Capstone 1

Distinct Hotels Corporation — Case

CPA Evaluation — 2020

It is February 15, 2020, and you have been working as a CPA with Wilson Consulting Group (WCG) for the past eight months. You have been assigned to develop a report for the board of directors (board) and management of Distinct Hotels Corporation (DHC).

DHC has approached WCG with a request to assist them in strategic analysis and to set a new direction for the company. DHC is planning to go public within three years and has been advised that the company needs to show sustainable revenue and profit growth rates and better than average return on investment. Based on past years' results, the board is concerned about DHC's ability to achieve the growth rates and investment returns required. There are conflicting viewpoints amongst the directors as to how to achieve these results, as well as many operational issues that they would like you to analyze and address. DHC has already performed extensive research analysis on the appropriateness of going public as a means to finance future growth and has decided that this is the direction it wishes to pursue; therefore, an analysis on the decision to go public itself has not been requested and is not required.

You have been provided with the following information to review and analyze. (All dollar values are in Canadian dollars unless specifically stated otherwise.)

Distinct Hotels Corporation

DHC is a Canadian privately held company operating four luxurious and unique boutique hotels in Canadian holiday destinations. The hotels vary in size from 165 to 235 rooms per hotel. DHC is owned by two unrelated families, Jessica and Derek Sterne and Alyson and Kelvin Chung, with each person owning 25%. Jessica and Alyson have been lifelong friends and had worked for many years in the hotel industry prior to starting DHC, along with their husbands, in 2001.

An organization chart is provided in Appendix I. DHC's most recent financial statements for the years ended December 31, 2017, 2018, and 2019 (prepared under International Financial Reporting Standards [IFRS]) are provided in Appendix II. Industry benchmarks are provided in Appendix III.

Industry information

Description and size

DHC operates in the hotel and motel industry, specifically in the boutique hotel segment, and is currently rated at a five-star level. Boutique[1] hotels are upscale hotels that are luxurious, unique in design, and intimate.

As outlined in the IBISWorld report,[2] boutique hotels tend to be smaller, with the number of rooms ranging from 150 to 200 per establishment. By having smaller rooms and lobbies, which add to their unique appeal, the capital costs for boutique hotels are lower than for upscale chain hotels. There is usually at least one unique feature that drives the hotel's brand and reputation, allowing the operator to charge higher prices. This feature can be the building itself (such as having unique architectural detail or being a historical landmark) or having a well-known restaurant, lounge, spa, or other amenity. Boutique hotels do not generally have conference rooms and therefore do not have large group sales revenues; however, they do rely on business travellers.

The hotel industry in Canada is expected to achieve low growth rates averaging 1.2% annually until 2022.[3] The major traveller segments for hotel lodging are domestic leisure (53.2%), business (24.1%), international (20.7%), and other (2.0%) (includes those staying for educational or health-related reasons). Specific to the boutique hotel segment, 50.0% of travellers come for domestic leisure and 30.1% for business. The boutique segment of the industry is expected to grow at an annualized rate of 3.2% over the same period.[4]

Star ratings are an industry standard used to compare quality of facilities and services across hotels. Hotels rated at three stars and below offer fewer services and facilities and lower prices, and they achieve lower growth rates than four- and five-star rated hotels.[5]

The hotel industry uses four main business models: owned hotel (DHC's model), leased model, managed model, and franchised model.[6]

Competition and trends

Although future per capita disposable income is expected to increase, low consumer confidence and increasing consumer debt levels will counter this positive trend,

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[1] Andrew Alvarez, IBISWorld Industry Report OD5464, Boutique Hotels in the US (June 2017).
[2] Ibid.
[3] Andrew Alvarez, IBISWorld Industry Report 72111CA, Hotels and Motels in Canada (February 2017).
[4] Ibid.
[5] Ibid.
[6] InterContinental Hotels Group, Annual Report and Form 20-F 2016 (2016), https://www.ihgplc.com/files/reports/ar2016/files/pdf/2016_annual_report.pdf

resulting in low growth rates for domestic hotel occupancy.[7] As well, while corporate profits are expected to increase, resulting in higher business traveller occupancy (at a rate of 5% annually), the number of international traveller visits to Canada is expected to continue to decline.[8] The number of international visitors, especially from the United States (Canada's largest market), has been declining since 2007.[9]

Competition from other global tourism destinations influences the demand for hotel rooms from both domestic and international consumers. Currently, the Asia-Pacific region, the Middle East, and South America are the destinations of choice, whereas Canada ranks low as the 18th most visited country.[10] As a result, global hotel operators are expanding and investing in these other areas and not in North America.

Overall competition within this mature industry is high, with hotels competing on price, service, location, and amenities within a given star-rating level. Prices vary throughout the year based on supply and demand, and the better locations are those that are favoured as tourist or business destinations. The highest occupancy rates are found in the large metropolitan centres, since these locations are visited by both leisure and business travellers.[11] The boutique segment is in a growth stage, and within this segment, world-class service, demonstrated by professional, skilled, polite, and competent staff, is required as a minimum.[12] Therefore, retaining a highly skilled and experienced workforce is important to success. Other important factors for success are offering unique amenities and services, maintaining the property in good condition, keeping up to date with technology changes, anticipating customers' needs, using market research, and retaining and attracting customers.

Consolidation has been occurring in the hotel industry, allowing participants to grow market share and achieve economies of scale, with the three largest operators accounting for 30.7% of the industry's revenue.[13] Large players often use a franchise model approach to expand their reach, effectively reducing the amount of initial capital outlay required for growth. In contrast, the boutique segment is highly fragmented, with most hotels being independently owned and operated.[14]

Growth in the number of hotel establishments will primarily come in metropolitan areas such as Toronto, Vancouver, and Montreal, which are currently underserved, as well as from refurbishing older establishments.[15] As capital costs are high for the land and buildings, many operators are moving to leasing these assets rather than owning.[16] This

[7] Alvarez, February 2017.
[8] Ibid.
[9] Ibid.
[10] Ibid.
[11] Ibid.
[12] Ibid.
[13] Ibid.
[14] Alvarez, June 2017.
[15] Alvarez, February 2017.
[16] Ibid.

trend allows capital providers to choose to invest in either the real estate or the hotel operations depending on their desired level of risk.

