designation of a previously recognized financial liability at fair value through profit and loss, the liability for trust units has been classified as such; therefore, changes in the market price of the units at subsequent reporting dates in 2010 are reported in the consolidated statements of net income (loss) and comprehensive income (loss).

On January 1, 2011 Royal Host converted from a trust to a corporation and the trust units were exchanged for common shares. As the common shares have neither a puttable feature nor a required distribution, they qualify to be classified as an equity instrument, measured at the fair value of the trust units at January 1, 2011 and subsequently carried at historical cost.

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

iv) Contributed surplus and accumulated distributions reclassification

At the date of transition to IFRS, the balance of contributed surplus represented the excess of the issue cost removed from trust units over the amount paid by Royal Host to repurchase these units up to December 31, 2009. Upon transition to IFRS, as the trust units are classified as a financial liability for the year ended December 31, 2010, the difference between the carrying value of the units repurchased and the amount paid by Royal Host is considered a gain or loss on repurchase of debt and is included in net loss. The distributions on the trust units are presented as finance costs on the consolidated statements of net income (loss) and comprehensive income (loss) due to the classification of the trust units as a financial liability.

v) Deferred income tax adjustments

The adjustment to deferred income tax is primarily a result of the changes to the carrying values and depreciation rates for the various property and equipment owned by the company. As a result of the property revaluations, a deferred income tax asset in respect of capital loss carryforwards has been recognized that previously was not recognized. The transition to IFRS also resulted in the recognition of deferred income taxes in respect of the conversion option of the convertible debentures.

vi) Overall change to 2010 net income (loss)

In order to understand the nature of the individual adjustments to net income (loss) for the three and six months ended June 30, 2010 and year ended December 31, 2010, see the reconciliations provided below.

#### d) Reconciliation of net loss and comprehensive loss as reported under CGAAP to IFRS

The following is a reconciliation of the company's net income (loss) reported in accordance with CGAAP to its net income (loss) in accordance with IFRS for the three and six months ended June 30, 2010 and the year ended December 31, 2010:

	Note	Three months ended June 30, 2010 \$	Six months ended June 30, 2010 \$	Year ended December 31, 2010 \$
<b>Net income (loss) as reported under CGAAP</b>		(956)	5,322	(2,729)
Adjustment to depreciation on property and equipment	(i)	(1,081)	(2,167)	(4,295)
Reversal of property impairment provision	(ii)	0	458	458
Unrealized gain (loss) on trust units liability	(iii)	5,459	(367)	6,560
Unrealized gain (loss) on convertible debenture option liability	(iv)	869	279	1,933
Distributions expense	(v)	(1,364)	(2,729)	(5,420)
Realized gain on repurchase of trust units	(vi)	2	4	49
Deferred tax recovery	(vii)	(495)	(524)	(3,106)
Other		0	1	(64)
<b>Total adjustments</b>		3,390	(5,045)	(3,885)
<b>Net income (loss) as reported under IFRS</b>		2,434	277	(6,614)

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

The following is a reconciliation of the company's other comprehensive loss reported in accordance with CGAAP to its other comprehensive loss in accordance with IFRS for the three and six months ended June 30, 2010 and the year ended December 31, 2010:

	Note	Three months ended June 30, 2010 \$	Six months ended June 30, 2010 \$	Year ended December 31, 2010 \$
<b>Other comprehensive loss as reported under CGAAP</b>		(3,183)	(10,366)	(10,143)
Deferred tax recovery	(vii)	-	-	2,012
<b>Other comprehensive loss as reported under IFRS</b>		(3,183)	(10,366)	(8,131)

The total of the reconciled net income (loss) and other comprehensive loss equals the comprehensive loss reported under IFRS for the three and six months ended June 30, 2010 and the year ended December 31, 2010.

#### Explanatory notes:

- i) Adjustment to depreciation on property and equipment

Certain items of property and equipment (land, building and building components) were recorded using fair value as "deemed cost" on transition, which varied from the previously recognized carrying value under CGAAP. As well, the property and equipment category previously reported as buildings was componentized into buildings, roofing, HVAC and interior finishings, resulting in the assignment of shorter useful lives than under CGAAP. Accordingly, the change in the carrying values and componentization resulted in an increase in depreciation expense for the periods.

- ii) Reversal of property impairment provision

This adjustment was necessitated by the revaluation of land and building assets as of January 1, 2010. Under CGAAP, impairment on a specific property owned by Royal Host was previously recorded at March 31, 2010; however, the revaluation as of January 1, 2010 negated this impairment as the asset was already recorded at fair market value less selling costs based on reference to prices within the real estate market. The reversal of the impairment resulted in increased profits reported by the company for the period. Under CGAAP, this property was reported as "property held for sale"; however, IFRS does not permit the separate presentation of this property. As a result, in these financial statements, this property is recorded within the land component (see note 8).

- iii) Unrealized gain (loss) on trust units liability

With the reclassification of the company's trust units to non-current liabilities effective January 1, 2010, the liability itself was classified at fair value with changes recognized in net loss. As the fair value was determined on the basis of the prevailing market prices, the resulting gain or loss from a change in the liability was reported in the comparative figures.

- iv) Unrealized gain (loss) on convertible debenture option liability

The convertible debenture conversion feature has been measured at fair value upon the IFRS transition date using the binomial method. The conversion feature will be re-valued at each reporting date with changes reported in the consolidated statements of net loss and comprehensive loss up until January 1, 2011. After January 1, 2011, the conversion option will no longer be fair valued due to the reclassification to equity.

- v) Distributions expense

The distributions declared during the three and six months ended June 30, 2010 and the year ended December 31, 2010 have been reclassified as a finance cost because of the liability reclassification of the trust units for which the

## Royal Host Inc.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

distributions were issued. IAS 32, paragraph 36 notes that the classification of a financial instrument as a financial liability or an equity instrument determines how the resulting expenses/distributions are classified. As the trust units were reclassified to liabilities as described above, the resulting distributions were reclassified to finance costs.

vi) Realized gain on repurchase of trust units

Under CGAAP, the gain or loss on repurchases of trust units was recorded directly to equity. As a result of the reclassification of trust units to liabilities, the gain or loss is included in the determination of net income (loss).

vii) Deferred income taxes

Deferred income tax assets were recognized under IFRS, at the transition date, for capital losses carried forward that were not recognized under Canadian GAAP. This was due to the increase in the valuation of the land portion of property and equipment when the fair value was used as “deemed cost” on the transition date. This created a deferred tax liability on the land and enabled Royal Host to recognize a deferred tax asset on the capital losses carried forward.

A significant portion of these capital losses were utilized by Royal Host to minimize taxes payable as of December 31, 2010, which caused a decrease in the tax asset and a corresponding deferred tax expense. The deferred tax liability on the land did not change during 2010. The net effect is a decrease in the deferred tax recovery under IFRS compared to CGAAP.

### e) Statement of Cash Flow as reported under CGAAP and IFRS

The changes made to the consolidated statements of financial position and net loss and comprehensive loss have resulted in reclassifications of various amounts on the statements of cash flows, however as there have been no changes to the overall net cash flows, no reconciliations have been presented. The primary difference relates to the reclassification of distributions from financing activities to operating activities.

## 3. SIGNIFICANT ACCOUNTING POLICIES

### (a) Statement of Compliance

These consolidated financial statements have been prepared in accordance with International Accounting Standard 34 Interim Financial Reporting (IAS 34) as issued by the International Accounting Standards Board (IASB) along with the accounting policies the company expects to adopt in its consolidated financial statements as at and for the year ended December 31, 2011. These interim financial statements should be read in conjunction with the company’s 2010 Canadian GAAP annual financial statements for the year ended December 31, 2010 and the company’s interim financial statements for the quarter ended March 31, 2011 prepared in accordance with IFRS applicable to interim statements along with the disclosures included therein.

### (b) Basis of Presentation

These consolidated financial statements include the accounts of Royal Host Inc., along with its wholly-owned subsidiaries and partnerships. All significant intercompany transactions and balances have been eliminated. The statements have been prepared on a going concern basis using the modified historical cost convention, which supplements the historical costs as the fair value has been elected as “deemed cost” for land, building, and building components.

### (c) Use of Estimates

The preparation of the consolidated financial statements in conformity with IFRS, particularly in the year of transition, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the

## **Royal Host Inc.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2011 and 2010

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

disclosure of contingent assets and liabilities at the date of the consolidated financial statements and revenue and expenses for the reported periods. Significant areas requiring the use of management estimates include the determination of future cash flows in assessing the recoverability of hotel properties and other long-term assets, the estimation of useful lives for depreciation and amortization purposes, determination of the allowance for uncollectible receivables, assumptions used in the calculation of carrying value of convertible debenture components and the determination of deferred tax assets and liabilities. As a result, actual results could differ materially from those estimates. These estimates are reviewed periodically, and, as adjustments become necessary, they are reported in earnings in the year in which they become known.

#### **(d) Marketable Securities**

The Company measures its investments in marketable securities at fair value as determined using the applicable stock market bid price. At the end of each reporting period subsequent to initial recognition, the company must assess whether there is evidence of impairment of these assets. The following list of items includes examples of events that typically provide evidence of impairment:

- (a) significant or prolonged decline in the fair value below its cost;
- (b) increased probability that the investee will enter bankruptcy or other financial reorganization.
- (c) a breach of contract, such as a default or delinquency by the investee in interest or principal payments; or
- (d) significant changes with adverse effects taking place in the environment in which the investee operates.

Declines in the fair value of marketable securities are reported in other comprehensive income unless there is objective evidence that the asset is impaired. In the case of impairment, the decline is recorded directly through profit and loss after clearing out any existing balances in accumulated other comprehensive income. Increases in fair value are reported in other comprehensive income; unless the increase can be objectively related to an event occurring after a previous impairment loss was recognized in profit or loss, in which case the increase can be recorded directly through profit and loss.