Hotels operating as boutique hotels, spas, and health retreats will see higher profits earned due to specialty offerings. In contrast, low-cost hotels and motels will see lower profits due to increased price competition on room rates.[17] Being service based, the industry is very labour intensive, with most employees being part time or casual to help hotels manage the seasonal labour requirements.[18] Access to this skilled but seasonal labour is important for success.

Emerging trends in the hotel industry affecting all segments include:[19, 20]

- Responding to increasing competition from Airbnb and VRBO by differentiating in order to attract travellers to stay in hotels for the added service and amenities.
- Defining a recognizable brand and design to attract a specific target customer.
- Providing a more personalized approach to experiences and providing more experiences beyond just the hotel itself.
- Redefining and enhancing customer loyalty programs to increase retention rates and attract new customers.
- Attracting more guests from the local community to reduce the reliance on travellers.
- Using and providing state-of-the-art technology to make “smart” hotels where guests can be instantly connected to access information about activities happening outside the hotel to “create a better temporary living experience.”[21]
- Providing services and food choices that emphasize health and well-being.
- Ensuring sustainable practices to reduce the consumption and cost of water and energy.

Trends specifically related to the boutique segment include:[22]

- Travellers are increasingly preferring boutique hotels over chain hotels, given their unique appeal.
- Young and affluent travellers with household incomes greater than $100,000 are attracted to boutique hotels.

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17 Ibid.
18 Ibid.
19 Smart Meetings Staff, “Top 10 Trends Impacting the Hospitality Industry,” *Smart Meetings*, August 3, 2017, https://www.smartmeetings.com/news/trends/74256/top-10-trends-impacting-hospitality-industry
20 Deanna Ting, “10 Hotel Trends that Will Shape Guest Experience in 2017,” *Skift,* January 3, 2017, https://skift.com/2017/01/03/10-hotel-trends-that-will-shape-guest-experience-in-2017/
21 Nicole Jenet, “Exploring the Idea of ‘Smart’ Hotels,” *Healthy Travel,* April 6, 2016, https://www.healthytravelblog.com/2016/04/06/exploring-the-idea-of-smart-hotels/
22 Alvarez, June 2017.

- With the attractiveness of higher profit margins, many global hotel chains are interested in expanding into the boutique hotel segment.
- Many boutique hotels are expanding into other specialized areas such as health retreats and extended stays.

Characteristics specifically related to the boutique segment include:[23]

- As the market becomes saturated, status quo strategies of a single unique feature may no longer be enough to attract customers, and hotels will have to expand their offerings.
- Customer retention by meeting their specific needs is critical for success.
- Promotion is done primarily through public relations and word of mouth, rather than mass marketing.

General risks in the hotel industry include:

- Customer risk: Hotels compete for consumers' holiday or business travellers' spending dollars.
- Health and safety risk: Hotels must ensure food and beverage health and safety, as well as safe living conditions.
- Exchange rate risk: Fluctuations in exchange rates can impact the number of international travellers coming to Canada or the number of domestic travellers staying in Canada.
- Political risk: An increased risk of terrorist activity, wars, or government instability, or a decrease in the ease of travel, such as increased border security, can reduce the number of international travellers.
- Reputational risk: Brand recognition is vital to ongoing success, and bad reviews can quickly translate into lost sales.
- Technology risk: Hotels must keep at the forefront of technology for internal systems and maintain a good web presence, given the increase in consumer preference for online research and bookings.
- Natural disasters or weather: Holiday destination choices, particularly for skiing and golfing, will be weather dependent. In addition, the proliferation of forest fires in the past few years have destroyed areas that used to be popular destinations.

Regulatory environment and technology

The industry is regulated for food safety; liquor sales and service (liquor licences as required by the provincial commissions); employment standards, especially for minimum wage rates; and fire, health, and building standards.

[23] Ibid.

Over the past few years, hotel operators have increased their investment in technology systems for reservations, property management, customer loyalty programs, revenue management, and guest amenities. Improvements in technology have allowed operators to have direct internet bookings, sell off excess capacity through either corporate-owned websites or specialist travel operators (such as Priceline.com and Expedia), and provide customers with access to their individual loyalty points for redemption purposes.[24] To appeal to guests, the technology must be available across multiple platforms, including mobile phones, tablets, and computers.

Vacation property ownership[25]

Many of the large global hotel operators are also involved in vacation property ownership or exchange and rental programs. Vacation ownership gives an owner the right to use a property (either in perpetuity or for a fixed number of years) and can be in the form of time-shares, fractional ownerships, or condo hotels. Generally, these properties are larger than hotel rooms and include living rooms in addition to one or two bedrooms and fully equipped kitchens. Based on U.S. data, vacation ownership sales have increased at a 7% annual compounded rate from 2011 and have an 80% occupancy rate, on average.[26] There are many risks in this industry, including economic conditions, competition, and collection of annual maintenance fees.[27] The vacation property ownership market is very competitive, with most of the competitors being large companies that are well diversified.[28] Owners receive limited use during any single year (one or two weeks, for example) dependent on the type of purchase, terms and conditions of the sale, or number of points purchased.

Company background

Alyson and Jessica both started their working careers as teenagers at Lake Banff Mountain Guesthouse in Alberta and continued to work at this hotel during their school summers and holidays. As they enjoyed working in this industry, they both pursued degrees in hotel management and continued to work in large, world-renowned resort hotels. Derek, being an avid golfer and skier, spent his holidays and summers working at golf courses and ski resorts. Kelvin, after receiving his degree in civil engineering, completed a degree in architecture. Kelvin then worked with an engineering firm that specialized in building restoration, which is where he discovered his passion for transforming old buildings into useful spaces while maintaining their historic integrity. In 2001, the four individuals decided that they had a good combination of skills and sufficient experience to open their own hotel.

[24] Alvarez, February 2017.
[25] ILG Inc., Form 10-K for the year ended December 31, 2016 (2016), https://www.sec.gov/Archives/edgar/data/1434620/000155837017001185/ilg-20161231x10k.htm
[26] Ibid.
[27] Ibid.
[28] Inside the Gate, "United States Timeshare Market Size, Trends and Forecasts 2017-2021," March 10, 2017, https://www.insidethegate.com/2017/03/united-states-timeshare-market-size-trends-and-forecasts-2017-2021/

In 2001, DHC was incorporated and purchased its first building in Kelowna, BC, a city located in the Okanagan Valley surrounded by mountains and forest. Kelowna was selected as the first site because the shareholders had lived there for many years, were familiar with the city, and also saw its potential as a tourist destination. At that time, Kelowna was growing as a destination, drawing tourists to its ski resorts, golf courses, hiking terrain, and wineries. The building selected for the hotel was Kelowna's original theatre, which had been designated as a heritage site. With Kelvin's architectural and engineering skills, the two couples transformed the building into a small luxury boutique hotel, which commenced operations in 2003 with 120 rooms and a restaurant and lounge. In later years, 50 more rooms were added so that today the hotel has 170 rooms. DHC's head office is located in Kelowna. Over the next five years, this hotel became very successful, drawing both Canadian and international travellers, and the shareholders decided it was time to expand.

The Kelowna hotel became the template for further expansion. To qualify as a future hotel site, the building would either have to be designated as a heritage site or have some special historical significance and be capable of accommodating between 150 and 250 rooms, along with a full-service restaurant, once fully renovated. This historical significance would be the unique feature that would differentiate DHC's hotels from its competitors. Furthermore, the building would also have to be in a tourist destination providing ski and/or golf activities or be downtown in a large metropolitan centre.

With these criteria in mind, in 2008, Kelvin located another possible hotel site in Canmore, Alberta, while visiting his brother. This site was one of the first churches in the area, which was no longer being used, along with several vacant church buildings and a schoolhouse, all situated on a large parcel of land. Canmore, being in the mountains, was already a popular tourist destination for ski, golf, and hiking enthusiasts. This hotel opened in 2010, with 190 rooms and a full-service restaurant.

In 2012, DHC decided to buy a local golf course, near its Kelowna hotel, that was experiencing financial difficulties. Since many tourists came to the hotel primarily to golf, the shareholders decided the golf course would be a good addition, rather than letting it close. Because of the golf course's financial difficulties, DHC was able to purchase the course at a discounted price.

In 2013, while vacationing in Cape Breton, Nova Scotia, Jessica and Derek were introduced to a decommissioned hospital dating back to the early 1900s. The hospital and adjacent heritage buildings, all situated on a large parcel of land, had a long and varied history, which was embodied in the local lore. After Kelvin's favourable assessment, DHC purchased the land and buildings and transformed the property into a 165-room hotel, along with a restaurant, lounge, and fitness facility, and opened in late 2014.

The last hotel was purchased in Northern Ontario. This site was found by Alyson and Kelvin when they were attending their niece's wedding. It was originally an old train station with an attached hotel and was designated as a heritage site. This site was renovated into a 235-room hotel, including a restaurant and lounge, and opened in 2016. As part of this hotel, DHC decided to add spa facilities. After an extensive search, the shareholders decided to open an Awani Spa. At the time, Awani Spa was an upscale, world-renowned spa business, and the shareholders believed it would be consistent with the DHC brand.

Today, the company has 1,120 hotel and head office employees (and 35 golf operation employees) and revenues of $124 million. The company has been profitable for the past 10 years. Because the company operates in attractive tourist destinations, it can charge premium prices.

Company overview

Now into its 20th year of business, DHC has not changed its business model. The company's objective is to purchase unique historical sites and transform them into luxurious boutique hotels. The DHC brand is well respected in the industry and is known for its "above-and-beyond hospitality in a unique and luxurious setting," as recently quoted in a trade magazine article that featured the company. Providing a high level of service in a unique setting continues to be critical to DHC's success. Alyson and Jessica want guests to feel as if they are being welcomed into their home. Guests are to be pampered and made comfortable and, with this in mind, each guest is greeted personally by one of the hotel's managers. Alyson and Jessica often visit the four hotels, despite the coast-to-coast locations, and when they are on site, they will often spend their afternoons and evenings in the lobby personally welcoming guests. Otherwise, the managers of the hotel have this responsibility. Both Alyson and Jessica believe that by being involved in the day-to-day operations and interacting with customers, or having key members of management do so, they can help increase the level of service and attention provided to guests, helping to differentiate DHC from its competitors and keep customers coming back.

While Alyson and Jessica strive to set the ambience of the hotels and ensure guests receive personalized service, Kelvin's role is to ensure that the architectural design provides the appropriate setting. The company has no stated growth targets on the number of new hotels to open in the future and does not actively search for sites. New hotels are added only as unique sites are found that match DHC's selection criteria and if Kelvin believes they can be renovated to meet his vision.

Derek's role is to provide overall leadership and vision for the company. Specifically, he has the skills and ability to bring all the resources (assets and people) together to achieve the company's mission. He also has the ability to interpret market trends and translate these into new services in anticipation of guests' requests.

Corporate vision, mission, and values

DHC's vision and mission statements, and core values, approved by the board in 2014, are as follows.

Vision statement: Make guests feel welcome and special, by providing attentive, personalized, and exceptional service in a unique and luxurious historical setting.

Mission statement: We are operators of unique boutique hotels built in noteworthy historical sites with a welcoming and luxurious atmosphere, providing each guest with attentive and caring service beyond expectations.

DHC has five main core values as follows:

1. Interact personally with guests and employees and take a hands-on approach.
2. Meet and anticipate guests' expectations by being friendly and attentive.
3. Foster teamwork and respect between all employees — includes listening to employees' concerns and viewpoints and bringing the best of our abilities each day to work.
4. Embrace new ideas and change to ensure we continuously strive toward perfection.
5. Become an important part of the local community.

This last core value was added in 2018. Derek made this recommendation after completing market research that indicated hotels should strive to meet the needs of local residents from the neighbourhood and not just outside travellers.

In light of this added core value, DHC started to participate more in community activities, encouraged its managers to be on at least one local volunteer board, opened its doors twice a year to community members for appetizers and drinks in the lobby, and provided free hotel accommodation as prizes or donations to community causes.