#### **(e) Accounts receivable**

Trade receivables are initially recorded at the invoice price and subsequently reduced by any allowance for uncollectible accounts. Royal Host evaluates the collectability of accounts receivable based on the age of the receivable as well as the specific customer details, with any losses recognized directly through profit and loss.

#### **(f) Inventories**

Inventories consist of linens, food, beverages, china, silverware, and glassware used or consumed in the rendering of services to customers of the hotel properties. These items are recorded at the lower of cost and net realisable value and are accounted for on a first-in, first-out basis. When circumstances that previously caused inventory to be written down below cost no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the amount of any previous write downs are reversed so that the new carrying amount is the lower of the cost and the revised net realisable value.

#### **(g) Assets held for sale**

Assets held for sale are presented separately within current assets at the lower of their carrying amount and fair value less costs to sell. In order to meet the criteria to be classified as held for sale, the asset must be available for immediate sale in its present condition and its sale must be highly probable. A sale is considered highly probable when the appropriate level of management is committed to a plan to sell the asset, and an active program to locate a buyer and complete the plan has been initiated. The asset must also be marketed for sale at a reasonable price in relation to its current fair market value and the sale must be expected to occur within the next twelve months.

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

#### (h) Property and Equipment

For certain classes of property and equipment, as described in note 2, the company elected to use fair value as “deemed cost”. Their carrying values were adjusted to fair value as of the date of the transition, only to be reduced by any subsequent accumulated depreciation and/or any accumulated impairment losses. On a quarterly basis, all property and equipment are evaluated for potential impairment to ensure that the carrying amount does not exceed the recoverable amount. Where the carrying amount of an asset is decreased, the decrease is recognized in the consolidated statements of net loss and comprehensive loss. The company accounts for its property and equipment under the cost model, whereby the assets are recorded at cost and subsequently depreciated over their useful lives, unless an impairment is identified requiring a write down to estimated fair value.

The useful life of each property is evaluated annually based on certain factors including construction materials used, location, condition of the property and the particular capital maintenance program and requirements of the property.

Land has an unlimited useful life and therefore is not depreciated. The depreciable amount of the assets are determined before deducting the residual value because in practice, the residual value of the assets are often insignificant and therefore immaterial in the calculation of the depreciable amount. The depreciation method noted below reflects the pattern in which the asset's future economic benefits are expected to be consumed by the company, assuming regular repair and maintenance of the properties. No amortization is taken on assets under construction until they are placed in use. Maintenance and repair costs are expensed against operations as incurred, while significant improvements, replacements and major renovations which extend the estimated useful life of an asset and enhance the service potential are capitalized to hotel properties. Property and equipment under development consists of renovations of properties and is recorded at the lower of cost and net recoverable value. Amortization of these assets begins once they are available for use.

Asset Class	Amortization Method	Useful Life
Building	Straight line basis	25 - 40 years
Roof	Straight line basis	25 years
HVAC	Straight line basis	15 - 20 years
Interior finishing	Straight line basis	10 years
Furniture, fixtures and equipment (FF&E)	Straight line basis	5 years
Computer hardware	Straight line basis	4 years
Computer software	Straight line basis	4 years
Assets under finance leases	Straight line basis	4 -5 years

#### (i) Intangible Assets

Intangible assets consist primarily of franchise rights and, in periods prior to 2011, management agreements, recorded at their initial cost and reduced by amortization over their useful lives. These assets are amortized using the straight-line method based on their finite useful lives (9-10 years). The company has no identifiable intangible assets for which the expected useful life is indefinite.

#### (j) Restricted Cash

Restricted cash represents funds on deposit with lenders pursuant to financing arrangements for future planned capital expenditures. The company assesses their intention and ability to hold this financial asset until maturity at the end of each reporting period.

## **Royal Host Inc.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2011 and 2010

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

#### **(k) Bank Indebtedness**

The company considers deposits in banks, certificates of deposit, and short-term investments with original maturities of three months or less as cash and cash equivalents. Cash balances, for which the company has the ability to and intent of offset, are used to reduce reported bank indebtedness; however, due to the seasonality of the cash flow cycle, the bank overdrafts usually exceed the cash on deposit.

#### **(l) Mortgages**

Mortgages are carried at their amortized cost; whereby any debt issuance costs were initially recorded as a reduction of the average carrying value of the debt to which they relate. Over the term of the debt, the liability will increase to the face value of the debt through the use of the effective interest method, with the accretion expense included in interest on mortgages on the consolidated statement of net loss and comprehensive loss. This treatment serves to yield a constant rate of interest over the life of the particular financial instrument.

#### **(m) Convertible Debentures**

Convertible debentures are carried at their amortized cost; whereby any debt issuance costs were initially recorded as a reduction of the average carrying value of the debt to which they relate. Over the term of the debt, the liability will increase to the face value of the debt through the use of the effective interest method, with the accretion expense included in interest on convertible debentures on the consolidated statements of net income (loss) and comprehensive income (loss). This treatment serves to yield a constant rate of interest over the life of the particular financial instrument.

Upon initial recognition, the fair value of the conversion option was recorded as a reduction of the carrying value of the convertible debentures and the same amount was recorded as a "conversion option liability". Similar to the debt issuance costs, the conversion option is amortized over the term of the debt using the effective interest method. The conversion option liability was fair valued at the end of each reporting period up until December 31, 2010 with changes in fair value recorded in the consolidated statement of net loss and comprehensive loss. On January 1, 2011 Royal Host converted from a trust to a corporation and the trust units were exchanged for common shares and were classified as an equity instrument and, therefore, the "conversion option liability" was reclassified to equity as "equity component of convertible debentures", measured at the fair value of the "conversion option liability" at January 1, 2011.

#### **(n) Leases**

Upon initial recognition, the company classifies all leases as either a finance lease or an operating lease, depending on the substance of the transaction. Finance leases are classified as such because they are found to transfer substantially all of and rewards incidental to ownership of the asset, whereas operating leases are classified as such because they are not found to meet the criteria required for classification as a finance lease. Upon commencement of the lease, finance leases are recorded as assets and liabilities in the statement of financial position at the lower of the fair value of the leased asset and the present value of the minimum lease payments. The rate used to discount the payments is either the interest rate implicit in the lease or the company's incremental borrowing rate. Upon subsequent measurement, the asset is depreciated over the life of the lease while the liability is decreased by the actual lease payments and increased by the accretion of the interest expense.

#### **(o) Employee Stock Options**

For equity-settled share-based payment transactions, the entity recognizes the goods or services received and the corresponding increase in equity indirectly by reference to the fair value of the stock options at the grant date because the fair value of the goods or services received cannot be reliably estimated. Fair value was estimated using the Black Scholes model, whereby each group of options vesting together are valued separately with a different vesting period. Compensation expense is recognized over the various vesting periods through the statement of net income (loss) with a corresponding increase (decrease) to contributed surplus based on the number of options expected to vest and the fair value of those specific options. The number of options expected to vest is reviewed quarterly with changes in expectations adjusted directly to fair value.

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

#### (p) Financial Instruments

Royal Host has elected to apply the following treatment to each of its significant categories of financial instruments:

Asset/liability	Classification	Measurement basis
Marketable securities	Available-for-sale	*Fair value with changes recognized in other comprehensive loss
Accounts receivable	Loans and receivables	
Restricted cash	Held-to-maturity	**Amortized cost
Bank indebtedness, accounts payable and accrued liabilities, interest accrued on convertible debentures, mortgages, finance leases and convertible debentures	Financial liability	
Trust units liability, conversion option on convertible debentures	Financial liability at fair value through profit or loss	*Fair value with changes recognized in net loss

\*Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

\*\*The amortised cost of a financial asset or financial liability is equal to the amount at which it is initially recognized minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction for impairment or uncollectibility. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability.

#### (q) Revenue Recognition

Revenue, consisting of rooms, food and beverage, franchising and management (in periods prior to 2011), tenant income and other revenue is measured at the fair value of consideration received or receivable, taking into account the amount of any discounts or volume rebates. Revenue is recognized when the amount can be measured reliably, it is probable that the economic benefits will flow to the company, and the costs incurred to complete the transaction can be reliably measured. Other revenue includes income from laundry and telephone usage, parking garage fees, and in-room movie rentals. Ongoing credit evaluations are performed and an allowance for potential credit losses is provided against the portion of accounts receivable which is estimated to be uncollectible.

#### (r) Income Taxes

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

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

Royal Host follows the liability method of accounting for deferred income taxes. This method requires recording a deferred income tax amount on differences between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered. Deferred income tax assets and liabilities are measured using the best estimate of the weighted average annual income tax rate expected for the full financial year and that are expected to apply when the tax assets or liabilities are expected to be either recovered or settled.

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

#### (s) Comprehensive loss

Comprehensive loss is the change in equity from transactions, events and circumstances from sources other than the company's shareholders. Other comprehensive loss refers to items recognized in comprehensive loss that are excluded from net loss calculated in accordance with IFRS. These items could include the following:

- (i) unrealized gains and losses on financial assets classified as 'available for sale' during the period (net of realized gains and losses as a reclassification to income);
- (ii) change in gains and losses on derivatives designated as cash flow hedges;

#### (t) Foreign Currency Translation

The Canadian dollar is the functional currency of the company. Transactions in currencies other than the company's functional currency are translated using the rate of exchange prevailing on the date of the transaction. At each statement of financial position date, monetary assets and liabilities denominated in currencies other than the functional currency are translated at the rate of exchange prevailing on the balance sheet date with any gains or losses recognized in net loss.