DHC also has a code of conduct and a code of ethics that outline the rules and regulations to follow and a set of values to ensure that employees' actions are based on honesty, fairness, and moral integrity.

Future plans and objectives

In early 2020, the board decided to explore the possibility of becoming a publicly traded and owned entity. The company's bank, H&A Bank, recommended an investment banker, Josh Baltimore. After some meetings and financial reviews, Josh indicated that to have a successful initial public offering (IPO), the following would be required:

- a highly recognized and reputable brand
- annual revenue growth rates of at least 10% for each of the three years prior to going public

- annual net profit growth rates of 8% to 10% for each of the three years prior to going public
- an operating margin and return on equity at least equal to, if not better than, the industry average
- an interesting story about how the company is differentiated from competitors and a five-year strategic plan that specifically outlines DHC's target market and growth objectives

Keeping Josh's advice in mind and planning for a public share offering in 2023, by the latest, the board met and set objectives for 2020 and 2021 to:

- increase the average daily rate (ADR) to $420 and increase occupancy rates to 75% in 2020 and 80% in 2021
- increase the operating margin to 13% for 2020 and to 16% for 2021
- increase net profit margin to 8%
- increase the return on equity to 11%
- ensure that any long-term strategic investments made provide an appropriate return required for the related risk of the investment

The board expects these same targets will continue into 2022 and 2023, but will reassess their appropriateness at that time.

Company structure

The company has a board of directors that consists of the four shareholders and meets formally each quarter. At the board meetings, the directors discuss possible sites for new hotels (when available) and areas of possible new growth, approve the annual audited financial statements, appoint the auditors for the next year, declare dividends, and elect the officers. There are no formal board committees.

Derek is considering whether DHC should have an advisory board in place. He has heard that often private companies have an advisory board and that once the company goes public, members of the advisory board join the board of directors. Derek still has many unanswered questions and would like some advice on the following before he makes a decision: the roles and responsibility of the board, advantages and disadvantages of having an advisory board, board size and composition, term of membership, remuneration, and meeting frequency.

Management team

DHC's corporate management team is made up of the following individuals:

Derek Sterne, chairman of the board and chief executive officer (CEO)

Derek is 49 years old, and prior to being a shareholder of DHC he worked as a manager for various golf and ski resorts. His university degree was in business, and he has gone on to take additional courses on being a director on boards and leadership training. Derek's strengths are in leadership, business strategy, and effective decision-making. The chief financial officer (CFO) reports to Derek.

Derek strongly supports the company going public and realizes that a few changes must occur to ready the company for a successful offering. He would like to see the company expand more quickly than it has in the past and diversify into other related areas of the hospitality business, while remaining true to DHC's luxury brand. In 2012, Derek pushed for the golf course purchase and believes that the company should consider additional investments of this nature to attract a new target customer.

Jessica Sterne, VP office operations and sales

Jessica is 46 years old, and prior to being a shareholder of DHC she worked at various destination resorts in managerial positions for front desk, housekeeping, human resources, and head office. Jessica's strengths are in working with people, being a good listener, having empathy and patience, working with numbers, and resolving conflicts. She is responsible for accounting and finance, human resources, and marketing and brand development. The director of marketing and brand development reports to Jessica.

Jessica believes that the company has grown too slowly in the past, as expansion has been limited by available cash and finding the right sites. She fully supports taking the company public to raise the funds necessary to finance future expansion and also to enhance DHC's reputation. She believes that the company should expand horizontally to offer upscale (but not luxurious) accommodations that would be four-star rated rather than having DHC's five-star rating, expanding the customer base and thereby diversifying the brand portfolio. Since her experience and interest lies in hotel management, this is where she believes the company's strategic direction should remain.

Alyson Chung, VP room operations and food and beverage

Alyson is 46 years old and has a similar history to Jessica's, working in various world-renowned resort hotels in Canada in managerial positions responsible for housekeeping, human resources, food and beverage, and spa. Alyson's strengths include dealing well with customers and employees, and organizational and team leadership skills. Her direct reports include housekeeping and the food and beverage directors.

Alyson has worked hard to build the company's reputation of exceptional service and wants to make sure that any future strategic plans do not negatively impact the brand. She believes DHC's best strength is customer service and therefore wants to expand in areas where attentive customer service is vital. As such, she would support any growth initiatives where the company can still provide the very high level of service for which it is now known.

Kelvin Chung, VP buildings

Kelvin is 48 years old. He is a professional engineer and architect and is responsible for the maintenance of facilities, new site development, and information technology. Prior to becoming a shareholder with DHC, Kelvin gained experience in designing and renovating historic buildings. Many of the projects that Kelvin previously worked on won engineering and design awards, recognizing his ability to create unique design and structures that also maintain the historical integrity of the original buildings. In 2015, DHC won a design award for the renovations completed on the Cape Breton hotel.

Kelvin is very proud of DHC's unique buildings and believes that this is part of the company's success and attractiveness. Although he wants to expand, he believes the chosen properties must still fit the criteria of being unique and having some historical significance. Expansion has been slow in the past, as he has never actively searched for sites and has found new ones only by chance. As he is very meticulous in selecting sites, there have been many sites that did not meet Kelvin's exacting specifications and therefore were not pursued. Kelvin is in favour of growth as long as he maintains control over the design of the buildings and other facilities, and any renovations.

Harry Vasudevan, CFO

Harry obtained a business administration degree in 2001, with a minor in accounting, and has been with DHC since 2014. Previously, Harry worked for 13 years with a global hotel company that owns time-share properties, hotels, resorts, and golf courses, where he worked as controller, financial analyst, and assistant director in investor relations. At DHC, Harry is responsible for finance and accounting, as well as human resources. Harry is excited about DHC going public and believes that this is vital for the continued growth and success of the company.

Doug Mallette, director of marketing and brand development

Doug has a university degree in marketing, which he received in 2004, and worked at various advertising agencies prior to joining DHC in 2015. Working for these agencies, Doug was responsible for rebranding companies in the hospitality, technology, and retail industries. Since joining DHC, Doug has redesigned all the marketing and promotional materials, developed various social media initiatives, and increased the size of his department by five employees who specialize in social media advertising and web design.

Rhonda Sharma, director of housekeeping

Rhonda previously worked alongside Jessica and Alyson, and she agreed to come work for DHC when operations commenced in 2003. Rhonda has more than 35 years of experience in housekeeping services, with over 20 years in a management position. Rhonda's strengths are in her fastidiousness about cleanliness and her response time to customer requests, as well as her empathy, organization, good communication, and loyalty.

Rhonda travels frequently between all four hotels to ensure that standards are consistent throughout the company. She meets with the housekeeping staff daily and also performs daily room spot checks to ensure that the staff continue to meet her high standards. Because many of the staff are young, part time, and initially untrained, Rhonda and her direct report managers focus on training and mentoring for new recruits, to ensure that staff know how important their work is to the success of the hotel.

Arne Kydd, director of food and beverage

Arne joined DHC in 2016 and is responsible for purchasing and for staffing the full-service restaurants and lounges, overseeing the food and beverage managers, as well as working with the chefs to set the menus. Arne has 25 years' experience working in restaurants. He attended culinary school and worked as a chef for various restaurants in Toronto and Vancouver for 14 years. He then moved into management and worked for a public company that owned 10 upscale restaurants operating under various banners. Arne's strengths are in people management, accountability, and flexibility.

Human resources

The majority of DHC's employees are from the local communities. DHC's work force has the following age and distribution:

Age	Senior management	Management	Non-management full-time employees	Part-time employees	Total
25 and under	-	-	15	161	176
26 to 49	6	42	168	582	798
50 +	2	17	118	9	146
Total	8	59	301	752	1,120

Total wage expense in 2019 was $41,574,000, which was allocated to the functional areas as below:

Room operating costs	$18,641,000
Food and beverage costs	14,354,000
Cost of spa services	614,000
Administrative and general expenses	7,965,000
Total	$41,574,000

Included in wage expense is the salary paid to each of the four current shareholders, which is at comparable market rates for the work they perform. Not included in the above tables are an additional 35 employees who work in the golf course operations during the period late March to early October and are paid an average salary of $21,000 for the seven-month period.

To provide professional and attentive service to its guests, DHC has found it is better to have a higher proportion of full-time to part-time employees in comparison to the industry average, and to promote from within the company whenever possible. Although this results in higher wage costs per employee, DHC's total number of employees is smaller, total staff turnover is lower, and overall service is better.

All employees receive dental and medical coverage and paid vacation, but there is no company pension plan. As well, the company tries to accommodate flexible working hours where possible. DHC also provides employee discounts for rooms and in the restaurant. The amount of the discount is based on years of service. The final perk is that each month, one employee from each department is recognized for their effort and gifted with a small bonus. These benefits help to boost morale and motivation and ensure that employees feel that they are part of a team and important to the company's success. DHC's compensation plans are significantly better than competitors' plans, contributing to a high employee morale and a low staff turnover at only 8% compared to the industry rate of 31%.[29] In addition, with low staff turnover, costs due to retraining and lost productivity are minimized.

Company operations

Room operations

The company has four hotels with a total of 760 rooms. All rooms have luxurious bedding, fixtures, and supplies, with many classified as either deluxe rooms or suites. Guests are provided with bottled water, Wi-Fi, snacks, and fruit as part of the room fee, along with the use of complimentary robes and slippers. Room rates vary throughout the year based on demand and room type and size, with prices as high as $750 per

[29] Josh Tolan, "Employee Turnover is a Hospitality Industry Problem: Here's 5 Ways to Fix It," *Recruiting Blogs,* May 8, 2014, https://recruitingblogs.com/profiles/blogs/employee-turnover-is-a-hospitality-industry-problem-here-s-5-ways

suite in the peak season and as low as $225 for a deluxe in the low season. For 2019, the company has an occupancy rate of 70%, its ADR is $400, and its revenue per available room (Rev/PAR) is $280.[30]

Most guests come for at least two nights, and one-week stays are common. If rooms are booked in advance, the company's policy is to receive a deposit equal to 50% of the total stay at the time of booking. This deposit is recognized as contract liabilities — revenue. The deposit is fully refundable on cancellation up to one month prior to the check-in date. If the booking is cancelled between one month and one week prior to check-in, the refundable amount is prorated based on the number of days to check-in. If the cancellation is within seven or less days from the check-in date, the deposit is non-refundable. These terms are customary in the resort hotel industry.

Most of the company's guests are individuals and couples travelling for leisure, since the company has no conference facilities and few corporate events. In fact, only 10% of total revenues are for business travellers and corporate events, for which credit terms of net 30 days are provided; remaining revenues are cash sales. In 2019, 20% of the guests were repeat customers, which is significantly higher than the industry standard.

Room operating costs include purchases for bedding, room supplies, cleaning supplies, and wages for housekeeping and maintenance.

Awani Spa

In 2016, the company paid $2,000,000 to Awani Spa International Inc. for a licensing fee. In return for this payment, Awani provided initial training and setup, ongoing marketing, and the right to use the Awani trademark name for 20 years. As part of the licence agreement, DHC is also able to buy any amount of Awani product at a discounted price. DHC takes advantage of this discount by purchasing all the soaps, hair products, and body products used in its rooms from Awani. These products are made only with organic ingredients and have been well received by the guests. The licence is amortized on a straight-line basis over 20 years with no residual value.

The spa provides services including massages, facials, manicures, and pedicures. Many local residents frequent the spa and are loyal customers. All the therapists and aestheticians are independent contractors paid on a commission basis, which is normal practice in the industry and considered acceptable by the CRA.

In 2018, a large well-known spa operator opened in the local area. During 2019, this competitor was able to hire two of DHC's key staff members by promising higher commission rates. As a result, many of the local customers went with these therapists,

[30] These are three industry standards that are calculated for a given period as:
Occupancy rate = Total rooms sold / Total rooms available for sale
Average daily rate (ADR) = Total room revenue / Total rooms sold
Revenue per available room (Rev/PAR) = Total room revenue / Total rooms available for sale = ADR × Occupancy rate

and revenue from the spa declined significantly. Jessica is concerned that there may be an impairment loss associated with the licence that should be recognized and has gathered information to assist with this assessment (Appendix IV).