#### (u) Provisions

Provisions are recognized in the financial statements only when all of the following three criteria are met: i) there is a present obligation as a result of a past event, ii) it is probable (more likely than not) that the company will be required to settle the obligation through the transfer of assets, and iii) the amount of the obligation can be reliably estimated.

## 4. MARKETABLE SECURITIES

	June 30, 2011		December 31, 2010	
	\$		\$	
	Cost	Fair Value	Cost	Fair Value
Marketable securities	21,290	1,875	21,144	1,886

## 5. ACCOUNTS RECEIVABLE

Accounts receivable are comprised of the following items:

	June 30, 2011	December 31, 2010
		\$
Hotel accounts receivable	3,992	3,029
Franchise accounts receivable	1,532	1,305
Other accounts receivable	279	405
	5,803	4,739
Less allowance for doubtful accounts	(408)	(284)
	5,395	4,455

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

#### 6. INVENTORIES

Inventories are comprised of the following items:

	June 30, 2011	December 31, 2010
	\$	\$
Linens	1,766	1,615
Food and beverage	341	388
China, glassware and other	363	363
	2,470	2,366

The carrying amount of inventory pledged as security for specific mortgages at June 30, 2011 was \$1,100 (December 31, 2010 - \$1,126).

#### 7. ASSETS HELD FOR SALE

During the period ended June 30, 2011, Royal Host finalized agreements with two separate purchasers for the sale of the Country Inn Saskatoon, Country Inn Regina, Country Inn Winnipeg, and the Super 8 Regina. Consequently, these properties have been reclassified to assets held for sale at the lower of the fair value less costs to sell and the carrying value. The following table provides detail in regards to the nature of the individual assets held for sale at June 30, 2011:

	Asset Balance by Class
Land	4,730
Building	16,718
Roof	574
HVAC	389
Interior finishings	1,881
Furniture, fixtures and equipment	369
Computer hardware and software	29
<b>Total Assets held for sale</b>	<b>24,690</b>

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

## 8. PROPERTY AND EQUIPMENT

Property and equipment (including assets held for sale) is comprised of the following items:

	June 30, 2011			December 31, 2010		
	Cost	Accumulated Amortization	Net book value \$	Cost	Accumulated Amortization	Net book value \$
Land	46,203	-	46,203	46,203	-	46,203
Buildings	129,668	6,590	123,078	127,501	4,387	123,114
Roof	4,838	1,064	3,774	4,830	755	4,075
HVAC	13,056	4,296	8,760	12,881	2,860	10,021
Interior finishings	19,074	6,962	12,112	18,663	4,771	13,892
Furniture, fixtures and equipment	36,171	32,452	3,719	35,252	31,591	3,661
Computer hardware and software	5,441	4,513	928	5,385	4,331	1,054
Assets under capital lease	4,801	4,665	136	4,801	4,624	177
	259,252	60,542	198,710	255,516	53,319	202,197
Property under development	93	-	93	2,602	-	2,602
	259,345	60,542	198,803	258,118	53,319	204,799
Less: Assets held for sale	29,274	4,584	24,690	-	-	-
	230,071	55,958	174,113	258,118	53,319	204,799

Changes to property and equipment (including assets held for sale) during the six months ended June 30, 2011 consist of the following:

	Beginning net book value at January 1, 2011 \$	Additions \$	Reclass assets held for sale \$	Transfers \$	Depreciation expense \$	Net book value at June 30, 2011 \$
Land*	46,203	-	(4,730)	-	-	41,473
Buildings	123,114	553	(16,718)	1,613	(2,202)	106,360
Roof	4,075	-	(574)	7	(308)	3,200
HVAC	10,021	149	(389)	27	(1,437)	8,371
Interior finishings	13,892	83	(1,881)	328	(2,191)	10,231
Furniture, fixtures and equipment	3,661	152	(369)	767	(861)	3,350
Computer hardware and software	1,054	53	(29)	3	(182)	899
Assets under capital lease	177	-	-	-	(41)	136
	202,197	990	(24,690)	2,745	(7,222)	174,020
Property under development	2,602	236	-	(2,745)	-	93
	204,799	1,226	(24,690)	-	(7,222)	174,113

\*At June 30, 2011, the land category includes \$1,846 in assets that are considered non-operating assets

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

#### 9. INTANGIBLE ASSETS

	Six months ended June 30, 2011	Year ended December 31, 2010
	\$	\$
Beginning cost of intangible assets	508	18,551
Additions	-	91
Write-off of fully amortized intangible assets	-	(18,134)
<b>Ending cost of intangible assets</b>	<b>508</b>	<b>508</b>
Beginning accumulated amortization of intangible assets	(415)	(16,192)
Impairment	-	(601)
Amortization expense	(8)	(1,756)
Write-off of fully amortized intangible assets	-	18,134
<b>Ending accumulated amortization of intangible assets</b>	<b>(423)</b>	<b>(415)</b>
<b>Net book value</b>	<b>85</b>	<b>93</b>

#### 10. BANK INDEBTEDNESS

Royal Host has a credit facility with a maximum availability, which is dictated by a valuation test. During the six months ended June 30, 2011, Royal Host renewed its \$25 million credit facility for a one year period. This line of credit is secured by six hotels with a net book value of \$45,172 at June 30, 2011 (December 31, 2010 - \$46,265). At June 30, 2011, the maximum availability of the facility was \$18,571 (December 31, 2010 - \$18,410) based on a valuation test for those assets pledged as security while the actual amount drawn was \$18,100 (December 31, 2010 - \$13,786). The facility bears interest at the Canadian bank prime rate plus a spread of 0.25% to 1.75% depending on a leverage test, and is payable on demand. At June 30, 2011, Royal Host is in compliance with all covenant requirements of the credit facility.

#### 11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities are comprised of the following items:

	June 30, 2011	December 31, 2010
	\$	\$
Trade accounts payable	1,564	1,631
Accrued liabilities	5,200	5,369
Taxes payable	852	257
Accrued payroll	2,263	2,041
Other liabilities	2,610	2,359
	12,489	11,657

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

#### 12. MORTGAGES

	Six months ended June 30, 2011 \$	Year ended December 31, 2010 \$
Beginning balance	44,311	80,224
Principal repayments	(633)	(36,329)
Interest accretion expense	69	416
Ending balance	43,747	44,311

Principal repayments required for the twelve months ending June 30:

	\$
2012	12,452
2013	24,908
2014	6,643
Total principal outstanding	44,003
Debt issuance costs	(256)
	43,747

Mortgages bear interest at rates ranging from 6.82% to 8.63% per annum (2010 – 6.82% to 8.50%) with a weighted average year-end rate of 7.56% per annum (2010 – 7.52%). The mortgages, which mature between 2011 and 2013, are secured by first charges over six hotel properties owned by Royal Host with a total net book value of \$86,549 at June 30, 2011 (December 31, 2010 – total net book value of \$89,502).

#### 13. OBLIGATIONS UNDER FINANCE LEASES

Royal Host has entered into a finance lease obligation to acquire furniture, fixtures and equipment. The lease outstanding at June 30, 2011 bears interest at a weighted average annual rate of 7.64% per annum (December 31, 2010 – 7.64%). During the six months ended June 30, 2011 and the year ended December 31, 2010, Royal Host did not acquire any new assets under finance leases. The net book value of assets under finance leases as at June 30, 2011 was \$136 (December 31, 2010 - \$177).

Following is a table summarizing the total repayments required for the twelve months ending June 30:

	\$
2012	74
Less: amounts representing interest	(3)
Present value of future minimum lease payments	71

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

#### 14. CONVERTIBLE DEBENTURES

	Six months ended June 30, 2011	Year ended December 31, 2010
	\$	\$
Beginning balance	144,552	147,292
Repurchase of debentures	-	(3,900)
Interest accretion expense	608	1,160
Ending balance	145,160	144,552

	June 30, 2011	December 31, 2010
	\$	\$
6.00% Convertible Unsecured Subordinated Debentures, Series B	44,234	44,077
6.25% Convertible Unsecured Subordinated Debentures, Series C	48,822	48,544
5.90% Convertible Unsecured Subordinated Debentures, Series D	52,104	51,931
	145,160	144,552

Principal repayments required for the twelve months ending June 30:

	\$
2012	-
2013	-
2014	103,566
2015	-
2016	45,984
Total principal outstanding	149,550
Debt issuance costs	(3,007)
Conversion option	(1,383)
	145,160

#### 15. SHAREHOLDERS' EQUITY

Under a plan of arrangement, effective January 1, 2011, unitholders of Royal Host Real Estate Investment Trust received one common share for each unit held prior to the incorporation of Royal Host Inc. Holders of common shares are entitled to one vote per common share at meetings of the shareholders, along with dividends when declared by the Board of Directors and the right to receive a pro-rata share of the remaining property and assets of Royal Host upon its dissolution or winding up. For the six months ended June 30, 2011, the Board of Directors did not declare dividends. During the year ended December 31, 2010, the Trust declared distributions of \$0.30 per unit.

Effective May 26, 2011, the company issued 170,000 common shares to the President and CEO of Royal Host through a private placement. On the same date, he was also granted 170,000 stock options at a price of \$1.48 per share. These stock options vest on the basis of 1/3 each year for the next three years and have an expiry date of five years from the grant date. As of June 30, 2011, no options have been exercised. The fair value of these options was estimated using the Black Scholes pricing model and the following assumptions:

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

Inputs to Model	Amount	Source of Inputs
Stock price at Grant Date	\$1.31	Market data
Exercise Price	\$1.48	Authorized Stock Option Agreement
Expected life of Options	5 years	Period of expiration
Risk-free interest rate	2.33%	5 yr Government of Canada bond rate
Expected volatility	39%	5 yrs of historical market data

For the six month period ended June 30, 2011, approximately \$4 in expense has been recorded in the “Corporate administration” expense category on the consolidated statements of net income (loss) along with a corresponding increase in contributed surplus for the same amount.