Property, plant, and equipment

The company owns four hotels and a golf course and has no significant lease arrangements for equipment or vehicles. The net book values related to the classes of property and equipment, as at December 31, 2019, are as follows:

(in thousands of dollars)		Amortization policy
Land	2,750	
Buildings	116,950	Straight-line over 40 years
Furniture, fixtures, and equipment	28,520	Straight-line over 8 years
Vehicles	5,600	Straight-line over 5 years
	153,820	

The depreciation expense includes all the depreciation related to rooms, food and beverage, and golf operations and the amortization of the Awani Spa licence fee.

Each hotel is on a rotation for renovations and upgrades to occur every seven to nine years. The Kelowna hotel was fully renovated in 2014, and the Canmore hotel in 2016. Renovations for the Nova Scotia hotel are planned to begin in the fall of 2020 with expected costs of $11,000,000. Hotels are closed during renovations to avoid disruptions for guests and ensure speedy completion. There will also be ongoing upgrades and improvements to other properties during 2020 that will cost an additional $4,000,000. These are mostly for upkeep of properties, not major renovations — that is, the operations will continue as normal when these costs are incurred.

Advertising and promotion

DHC spends little on marketing and has relied heavily on return guests and word of mouth to attract new customers. Promotion costs, part of marketing and sales expenses, include the costs incurred for community promotional events and donated items, advertising in select travel magazines, and website costs. The company does not use third-party websites to sell off excess room capacity. Although Doug has been pushing for the company to do so, Jessica and Alyson are both reluctant, as they believe it will have a detrimental impact on the brand.

DHC does not have a loyalty points program. Jessica, after completing extensive research, determined that loyalty programs for the small boutique hotel really do not work well and, quoting a marketing expert, argued that “loyalty programs do practically nothing to drive growth."[31] Loyalty programs are designed to attract past customers with discounts and other perks. Jessica believes that DHC already has a loyal customer base, when compared to competitors, attained by providing attentive and high-quality service. If DHC wants to attract new customers, she agrees with the philosophy that costs are better put into advertising the brand to reach new market segments.[32]

Based on this conclusion, Jessica decided to have the marketing department overhaul the entire website by making it more interactive for potential guests. Doug and his group were instrumental in the new design and function of the site, with the help of outside consultants. Currently all the related expenses for this redevelopment have been expensed and included as marketing costs, but Doug has argued that these should have been capitalized. Details of the costs incurred and the new website capabilities are outlined in Appendix V.

The company has a relationship with First Canadian Hotel Reviews (FCHR), a website where individuals can rate hotels on a scale of 1 to 10 and write reviews. Guests can directly click on a link from FCHR's site to DHC's website to book accommodation. Doug's department monitors all the hotel review sites, including FCHR, and follows up on any reviews that rate the company at satisfactory or below. In 2018, at Doug's request, DHC agreed to tie part of Doug's compensation to the number of rooms or restaurant bookings made through FCHR as well as the number of reviews that rated DHC at 8.5 or higher. The shareholders thought that this would incentivize Doug and his department to closely monitor the site and immediately pursue any poor reviews for quick resolution.

Golf course

Near Kelowna, the golf course is an 18-hole, championship-length golf course spanning 175 acres up the mountains. In 2016, it was rated as one of the top 10 in British Columbia. In 2019, the golf course had 16,424 player rounds for the season at an average price of $85 per round. In the past, player rounds have been as high as 25,000 but declined in 2019 due to poor weather conditions and an increase in the number of golf courses in the area.

The golf services costs include wages, course maintenance costs (including chemicals, sand, soil, and seed), fuel and lubricants, electricity, and water.

Derek is concerned about the decline in the number of golf visitors. He knows that the golf course needs some improvements, but these have been put off in prior years to free up the cash for other divisions. Many local golfers have mentioned that they would like to see DHC's golf course become a private club, since there is currently only one in Kelowna. Derek thinks that a semi-private model might work best, which would allow

[31] Tambourine, "The Painful Truth about Hotel Loyalty Programs," March 28, 2017, http://www.tambourine.com/blog/the-painful-truth-about-hotel-loyalty-programs/
[32] Ibid.

only members, members' guests, and registered hotel guests to play. With the help of the golf course's head professional and manager, Derek has gathered some information on this proposal (Appendix VI).

Food and beverage

Each hotel has a full-service restaurant offering breakfast, lunch, and dinner. Each restaurant has a renowned chef who has made a name for themselves in restaurants in large metropolitan centres. The chef is given freedom in designing the menus, with oversight from the director of food and beverage. Each hotel is encouraged to have a unique menu and food choices, using local ingredients where possible and providing healthy meal options, as well as having an extensive wine selection, which must include local wines. All four restaurants have received several "best in class" reviews between 2017 and 2019.

Food and beverage costs include food and beverage purchases, wages, and supplies directly related to the operation of the restaurants and lounges.

Recently, Arne, the director of food and beverage, came to Alyson with some concerns about inventory losses of liquor, wine, and beer at the Nova Scotia hotel. For the past three months, he has seen increasing differences between the inventory that should be on hand at the end of the month and the physical count. There is definitely a loss of inventory, but he is not sure of the reason. He is concerned that the existing inventory controls on the alcoholic beverage operations at that hotel are weak and need improvement. Arne has outlined the existing controls (Appendix VII). Alyson said that she would bring up his concerns at the next directors' meeting to decide the next steps.

Financial reporting and budgeting

DHC prepares its financial statements using IFRS. The bank and other lenders require audited annual financial statements. Tory & Bishop LLP, a large national firm with offices across Canada, has been the company's auditors since 2001, with audit partners rotating every five years. These auditors will also be involved in preparing any documents required for the IPO, if it occurs, and it has been determined that there will be no independence issues. Currently, the auditors are working on the 2019 year-end audit, for completion by March 27, 2020.