Following is a table summarizing the changes in the number of common shares outstanding for the six months ending June 30, 2011 and the year ending December 31, 2010:

	Six months ended June 30, 2011	Year ended December 31, 2010
	#	#
Beginning balance	17,650,478	18,304,670
Shares/units repurchased under NCIB	(238,100)	(548,700)
Shares issued	170,000	0
Trust units repurchased under SIB	-	(99,102)
Trust units cancelled under employee loans	-	(6,390)
Ending balance	17,582,378	17,650,478

#### Normal Course Issuer Bids

Commencing on January 12, 2011, Royal Host initiated a normal course issuer bid (“NCIB”) to repurchase a maximum of 1.3 million of its issued and outstanding common shares. Pursuant to this bid, the company has repurchased and cancelled 204,100 common shares as at June 30, 2011.

Commencing on January 12, 2010, Royal Host initiated an NCIB to repurchase a maximum of 1.3 million of its issued and outstanding trust units. During the year ended December 31, 2010, Royal Host repurchased 620,000 units with an aggregate cost of \$1,411 (average price of \$2.28 per unit) pursuant to this bid. Of the units repurchased, 71,300 were cancelled subsequent to year end. In the six months ending June 30, 2011, Royal Host repurchased 34,000 common shares pursuant to this bid.

**Royal Host Inc.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2011 and 2010

*Unaudited (in thousands of Canadian dollars, except per unit amounts)***16. OTHER OPERATING EXPENSES**

	Three months ended June 30, 2011 \$	Three months ended June 30, 2010 \$	Six months ended June 30, 2011 \$	Six months ended June 30, 2010 \$
Sales and marketing	878	1,005	1,736	2,051
Repairs and maintenance	756	897	1,550	1,749
Food and beverage cleaning and amenities	1,574	1,590	3,073	2,953
Communications	199	206	404	398
Insurance	139	167	295	324
Information technology	57	55	128	133
Accounting fees	226	183	487	351
Credit card commissions	415	400	775	717
Miscellaneous charges	962	1,265	1,808	2,229
Total other operating expenses	5,206	5,768	10,256	10,905

**17. INCOME TAXES**

As a mutual fund trust, Royal Host was not subject to income tax but instead was obligated to distribute all of its taxable income to unitholders. Effective January 1, 2011, Royal Host converted to a corporation through the Arrangement whereby each unitholder received common shares of the new corporation "Royal Host Inc." in exchange for their units. The exchange was completed on a tax-deferred basis; however, Royal Host will be subject to Canadian federal and provincial corporate income tax on its taxable income beginning January 1, 2011.

The income tax recovery is comprised of:

	Three months ended June 30, 2011 \$	Three months ended June 30, 2010 \$	Six months ended June 30, 2011 \$	Six months ended June 30, 2010 \$
Current income tax expense	-	-	185	-
Deferred income tax recovery	(1,197)	124	(1,750)	(1,078)
Income tax recovery	(1,197)	124	(1,565)	(1,078)

The income tax recovery differs from that computed using the best estimate of the weighted average annual statutory rate expected to apply as shown in the following table:

# Royal Host Inc.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

	Six months ended June 30, 2011		Six months ended June 30, 2010	
	\$	%	\$	%
Net loss before income taxes	7,833		801	
Recovery of income taxes at statutory rate	2,209	28.2	245	30.6
Increase (decrease) from statutory rate:				
Effects of rescheduling temporary differences in capital assets	(457)	(5.8)	930	116.1
Items not deductible (taxable)	(185)	(2.4)	(17)	(2.1)
Other items	(2)	(0.03)	(80)	(10.0)
Income tax recovery	1,565	20.0	1,078	134.6

As Royal Host was not subject to income taxes prior to January 1, 2011, in periods prior to December 31, 2010 a deferred tax asset (liability) was recognized in respect of those differences expected to reverse after January 1, 2011. Royal Host's net deferred income tax asset (liability) is comprised of the following:

	June 30, 2011	December 31, 2010
	\$	\$
Marketable securities	2,036	2,012
Property and equipment	2,098	1,194
Debt issuance costs	(722)	(769)
Convertible debentures and conversion options	(363)	215
Non-capital loss carryforward	802	-
Capital loss carryforwards	40	36
Intangible assets	102	162
Net deferred tax asset (liability)	3,993	2,850

### 18. PER SHARE CALCULATIONS (Per unit in previous period)

	Three months ended June 30, 2011			Three months ended June 30, 2010		
	Net income (loss)	Weighted average shares (in thousands)	Per share amount	Net income (loss)	Weighted average units (in thousands)	Per unit amount
	\$	#	\$	\$	#	\$
<b>Basic income (loss) per share</b>						
Net income (loss)	(1,678)	17,479	(0.10)	2,434	18,304	0.13
<b>Diluted income (loss) per share</b>						
Net income (loss)	(1,678)	17,479	(0.10)	4,636	47,531	0.10

	Six months ended June 30, 2011			Six months ended June 30, 2010		
	Net income (loss)	Weighted average shares (in thousands)	Per share amount	Net income (loss)	Weighted average units (in thousands)	Per unit amount
	\$	#	\$	\$	#	\$
<b>Basic and diluted income (loss) per share</b>						
Net income (loss)	(6,278)	17,492	(0.36)	277	18,206	0.02

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

The diluted earnings per share/unit for the six months ended June 30, 2011 and 2010 and the earnings per share for the three months ended June 30, 2011 do not include common shares/trust units issuable on the conversion of the convertible debentures or employee stock options because they are all anti-dilutive. For the three months ended June 30, 2010, the weighted average shares calculation for the diluted earnings per share includes an additional 29,227 shares from the assumed conversion of all convertible debentures.

Based on the market price of Royal Host trust units at June 30, 2011, the company would have to issue 120,604,839 common shares if 100% of the debentures were settled at their various maturity dates by the issuance of equity.

## 19. SUPPLEMENTAL CASH FLOW INFORMATION

<b>Adjustment for items not involving cash</b>	<b>Six months ended June 30, 2011 \$</b>	<b>Six months ended June 30, 2010 \$</b>
Depreciation and amortization	7,230	8,576
Impairment of intangible assets	-	601
Realized gains on available-for-sale securities	-	(12,746)
Unrealized loss on trust units liability and conversion options	-	88
Deferred income tax recovery	(1,750)	(1,078)
Gain on convertible debenture repurchases	-	(408)
Gain on trust unit repurchases	-	(4)
Employee stock options expense	4	-
Accretion on mortgages and finance leases	69	118
Accretion on convertible debentures	608	577
	<b>6,161</b>	<b>(4,276)</b>

<b>Net changes in non-cash working capital balances</b>	<b>Six months ended June 30, 2011 \$</b>	<b>Six months ended June 30, 2010 \$</b>
<b>Decrease (increase) in:</b>		
Accounts receivable	(940)	(701)
Prepaid expenses	(1,416)	(642)
Inventories	(104)	(126)
	<b>(2,460)</b>	<b>(1,469)</b>
<b>Increase (decrease) in:</b>		
Accounts payable and accrued liabilities	832	(907)
Interest accrued on convertible debentures	-	(24)
Distributions payable	-	(2)
Deferred revenue	76	198
	<b>908</b>	<b>(735)</b>
<b>Net change in non-cash working capital balances</b>	<b>(1,552)</b>	<b>(2,204)</b>

## Royal Host Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011 and 2010

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

#### 20. RELATED PARTY TRANSACTIONS

At June 30, 2011, Clarke Inc. owned approximately 5.294 million or 30% (December 31, 2010 – 5.294 million (30%)) of Royal Host's issued and outstanding common shares and, as such, is considered a related party to Royal Host. During the three and six months ended June 30, 2011, Royal Host incurred professional and management fees of \$80 and \$184 for services supplied by Clarke Inc. (Three and six months ended June 30, 2010 - \$401 and \$862). As at June 30, 2011, \$nil was owing in respect of these fees (December 31, 2010 - \$57).

During the three and six months ended June 30, 2011, Royal Host incurred leasing costs for office space provided by a company controlled by a shareholder of Royal Host of \$27 and \$54 (Three and six months ended June 30, 2010 - \$nil). As at June 30, 2011, \$nil was owing in respect of these fees (December 31, 2010 - \$nil).

#### 21. SEASONALITY

The hospitality industry is seasonal in nature and the periods during which individual properties experience higher demand vary depending primarily on location. While Royal Host's revenue is typically higher in the second and third quarters of the fiscal year, as compared to the first and fourth quarters, several of the company's costs, including property taxes, depreciation, interest and utilities do not vary significantly by quarter. As a result, profitability of Royal Host can vary significantly from quarter to quarter.

#### 22. COMMITMENTS AND PROVISIONS

##### Operating lease commitments

Royal Host has operating lease commitments related to furniture, fixtures, equipment and office space. At June 30, 2011 future minimum annual lease payments are as follows:

	\$
2012	490
2013	424
2014	385
2015	133
2016	11
	1,443

##### Other commitments

Under the terms of the hotel franchise agreements expiring at various dates through July 12, 2022, annual payments for franchise expenses (including fees, reservation and advertising services) are due to franchise brands for 29 of the 31 hotels owned by Royal Host (2010 - 29 of the 31 hotels). The franchise expenses paid to external parties are calculated based upon percentages of revenue.

**Royal Host Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2011 and 2010

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

**23. SUBSEQUENT EVENTS**

Effective July 22, 2011, the company's Super 8 Regina hotel was sold for \$5,200 less costs to sell. The portfolio sale of the company's Country Inn and Suites properties in Winnipeg, Saskatoon and Regina was completed on August 3, 2011 for \$25,800 less costs to sell. The aforementioned properties were unencumbered as of June 30, 2011.

A refinancing of the company's credit facility was completed on July 15, 2011. The new facility matures in July 2014.

# **ROYAL HOST** INC.

**June 30, 2011**

**Management's Discussion and Analysis**

## **MANAGEMENT'S DISCUSSION & ANALYSIS FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2011**

Management's Discussion & Analysis ("MD&A") presents management's view of the financial position and performance of The Company Inc. ("The Company" or "the Company") for the three and six months ended June 30, 2011 compared with the three and six months ended June 30, 2010. This interim MD&A should be read in conjunction with the information disclosed within the unaudited, consolidated financial statements and notes thereto for the three and six months ended June 30, 2011. This interim MD&A is prepared as at August 8, 2011 (unless otherwise stated). All dollar amounts are shown in thousands of Canadian dollars unless otherwise indicated. Additional information relating to the Company, including risk factors as described on pages 29 to 34 of the Company's Annual Information Form ("AIF") dated as of March 31, 2011 is hereby incorporated by reference into this interim MD&A, and can be obtained from SEDAR at [www.sedar.com](http://www.sedar.com).

### **Non-GAAP Measures**

This interim MD&A includes certain non-IFRS measures (measures that are not calculated or presented in accordance with IFRS). Because these measures are not defined under IFAS, The Company's method of calculation may not be comparable to similar measures presented by other entities. These measures should not be used as an alternative to net earnings or cash flows from operations determined in accordance with IFRS when assessing the Company's financial performance. However, the Company believes these measures are useful in supplementing the reader's understanding of the Company's performance.

This interim MD&A includes the following non-IFRS measures: Revenue per Available Room ("RevPAR"), Average Daily Rate ("ADR"), Occupancy, Hospitality Gross Margin, Cash Flows From Operations, Funds from Operations and Adjusted Funds from Operations.

Management and the Board of Directors use these measurements, among other purposes, to assess each property's market position among its competitive set and to assess Management's effectiveness in optimizing each property's room inventory.

### **Cautionary Statement Regarding Forward-looking Information and Statements**

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

## OVERVIEW

This MD&A reflects the Company's adoption of IFRS effective from January 1, 2010, with information for 2010 being restated from that which was previously issued under Canadian GAAP. Periods prior to January 1, 2010 have not been restated.

During the three months ending June 30, 2011, revenue decreased slightly compared to the prior year:

- Generated overall Revenue per Available Room of \$56.44 (2010 - \$56.95), Occupancy of 58.2% (2010 – 58.0%), and Average Daily Rate of \$96.90 (2010 - \$98.11).
- Generated \$5,352 of hospitality gross margin (2010 - \$4,981) from \$24,020 of hospitality revenue (2010 - \$24,371). Hospitality gross margin increased to 22.3% in 2011 (2010 – 20.4%).
- Recorded Funds From Operations of \$1,040 (2010 - \$370).

Subsequent to June 30, 2011, the Company sold four select service hotels for gross proceeds of \$31,000.

## INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) – KEY CHANGES

The Company has presented its financial results for the three and six months ended June 30, 2011 and the comparative prior periods in accordance with IFRS.

IFRS is based upon a conceptual framework similar to Canadian GAAP; however, there are significant differences in the recognition, measurement and disclosure requirements for certain accounting areas. The key changes in accounting policies due to the initial adoption of IFRS were outlined in the Company's Interim Consolidated Financial Statements at March 31, 2011. The following list captures certain key changes under IFRS:

### Property and Equipment

The Company has selected the cost model to account for the property and equipment at its hotels, and has elected under IFRS 1 to record its land, building and building components on January 1, 2010 (the Transition Date) at fair value. The Company has also further componentized its property and equipment. Depreciation and amortization expense has increased from the depreciation and amortization expense reflected under Canadian GAAP due to; (1) the fair value increase for certain hotel properties on the Transition Date; and (2) componentization of hotel properties resulted in accelerated depreciation under IFRS compared to Canadian GAAP.

### Classification of the Company Trust Units

Prior to January 1, 2011 the Company was a Trust entity with its Trust Units listed on the TSX. Under Canadian GAAP, the Company's Trust units were presented as equity. Under IFRS, a component of a trust unit is considered a financial instrument, where a liability arises due to a contractual obligation to deliver cash or another financial asset to another entity. Prior to January 1, 2011, the mandatory requirement to distribute taxable income under the Declaration of Trust constituted a contractual obligation. The components of the Trusts' units representing the future distribution obligation are presented as a financial liability under IFRS. This component is measured at fair value with any related gains and losses recognized on the consolidated statement of net loss and comprehensive loss. As the fair value of the future distribution obligation cannot be reliably measured separately from the Trust's units, the entire Trust unit is considered a financial liability measured at fair value, with any related gains and losses recognized on the consolidated statement of net loss and comprehensive loss.

At the Special Unitholders' meeting on December 15, 2010, Unitholders voted to convert the Company to a Corporation effective January 1, 2011. As a result, the share capital of the Company is presented as equity from January 1, 2011 forward. For January 1, 2010 through December 31,

2010, the Company's trust units are presented as a liability on the consolidated statement of financial position and distributions to Unitholders are reflected as distribution expenses with any unrealized change in the fair value of the trust units recognized on the consolidated statements of net loss and comprehensive loss at each reporting date in 2010.

### Discontinued Operations

The definition of discontinued operations under IFRS is more restrictive than under Canadian GAAP. While disposals of an individual hotel property constituted a discontinued operation under the Canadian GAAP standards, IFRS mandates that only significant operations, such as a major line of business or geographical area of operation, meet the IFRS requirements to present the results as discontinued operations. This different treatment under IFRS resulted in the reclassification of amounts previously reported as discontinued operations to continuing operations in the Company's comparative consolidated statement of net loss and comprehensive loss, affecting net loss before income taxes in 2010, but not net loss.

### SELECTED FINANCIAL INFORMATION

Highlights of the consolidated statement of net loss and comprehensive loss for the three and six months ended June 30, 2011 and the comparative period for 2010 are as follows:

(\$000's, except as otherwise noted)	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
Hospitality Revenue	24,020	24,371	45,722	45,112
Hospitality Expenses	18,668	19,390	37,486	37,241
Gross Margin <sup>(1)</sup>	5,352	4,981	8,236	7,871
Gross Margin % <sup>(1)</sup>	22.3%	20.4%	18.0%	17.4%
Investment Income	4	28	5	292
Finance Costs	3,534	5,519	7,092	11,231
Depreciation and Amortization	3,571	4,286	7,230	8,576
Other Expenses (Income)	1,126	(7,354)	1,752	(10,843)
Income Tax Expense (Recovery)	(1,197)	124	(1,565)	(1,078)
Net Income (Loss)	(1,678)	2,434	(6,268)	277
Basic Income (Loss) per Share (\$)	(\$0.10)	\$0.13	(\$0.36)	\$0.02
Diluted Income (Loss) per Share (\$)	(\$0.10)	\$0.10	(\$0.36)	\$0.02
Funds From Operations	1,040	370	(107)	(1,270)
Basic and diluted Funds From Operations per share	\$0.06	\$0.02	(\$0.01)	(\$0.07)
Number of Shares Outstanding (000's)	17,582	18,197	17,582	18,197
Weighted Average Shares Outstanding (000's)	17,479	18,304	17,492	18,206
Closing Share Trading Price (\$)	\$1.24	\$2.45	\$1.24	\$2.45

As at August 8, 2011, the Company had 17,582,378 shares outstanding.

<sup>(1)</sup> Items represent non-IFRS financial measures.

**Hospitality Revenue**

	Three months ended June 30			Six months ended June 30		
	2011	2010	Variance	2011	2010	Variance
Hotel revenue - full service	15,086	15,032	54	29,084	27,842	1,242
Hotel revenue - select service	8,193	8,518	(324)	15,254	15,705	(452)
Franchise fee revenue	410	484	(74)	746	899	(153)
Tenant revenue	301	306	(5)	606	593	13
Other revenue	29	31	(2)	32	72	(40)
<b>Hospitality Revenue</b>	<b>24,020</b>	<b>24,371</b>	<b>(351)</b>	<b>45,722</b>	<b>45,112</b>	<b>610</b>

Hospitality revenue decreased \$351 to \$24,020 for the three months ended June 30, 2011 from \$24,371 for the same period in 2010. The decline was primarily a result of a \$324 decrease in the revenue from our select service hotels. Revenue from the Company's 21 select service hotels declined from \$8,518 to \$8,193, a decrease of 3.8%. This decrease was partially offset by an increase in revenue from our 10 full service hotels of \$54, or 0.4%, from \$15,032 in 2010 to \$15,086 in 2011.

Hospitality revenue increased \$610 to \$45,722 for the six months ended June 30, 2011 from \$45,112 for the same period in 2010. The primary reason for this change was a \$1,242 increase in revenue from our full service hotels from \$27,842 to \$29,084, an increase of 4.5%. This increase was partially offset by a decrease in revenue of \$452 from our select service hotels from \$15,705 in 2010 to \$15,254, a decline of 2.9%.

Franchising and management revenue was down \$74, or 15.2%, to \$410 for the three months ended June 30, 2011 from \$484 during the same period in 2010. The Company was managing two hotels owned by third parties during the first six months of 2010. These management contracts terminated as of June 30, 2010. Additionally, Travelodge franchise revenue was down slightly in 2011 compared to 2010. These same two factors affected the six month period ended June 30, 2011 as compared to 2010, as revenue was down by 17.0%, decreasing \$153 from \$899 to \$746.