Banking, financing, and insurance

DHC has one line of credit and two long-term loans, described below:

- Line of credit with DHC's bank, H&A Bank: This line of credit has a maximum limit of $4,000,000 and two covenants. One covenant is that the company will not pay dividends in excess of $2,000,000 without lender approval. Although $2,000,000 in dividends had been paid annually in the past, in 2019 the company cut the dividend to save cash. The second covenant is to maintain a debt-to-equity ratio below a maximum of 2.5. The line of credit is to be renewed in July 2022. In previous years, the company had only drawn down on the line of credit for short periods of time and was always able to pay it back before year end. Since there was no balance outstanding at year end, the bank was not concerned about the breach of covenant in 2017 and 2018. In 2019, for the first time in seven years, DHC was not able to pay off the line of credit by year end.

- Long-term loan — Nova Scotia: This loan is also with H&A Bank. The loan is secured by the Nova Scotia property and comes due in 2033. The loan is repayable in annual principal payments of $3,000,000 on June 30 of each year, with an annual interest rate of 6.5%.
- Long-term loan — Ontario: This loan is with Northern Land Loans Ltd. The loan currently bears interest at 6.0% and matures in November 2020. Currently, the company pays principal of $4,000,000 annually on June 30. The company has come to an agreement with Northern Land Loans Ltd. to refinance the loan in November 2020. The new loan will be due in November 2034, bear interest at the prime rate plus 3.0% (prime is currently 4.0%), be secured by the Ontario hotel property, and be payable in annual principal payments of $4,000,000 annually for the first two years and $3,000,000 for the next 12 years.

Jessica has also found two alternative sources of capital. The terms and conditions proposed for each alternative are provided in Appendix VIII.

Board meeting dialogue

The board met on February 11, 2020. Prior to the meeting, a briefing was distributed to the board members on the four proposed new projects that had been discussed at earlier meetings: the investment in Topomo Mountain Ski Resort (Appendixes IX, X, and XI), the purchase of Artists Warehouse Hotel (Appendixes XII and XIII), the renovation and sale of condos at the Northern Ontario hotel (Appendixes XIV and XV), and the management fee contract with Huron Heights Hotel (Appendix XVI).

The meeting's agenda was announced as follows:

1. Consider the four proposed projects.
2. Any other business.

Excerpts from the discussions that took place are detailed below.

Derek: Let's discuss the purchase of Topomo Mountain Ski Resort (TMSR) first, since we have to make a decision before the deadline of April 28. As you know, we have been approached by Scott Potterman, the owner of several restaurants and retail shops in Canmore, to invest in the ski resort. The proposal is for DHC to take a 20% ownership. As skiers, we are all familiar with the resort and its importance to the community. In fact, this is a way that we can become more involved in the community as well as help provide a better all-round experience for our guests.

Alyson: I looked back in our records and found that during the period December to March, 80% of our guests at the Canmore hotel were here to ski at the resort. I also noticed that our occupancy rates have slipped during this period from a high of 95% in 2017 to a low of 70% in 2019. I am assuming that this results directly from a decline in the number of skiers visiting the ski resort.

Jessica: Based on my research, though, I think that this is due to the general decline in the ski industry over the past few years. And from my discussions with some of the other local ski resort operators, the number of skier visits is down all across the area, not just at TMSR. As well, only slight growth rates are expected in this mature industry over the next few years.[33]

Kelvin: Who are these other partners, Derek? Do you know them personally, since I have never met them before? Do any have experience managing a ski resort?

Derek: I know three of them very well and have worked on local town committees with them. However, the fourth investor I know nothing about, except that he had only been in Canmore for about six months when he purchased a local taxi company. None of the investors have any experience in operating a ski resort, but we can hire managers to do that.

Jessica: I have also read that consolidation is occurring in the ski industry to achieve economies of scale and that is why there are two other parties interested in this purchase. One of the potential acquirers already owns three other ski resorts in British Columbia and one in the local area. I am not sure we can compete against these larger companies. We also have no experience in the ski industry; our success is in hotel operations, and this is where I think we should focus.

Derek: But we could do some joint marketing and also sell ski packages that include both accommodation and lift tickets. With the sharing of these costs, DHC's marketing expenses could be reduced.

Alyson: I think that we have a lot of other strengths that we can bring to TMSR to make it successful. For example, we know how to manage employees so that they care about their work and will provide good service. We can easily transfer this competency to the ski resort employees, since ski resorts are also customer service focused. We are also local and can be more attentive to what is needed to be successful. I think this is a great way to expand on these strengths.

[33] Andrew Alvarez, IBISWorld Industry Report 71392CA, Ski & Snowboard Resorts in Canada December 2016: "Big air: Diverse industry offerings will combat mounting competition and global warming"

Kelvin: But this is not a hotel — it is a ski resort. And the hotel business is what we know. Having looked at the property and the building, I do not see how this ski resort is unique or has any historical significance, and this is what we have built our reputation on. The building is quite ordinary and utilitarian with absolutely no charm or character. Wouldn't we be better off to take these resources and invest in new hotel properties?

Jessica: Yes, I think we should look instead at the proposal that I have about investing in a four-star hotel that is for sale in Toronto. As you know, my good friend Isabelle Logan is selling her Artists Warehouse Hotel. I have stayed in the hotel many times, and although it is not up to DHC's standards in luxury and service, it does provide an adequate level of service.

Kelvin: I visited this building when I was in Toronto and was quite intrigued by its design. I already have some ideas about how we could renovate it if we wanted to add more amenities or even more rooms. And it certainly has historical significance.

Alyson: I am not sure we want to invest in a four-star rated hotel. I looked on FCHR, and it is only rated at 6.5 with most of the comments being that the beds are uncomfortable and of a low quality, and that there is a lack of soundproofing between the rooms. Our reputation is based on luxury and a high standard of service, and so our reputation might be hurt with this acquisition.

Jessica: We could always start another brand for a lower-level offering so that it doesn't get associated with the DHC brand. I foresee that eventually we have a portfolio of different brands that target different price segments of the market similar to the larger competitors in the market.

Derek: I have to agree with Alyson. We have worked hard to build our brand, and this acquisition could really harm it. But more importantly, I am concerned about the initial price for this hotel. Since it is in Toronto, we are going to have to pay top price, since real estate prices in the city are inflated. Even though Isabelle is offering some financing alternatives, I am not sure this purchase, at this price, is appropriate for us right now.