As of June 30, 2011, Royal Host owned 31 hotels. Of these 31 hotels, management classified 10 of them as full service and 21 of them as select service. Over 70% of "hotel revenue – full service" is generated by room revenue. Over 95% of "hotel revenue – select service" is derived from room revenue. Statistical information on full service and select service hotels is contained in the section of this MD&A titled "Key Performance Indicators".

**Hospitality Expenses**

Hospitality gross margin increased \$371, or 7.4%, to \$5,352 in the second quarter of 2011 compared to \$4,981 in the second quarter of 2010. We are benefiting from a more efficient cost structure associated with contracting the management of 100% of our hotels to third party management companies. Prior to the second quarter of 2010, third party management companies managed all of the Company's 21 select service hotels. In the second quarter of 2010, we transitioned the management of our remaining hotels, all full service, to a third party management company. Subsequent to this, the Company incurred higher third party management fees, but these were more than offset by reductions in corporate payroll and administrative costs. As a result, cost savings are evident in comparing current year to prior year, commencing in the second quarter of 2011.

Hospitality gross margin increased \$365, or 4.6%, to \$8,236 for the six months ended June 30, 2011 from \$7,871 for the same period in 2010. This increase is slightly less than the increase in the hospitality gross margin of \$371 for the three months ending June 30, 2011. This is primarily due to

utilities and workers' compensation expenses in the three months ending March 31, 2011 exceeding the level of these expenses during the same period in 2010.

### **Investment Income**

Investment income decreased from \$8,831 in the three months ended June 30, 2010 to \$4 during the same period of 2011. There were three large components of investment income in three months ended June 30, 2010 that did not recur in the three months ended June 30, 2011;

(1) \$6,328 of "unrealized gains on trust units liability and conversion options" resulted from the IFRS restatement of 2010's financial statements. Under IFRS, the Company's trust units (converted to common shares on a 1:1 basis on January 1, 2011 reorganization) were considered a liability. As a result, changes in fair value were recorded as a gain or loss in the statement of income (loss). The large unrealized gain reflects the fact that the market price of our trust units decreased from March 31, 2010 to June 30, 2010. This decline resulted in the trust unit liability being \$6,328 less at June 30, 2010 compared to March 31, 2010. There is no such gain or loss in 2011 as our common shares are now classified as equity at historical cost.

(2) A \$2,065 "gain on available-for-sale securities" was recorded in the three months ended June 30, 2010 as the Company sold marketable securities during the period. There were no sales of securities in same period in 2011.

(3) A \$408 "gain on repurchase of convertible debentures" was recorded in the three months ended June 30, 2010 as we repurchased our convertible debentures at a discount to face value. There were no such repurchases in the same period of 2011.

The investment income recorded in the three months ended June 30, 2011 resulted from interest on operating accounts.

Investment income decreased for the six months ended June 30 from \$13,362 in 2010 to \$5 in 2011. The decline is mainly the result of the "gain on available for sale securities" of \$12,746 in the six months ended June 30, 2010 as the Company had additional sales of marketable securities in the three months ended March 31, 2010. There was an "unrealized loss on trust units liability and conversion options" in the three months ended March 31, 2010 of \$6,416 which resulted in an "unrealized loss on trust units liability" for the six months ended June 30, 2010 of \$88. There were no repurchases of convertible debentures in three months ended March 31, 2010.

### **Finance Costs**

Finance costs decreased by \$1,985 to \$3,534 in the three months ended June 30, 2011 from \$5,519 in same period in 2010. This was primarily due to two factors: (1) Distributions, which totaled \$1,364 in the three months ended June 30, 2010. Distributions were nil during the same period of 2011. In 2010, our trust units were classified as a liability under IFRS and all distributions on these units were considered a finance charge. As the trust units were converted into common shares on January 1, 2011, this is no longer applicable. We have not paid any dividends in 2011; (2) interest on mortgages decreased \$580 from \$1,545 to \$965. This decline was due to repayments made in June and August of 2010 on mortgages at their maturity dates.

Finance costs decreased by \$4,139 to \$7,092 in for the six months ended June 30, 2011 from \$11,231 compared to the same period in 2010. The same two factors generated the decline for the six months ended June 30, 2011.

### **Other Expenses**

Other expenses declined \$1,038 to \$4,697 in the three months ended June 30, 2011 from \$5,735 in the same period in 2010. The majority of this decline was due to a reduction of depreciation and amortization of \$715 and a reduction of corporate administration charges of \$312.

### Income Tax Recovery

The Company recognized an income tax recovery of \$1,197 in three months ended June 30, 2011 compared to income tax expense of \$124 in the same period in 2010. The income tax recovery in the three months ended June 30, 2011 was primarily due to timing differences in property and equipment, as financial reporting depreciation exceeded projected CCA for income tax purposes. The main reason for the income tax expense in the second quarter of 2010 was due to the decrease in the fair value of the conversion option liability during the quarter. The conversion option liability is no longer fair valued subsequent to our conversion to a corporation on January 1, 2011. Subsequent to the conversion, the conversion option liability is a component of equity presented as "equity component of convertible debentures".

We recognized an income tax recovery of \$1,565 in the six months ending June 30, 2011 compared to an income tax recovery of \$1,078 in the same period in 2010. In both cases, the main driver behind the income tax recovery was depreciation of property and equipment exceeding the capital cost allowance taken on these assets for income tax purposes.

### Other Comprehensive Loss

As the result of an unrealized loss on available for sale securities, the Company recorded a loss through other comprehensive loss of \$105 in the three months ended June 30, 2011 and a loss of \$133 for the six months ended June 30, 2011. We recorded other comprehensive loss of \$3,183 in the three months ended June 30, 2010 and a loss of \$10,366 for the six months ending June 30, 2010.

The losses for both the three and six months ended June 30, 2011 were due to decreases in the market value of our marketable securities.

The losses for both and the three and six months ended June 30, 2010 were due to unrealized gains on available for sale securities being transferred out of other comprehensive income (loss) and into "gain on available for sale securities", which resulted in losses recorded through other comprehensive loss.

### SUMMARY OF QUARTERLY FINANCIAL RESULTS

(\$000's, except per share results)	IFRS Standards						CGAAP Standards	
	2011		2010				2009	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenue	24,020	21,702	22,522	24,634	24,371	20,741	22,746	25,196
Net Income (Loss)	(1,678)	(4,595)	(5,296)	(1,593)	2,433	(2,158)	1,151	(2,223)
Per Share Results:								
Basic Income (Loss)	(0.10)	(0.26)	(0.30)	(0.08)	0.13	(0.12)	0.06	(0.10)
Diluted Income (Loss)	(0.10)	(0.26)	(0.30)	(0.08)	0.10	(0.12)	0.06	(0.10)

**ROYAL HOST AT A GLANCE**

The Company is a diversified hospitality company that delivers shareholder value through hotel ownership, investment and franchising. At June 30, twenty-nine of The Company's hotels operated under recognizable brands (set forth in the table below); two of the company's hotels are unbranded. The Company's holdings are further enhanced by a stable franchising business and units that it owns in a publicly-traded hospitality trust.

	ONTARIO			ATLANTIC			WESTERN			TOTAL		
	# of Hotels	# of Rooms	% of Guest Rooms	# of Hotels	# of Rooms	% of Guest Rooms	# of Hotels	# of Rooms	% of Guest Rooms	# of Hotels	# of Rooms	% of Guest Rooms
Travelodge® Thriftlodge®	9	1,253	33.8	3	209	5.7	4	415	11.2	16	1,877	50.7
Country Inns & Suites®	-	-	-	1	64	1.7	3	228	6.1	4	292	7.8
Independent	1	256	6.9	-	-	-	1	129	3.5	2	385	10.4
Hilton®	1	323	8.7	-	-	-	-	-	-	1	323	8.7
Super 8®	2	159	4.2	-	-	-	2	132	3.6	4	291	7.9
Holiday Inn®	2	254	6.9	-	-	-	-	-	-	2	254	6.9
Best Western®	-	-	-	-	-	-	1	159	4.3	1	159	4.3
Ramada®	1	124	3.3	-	-	-	-	-	-	1	124	3.3
	16	2,369	63.9	4	273	7.4	11	1,063	28.7	31	3,705	100.0
Full Service	8	1,590	67.1	-	-	-	2	288	27.1	10	1,878	50.7
Limited Service	8	779	32.9	4	273	100.0	9	775	72.9	21	1,827	49.3

The above information is as of June 30, 2011. Four hotels were sold subsequent to June 30, 2011 and prior to the date of this MD&A (see "Subsequent Events" section of this MD&A). The four hotels sold were all from the "Western" region and account for 288 rooms. These sales bring the total hotels and rooms to 27 and 3,417 as of the date of this MD&A.

The Company's hotel portfolio of mostly mid-scale and select service hotel properties is diversified geographically among seven provinces and territories within Canada and derives its revenues from numerous customer segments. The majority of the Company's hotels derive the bulk of their revenue from corporate and leisure segments; they depend less on the group segments as they are generally not configured with significant meeting space. Approximately 75% - 80% of the Company's room revenue is derived from corporate and leisure transient room nights with the remainder derived from group business.

## KEY PERFORMANCE INDICATORS

### RevPAR, Occupancy and ADR

Maximizing revenue remains a key priority in 2011. The managers of our hotels continue to devote substantial resources and attention to maintaining and growing market share and revenue, stimulating demand through local, regional, national and international sales and marketing initiatives.

Companies operating in the hospitality industry commonly use three statistics as key performance indicators:

- **RevPAR**, which combines pricing levels with occupancy. This measure of revenue is based on all available rooms regardless of whether they are occupied or not. RevPAR is calculated by dividing the room revenue for the period by the number of rooms available during the period;
- **Occupancy**, which measures the level of hotel room utilization and is calculated by dividing the number of rooms rented during the period by the number of rooms available in the same period; and
- **ADR**, which measures the average room price for all occupied guest rooms and is calculated by dividing total room revenue during the period by the number of rooms rented in the same period.

### Full Service Hotels and Select Service Hotels – Occupancy, ADR and RevPAR

	Three months ended June 30, 2011			Three months ended June 30, 2010		
	Occupancy	ADR	RevPAR	Occupancy	ADR	RevPAR
Full Service	61.7%	\$104.57	\$64.51	59.7%	\$106.87	\$63.75
Select Service	54.7%	\$87.95	\$48.13	56.4%	\$88.54	\$49.93

	Six months ended June 30, 2011			Six months ended June 30, 2010		
	Occupancy	ADR	RevPAR	Occupancy	ADR	RevPAR
Full Service	60.1%	\$104.65	\$62.85	55.8%	\$106.01	\$59.18
Select Service	51.3%	\$87.70	\$44.99	52.3%	\$88.42	\$46.22

Our 10 full service hotels experienced an increase in occupancy in both the three and six month periods ended June 30, 2011 compared to the same periods in 2010. The improvement in occupancy was partially offset by a decrease in ADR in both the three and six month periods ended June 30, 2011 compared to 2010. The increase in occupancy and decrease in ADR has resulted in an increase in RevPAR of 1.2%, or \$0.76, for the three month period ending June 30, 2011 and an increase in RevPAR of 6.2%, or \$3.67, for the six month period ending June 30, 2011, both in comparison to the same periods of 2010.

Our 21 select service hotels experienced a decrease in occupancy in both the three and six month periods ended June 30, 2011 compared to the same periods in 2010. This decline in occupancy has been compounded by a decline in ADR in both the three and six month periods ended June 30, 2011 compared to 2010. The drop in occupancy and ADR resulted in a decline in RevPAR of 3.6%, or \$1.80, for the three month period ending June 30, 2011 and a decline in RevPAR of 2.7%, or \$1.23, for the six month period ending June 30, 2011, both in comparison to the same periods of 2010.

**Royal Host Hotels – Occupancy, ADR and RevPAR – Regional and Total**

Region	Three months ended June 30, 2011			Three months ended June 30, 2010		
	Occupancy	ADR	RevPAR	Occupancy	ADR	RevPAR
Ontario	59.6%	\$94.60	\$56.35	59.6%	\$97.17	\$57.88
Western	56.7%	\$104.23	\$59.07	54.6%	\$102.59	\$56.02
Atlantic	52.9%	\$89.01	\$47.09	58.1%	\$90.30	\$52.47
<b>Total</b>	<b>58.2%</b>	<b>\$96.90</b>	<b>\$56.44</b>	<b>58.0%</b>	<b>\$98.11</b>	<b>\$56.95</b>

*Occupancy has been calculated including all available room nights at the Company's hotels; available room nights have not been adjusted to exclude rooms/room nights unavailable during renovations*

Region	Six months ended June 30, 2011			Six months ended June 30, 2010		
	Occupancy	ADR	RevPAR	Occupancy	ADR	RevPAR
Ontario	57.1%	\$94.76	\$54.14	54.8%	\$96.64	\$52.96
Western	54.4%	\$103.99	\$56.55	52.7%	\$102.25	\$53.90
Atlantic	48.8%	\$89.18	\$43.51	53.0%	\$89.16	\$47.23
<b>Total</b>	<b>55.7%</b>	<b>\$96.97</b>	<b>\$54.04</b>	<b>54.1%</b>	<b>\$97.65</b>	<b>\$52.80</b>

**Ontario**

RevPAR at the Company's Ontario hotels, decreased \$1.53, or 2.7%, to \$56.35 in the three months ended June 30, 2011 from the same period in 2010. In the three months ended June 30, 2010, the Ontario hotels benefited from the G8 and G20 summits that were one-time events. RevPAR gains at The Company's London, Trenton, Belleville and Thunder Bay properties in the three months ended June 30, 2011 were offset by weaker results in northern Ontario, Ottawa and the Greater Toronto Area hotels.

**Western**

RevPAR at the Company's western hotels increased \$3.05, or 5.5%, to \$59.07 in the three months ended June 30, 2011 compared to 2010. There was strong growth in RevPAR at the Yellowknife Inn. Additionally, there was improvement in RevPAR at The Company's Calgary hotel, the three Saskatchewan hotels and the Winnipeg hotel. Improvements at these hotels were partially offset by declines in RevPAR at the Company's five Alberta hotels located outside of Calgary.

**Atlantic**

RevPAR at the Company's four Atlantic Canada properties was down \$5.38, or 10.3%, in the three months ended June 30, 2011 compared to 2010. The Company converted three of the four hotels in the Atlantic region from Country Inns to Travelodge Suites. On May 16, 2011, the former Country Inn & Suites in Saint John and Moncton, New Brunswick and Dartmouth, Nova Scotia were re-branded to Travelodge Suites. This expanded The Company's Travelodge franchise business into Atlantic Canada, boosting its profile. However, the transition had a negative impact on second quarter operating results of these hotels as the Country Inn reservation system was terminated and reservations generated by the newly introduced Travelodge system were lower than what had been achieved in 2010 by the Country Inn reservation system.

**CASH FLOWS FROM OPERATIONS**

The following table illustrates the components of cash flows from operations:

(\$000's, except as otherwise noted)	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
Hospitality Gross Margin	5,352	4,981	8,236	7,871
Interest Income	4	28	5	292
Other Expenses:				
Corporate Administration	(536)	(848)	(1,162)	(1,626)
Remediation of Vacant Land Costs	(590)	-	(590)	-
Interest on Mortgages and Capital Leases	(933)	(1,467)	(1,892)	(3,164)
Interest on Convertible Debentures	(2,257)	(2,324)	(4,519)	(4,643)
Distribution Expenses	-	(1,364)	-	(2,729)
Income Tax Expense	-	-	(185)	-
	1,040	(994)	(107)	(3,999)
Net Changes in Working Capital	(1,552)	915	(1,552)	(2,204)
<b>CASH FLOWS FROM OPERATIONS</b>	<b>(512)</b>	<b>(79)</b>	<b>(1,659)</b>	<b>(6,203)</b>

During the three months ended June 30, 2011, the Company's operations, before net changes in working capital, generated positive cash flow of \$1,040, an increase of \$2,034 over the same period in 2010. The improvement was primarily driven by an increase in Hospitality Gross Margin of \$371 and a reduction in Other Expenses of \$1,687. The increase in Hospitality Gross Margin is due to reduced expenses as discussed in the "Hospitality Expenses" section. The majority of the reduction in Other Expenses is due to reduced mortgage interest expense, reduced Corporate Administration expenses and the elimination of Distribution Expenses in 2011 as discussed further in the "Other Expenses" section above.

Cash Flows From Operations for the three months ended June 30, 2011 were negative \$512, a decline of \$433 from the same period in 2010 as net changes in working capital produced cash outflows of \$1,552, compared to cash inflows of \$915 in the same period in 2010. An increase in accounts receivable and a decline in accounts payable used \$1,327 more cash in the three month period ended June 30, 2011 compared to 2010. An increase in prepaid expenses used \$1,105 more cash in the three month period ended June 30, 2011 compared to 2010..

During the six months ended June 30, 2011, the Company's operations, before net changes in working capital, generated negative cash flow of \$107, an increase of \$3,892 over the same period in 2010. The improvement is also due to improved Hospitality Gross Margin and reduced Other Expenses in 2011 as compared to 2010 and is discussed further under those headings. Cash Flows From Operations for the six months ending 2011, were negative \$1,659, representing an increase of \$4,544 compared to the same period of 2010 as cash outflows due to net changes in working capital of \$1,552 were \$652 less than in 2010 primarily due to increased accounts payable balances in 2011 as compared to 2010 offset by an increase in prepaid expenses over the same period. .

**FUNDS FROM OPERATIONS AND ADJUSTED FUNDS FROM OPERATIONS**

Funds From Operations (FFO) and Adjusted Funds From Operations (AFFO) are non-IFRS measures commonly used by the real estate industry. The presentation of FFO, combined with the required IFRS presentations, is included in an effort to supplement the disclosure related to The Company's operating results. The Company has presented the calculation of FFO to follow the guidance in the "White Paper on Funds From Operations for IFRS – Final June 2010" issued by the Real Property Association of Canada ("REALpac").

(\$000's, except as otherwise noted)	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
Cash Flows from Operations	(512)	(79)	(1,659)	(6,203)
Distribution Expenses	-	1,364	-	2,729
Net changes in non-cash working capital	1,552	(915)	1,552	2,204
<b>Funds From Operations</b>	<b>1,040</b>	<b>370</b>	<b>(107)</b>	<b>(1,270)</b>
Provision for Capital Replacement	(910)	(919)	(1,732)	(1,697)
<b>Adjusted Funds From Operations</b>	<b>130</b>	<b>(549)</b>	<b>(1,839)</b>	<b>(2,967)</b>
Funds From Operations per Share:				
Basic	\$0.06	\$0.02	(\$0.01)	(\$0.07)
Diluted	\$0.06	\$0.02	(\$0.01)	(\$0.07)
Adjusted Funds From Operations per Share:				
Basic	\$0.01	(\$0.03)	(\$0.11)	(\$0.16)
Diluted	\$0.01	(\$0.03)	(\$0.11)	(\$0.16)

(1) Calculated as 4% of total room revenue and food & beverage revenue for the period

For the three months ended June 30, 2011, the Company recorded an increase in FFO of \$670 to \$1,040 from \$370 in the same period in 2010 as Hospitality Margin improved and Other Expenses were reduced in 2011 as discussed in the Cash Flows From Operations section.

For the six months ended June 30, 2011, the Company recorded FFO of negative \$107, an improvement of \$1,163 from the same period in 2010 with negative \$1,270. The improvement for the six month period was the result of the same factors which affected the three month period as discussed in the Cash Flows From Operations section.

Adjusted Funds From Operations for the three months ended June 30, 2011 were \$130 (2010 - negative \$549). Adjusted Funds from Operations for the six months ended June 30, 2011 were negative \$1,839 (2010 - negative \$2,967). The "provision for capital replacement", which is deducted from FFO to calculate AFFO, equates to four percent of total room revenue and food and beverage revenue. The provision for capital replacement did not vary significantly during the three and six months ended June 30, 2011 compared to 2010. Therefore, factors which resulted in the variance in FFO from 2010 to 2011 are the same factors which resulted in the differences in AFFO from 2010 to 2011.

**Dividends - Distributions to Unitholders**

On January 1, 2011 we converted from a trust to a corporation. In March 2011 the Company announced that the Board of Directors had determined to not pay a dividend for the first quarter of 2011. During the second quarter of 2010 and the six months ending June 30, 2010, a monthly distribution of \$0.025 per trust unit was paid totaling \$1,364 for the second quarter and \$2,729 for

the six months ending June 30, 2010. Under IFRS accounting standards, the trust unit distributions paid in 2010 were classified as a finance cost on the consolidated statement of net loss due to the classification of trust units as a long term liability.

Our Board of Directors reviews the Company's cash flow and cash position on a quarterly basis and it makes a determination as to whether or not to pay a dividend based on, among other considerations, financial performance, projected cash flows, required capital expenditures and working capital requirements.

### Seasonality

The hospitality industry is seasonal in nature and the periods during which individual properties experience higher demand vary depending primarily on location. While the Company's revenue is typically higher in the second and third quarters, as compared to the first and fourth quarters, many of its costs, including depreciation, property taxes and interest, are fixed and other costs, such as payroll and utilities, are largely fixed. Consequently, profitability and cash flow vary significantly from quarter to quarter.

### SELECTED INFORMATION FROM STATEMENT OF FINANCIAL POSITION

The following information is for reference in reading the "Liquidity and Capital Resources", "Capital Structure" and "Mortgages" sections of this MD&A:

	June 30, 2011	December 31, 2010
<b>Current:</b>		
Bank Indebtedness	18,100	13,786
Mortgages (1)	12,321	12,477
Subtotal	30,421	26,263
<b>Non-Current:</b>		
Mortgages (1)	31,426	31,834
Convertible Debentures (2)	145,160	144,552
Subtotal	176,586	176,386

(1) "Mortgages" are carried on the Statement of Financial Position at the principal balance, net of unamortized debt issuance costs.

(2) "Convertible debentures" are carried on the Statement of Financial Position at the principal balance, net of unamortized debt issuance costs and unamortized portion allocated to the "Equity component of convertible debentures".

### Liquidity and Capital Resources

The Company's principal sources of funds to satisfy cash requirements are cash flows from operations, its credit facility, proceeds from sales of property and equipment, additional borrowing on unencumbered assets and liquidations from its portfolio of marketable securities.

At June 30, 2011, the Company had undrawn credit facilities of \$471 (December 31, 2010 - \$4,624), marketable securities of \$1,875 (December 31, 2010 - \$1,886), and access to potential additional borrowing on its nineteen unencumbered properties.

On July 22, 2011 the Super 8 Regina was sold for gross proceeds of \$5,200. These proceeds, net of selling costs and post-closing adjustments, were used to repay a portion of the amount drawn on the Company's credit facility.

The Company anticipates an additional \$25,800 of gross proceeds from the sale of three Country Inn & Suites (located in Saskatoon, Regina and Winnipeg) in early August 2011. These proceeds, net of selling costs and post-closing adjustments, are anticipated to be used to fully extinguish the balance drawn on our credit facility. Management is assessing the optimal utilization of the excess funds from this sale.

As at June 30, 2011, the Company also had restricted cash of \$1,674 (December 31, 2010 - \$1,133) in the form of funds held by lenders pursuant to financing arrangements for future planned capital expenditures.

### Capital Structure

As at June 30, 2011, mortgages and convertible debentures had an aggregate carrying value of \$188,907 (December 31, 2010 - \$188,863). Principal outstanding at June 30, 2011 totaled \$193,553 (December 31, 2010 - \$194,186). The Company had also drawn \$18,100 of its \$25,000 credit facility which was subject to a maximum availability at June 30, 2011 of \$18,571.

### Mortgages

As at June 30, 2011, the carrying value of the Company's mortgages was \$43,747 (December 31, 2010 - \$44,311). The carrying value reflects total outstanding principal of \$44,003 (December 31, 2010 - \$44,636) less \$256 of debt issuance costs (December 31, 2010 - \$325). The \$563 decrease in carrying value during the year is attributable to the accretion of debt issuance costs of \$70 and \$633 of scheduled mortgage principal repayments made during the six months ended June 30, 2011.

The Company has one mortgage with a June 30, 2011 outstanding balance of \$11,522 coming due within the next 12 months. The mortgage is due in October 2011 and is secured by the Toronto Airport property. The Company is evaluating options which include refinancing in whole or in part or repaying the mortgage with proceeds from the asset sales.

The Company has a mortgage loan which contains a quarterly Debt Service Coverage Ratio ("DSCR") covenant based on the earnings of the two properties that are collateral for the loan. At June 30, 2011, the ratio calculation falls into a "low DSCR" range as prescribed by the loan agreement. This allows the lender to place additional restrictions on the cash flow generated by the two properties.

### Mortgage Maturities

	Principal Outstanding (\$000's)	Interest Rate	Security
October 2011	11,522	8.46%	1 hotel
March 2013	4,707	8.50%	2 hotels
June 2013	20,580	6.82%	2 hotel
October 2013	7,194	7.37%	1 hotel
Total	44,003		

As at June 30, 2011, the Company has nineteen operating hotel properties which have not been directly pledged as mortgage security.

The Company has a \$25,000 secured revolving credit facility with a maximum availability which is dependent on a valuation test. At June 30, 2011, the maximum availability of the facility was \$18,571 of which \$18,100 was drawn. At June 30, 2011 the facility was secured by six hotel

properties with interest on the outstanding amount accruing at the bank's prime lending rate plus a spread of 0.25% to 1.75% per annum.

### **Related Party Transactions**

At June 30, 2011, Clarke Inc. owned approximately 5.294 million (approximately 30%) of the Company's issued and outstanding shares and, as such, is a related party.

During the three and six months ended June 30, 2011, the Company incurred professional and management fees totaling \$80 (2010 - \$401) and \$184 (2010 - \$862) for services provided by Clarke Inc. The Company incurred leasing costs for office space provided by a company controlled by a shareholder of Royal Host of \$27 for the three months ended June 30 (2010 - \$nil) and \$54 for the sixed months ended June 30 (2010 - \$nil).

### **Subsequent Events**

The Company closed the sale of one of its hotels on July 22, 2011. The 60 room Super 8 Regina was sold for gross proceeds of \$5,200, resulting in a gain on sale of approximately \$725.

On August 4, 2011, the Company closed the sale of three Country Inn & Suites (located in Saskatoon, Regina and Winnipeg), which had a total of 228 rooms. . The gross proceeds from the sale of these three hotels totaled \$25,800, resulting in a gain on sale of approximately \$4,130.

The gains from these four sales will be recognized in the third quarter.

A refinancing of the Company's credit facility was completed on July 15, 2011. The new facility is a three year committed facility that matures in July 2014.

### **Environmental Matters**

The Company is exposed to certain environmental risks in conducting regular operations including contamination of owned properties and improper care and handling of materials and wastes.

We regularly review our operations and facilities to identify any potential environmental contamination or liability. The property at Orillia has been identified as requiring remediation for certain hazardous building materials that remain within the structure. The total cost of the remediation work is not known at this time. Other than the Orillia property, these reviews identified no material remediation issues and potential risks and there have been no material events arising subsequently that would indicate additional obligations. We believe we are in compliance with all relevant environmental laws and regulations. The Company is not aware of any pending or proceeding actions against it or any of its subsidiaries relating to environmental issues.

### **Disclosure Controls and Procedures**

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company is communicated to Management on a timely basis to allow timely and appropriate decisions regarding required public disclosure.

An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was conducted as of June 30, 2011 by Management under the supervision of the Chief Financial Officer. Based on that evaluation, the CFO concluded that the design and operation of these disclosure controls and procedures were effective as at June 30, 2011.

### **Internal Controls Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal controls over financial reporting ("ICFR") to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS.

Management, under the supervision of the President and Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's ICFR using the COSO framework, published by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that the design and operating effectiveness of the Company's ICFR were effective as of June 30, 2011.

### **Key Accounting Policies and Estimates**

Note 3 to the consolidated financial statements for the three months ended June 30, 2011 includes a summary of the Company's significant accounting policies.

The application of some of these policies requires the Company to make estimates related to future events that may have a material effect on current or future financial results. These estimates require experience and judgment and are subject to the inherent risk of inaccuracy, particularly where they relate to events that are expected to take place well in the future.

### **Changes in Accounting Policies**

International Financial Reporting Standards ("IFRS")

Effective January 1, 2011, the Company has adopted International Financial Reporting Standards (IFRS). Note 2 to the consolidated financial statements for the three months ended March 31, 2011 and for the three months ended June 30, 2011 includes a summary of elective exemptions and reconciliations of equity and comprehensive loss reported under Canadian GAAP and IFRS.

### **Outlook**

The increased occupancies that the industry has experienced in the first six months of 2011 when combined with industry forecasts for the remainder of 2011 support the view that the Canadian lodging sector may be through the trough of the most recent cyclical downturn. The Company's strategic plan calls for the sale of certain assets with the proceeds used to reduce debt and fund capital investment in its core holdings.