Jessica: But this acquisition will give us a hotel in a growing metropolitan centre. At some point we are going to have to invest in one of the big cities, and I think now is the time to do so with this unique opportunity that we have been given. Prices are only going to go up. And, if you look at the operating ratios, you will see that they are very good in comparison with the industry.

Kelvin: The other point to consider is how often a building of this nature comes up for sale. I have been keeping my eye out for the past five years, and this is the first one I have found that I would be interested in purchasing.

Alyson: In the past, we have done well by purchasing properties that needed renovations at reasonable or even discounted prices. By keeping these initial capital costs under control, our returns on investment have been good. I cannot see how we are going to be able to achieve a good return on this property when the initial purchase price is so high.

Derek: I think we can all agree that we should pursue this investment only if the price is less than the estimated value of the business. Well, now that everyone has had their say on this investment, perhaps Kelvin you could summarize for us the vacation property proposal that you have been investigating?

Kelvin: For a few years now, guests have expressed an interest in the possibility of having condos available for sale in our hotels. I have spoken to some local developers, and this does appear to be a growing market in Ontario. I am proposing that we take the Northern Ontario hotel, our largest one, and convert some of its rooms to condos that would be sold.

Derek: I have also been doing some market research and found that the vacation property ownership market is a growth market, with sales to new owners increasing each year. It appears that families are also now getting into this market, so this investment would allow us to attract a new customer group.

Jessica: Is this not a risky business? We are not really in the business of selling real estate or managing properties.

Alyson: We also do not have amenities that appeal to families or that are appealing for longer-term stays, such as swimming pools, game rooms, or planned activities. I am not sure we will be able to compete against the other vacation properties that are available for sale.

Jessica: I am worried about the increased legal issues that we would be dealing with as a result of selling a portion of an owned building, and the potential legal disputes that may develop, such as disagreements over the contractual terms. I wouldn't want litigation issues to arise just as we are going public.

Derek: I am still in discussions with the lawyers. They tell me it can be done, and we just have to decide if we want to proceed and then they will provide the legal details on how to accomplish it. They don't think it will be a problem.

Kelvin: I am hoping we can use this as a pilot project to see if it works. We can learn from this experience and then decide if we want to continue with our other hotels. I am also envisioning that if this is successful, we can renovate entire buildings into condos. With my architectural and engineering background, I think this could become a very successful new line of business.

Derek: As all the major hotel operators are involved in this part of the vacation industry, I think we should be also, but at the luxury level. I believe it will be beneficial when we go public, by showing that we can adapt to changes in the market.

Alyson: I am really concerned about the disruption in the rest of the hotel while the construction is going on. Our revenues will certainly decline. First, we will lose the room revenue from the rooms being converted. Secondly, we will also lose revenue on the remaining rooms because we will have to warn guests before they book that renovations are being completed. As well, what about the new sports stadium that is being built a few blocks from the hotel? Won't that have the potential to increase the occupancy rates without this condo conversion?

Jessica: We also don't know anything about marketing condos for sale. If we can't sell all of them, then what?

Derek: If we don't sell all of them, then we just rent them out like we would a hotel suite.

Alyson: I also wonder if these condo owners will be more demanding, since they are here all the time and have an ownership interest, rather than just being a guest at the hotel. I know that my perspective and needs would be different.

Derek: All good points and things to consider. Let's move on to our last proposal, which I think, Alyson, you have the most information about.

Alyson: I am really excited about this opportunity. My long-time friend, Martha LaVoie, recently approached me about having DHC manage her Huron Heights Hotel (HHH) in downtown Vancouver. Her husband recently died, and she is trying to decide what to do with the hotel, which was his life's work. Her lawyer suggested she look at hiring a hotel management company and thought of us.

Jessica: Alyson was able to get the financial statements and a draft management contract, and it looks interesting. It would be a managed model for us, which as you know, is a business model commonly used in the industry. It allows hotel operators to expand their scope without a requirement for upfront capital for the property.

Derek: It looks like HHH also wants to licence our brand for a fee. Our reputation is critical to our success, and licensing its use to another company means that we will lose some control over the standards, particularly in the building and furnishings.

Kelvin: I agree. I don't think we want to operate in a building we don't own, and making the required design changes to fit with DHC's branding would be very difficult. I have been to that hotel and there is nothing unique or historical about it. In fact, it looks like any other hotel in downtown Vancouver, and I really don't want our name associated with it.

Jessica: Martha has agreed to spend whatever needs to be spent to upgrade the hotel to our level of standards, and she would also be hiring us to oversee the complete renovations.

Derek: That is fine for the first few years or so, but what about after that when items need replacement and the hotel starts to show some wear? Are we sure that HHH will be willing to spend the funds required to maintain our specific standards? And how would we resolve any disputes about this?

Alyson: But remember, we are experts at managing hotel operations. We will have full control over the management of the operations and be able to hire good people at all levels. We have built our reputation on providing exceptional customer service, and I don't see how this will be compromised.

Jessica: I also like this idea because it would give us a presence in metropolitan Vancouver. This will give us another target market and may help to promote our other hotels.

Kelvin: I have looked at the draft contract, and there are many conditions that seem to favour HHH and be detrimental to DHC. Are we able to negotiate any of these conditions?

Alyson: Martha said that this was a draft, and so I am sure that we can work out any differences. But we should highlight areas where we would want changes to be made.

Derek: Now that we have discussed our proposals, we also must consider how we will finance the cash required for these investments.

Jessica: As you know, Harry and I have been working on this. Our acquaintance, Patrick Kuzoff, is interested in investing in DHC and has offered two interesting alternatives. I know we have already decided we want to pursue financing through Patrick, but we need to decide which option to select. Let's have WCG examine these options and give us a recommendation for the best alternative from DHC's perspective.

Derek: That is a great idea. WCG are CPAs and have a good understanding of our industry. We have used them in the past for financial and tax services, and so they are familiar with our company and how we operate. Why don't we also have them assess these four strategic proposals and give us a report on their recommendations?

Kelvin: I will make the motion that we hire WCG to review these proposals and financing alternatives. As well, let's have them look at the operational issues that have arisen earlier in the month. In addition, let's ask them to prepare a five-year financial projection that incorporates the implications of their strategic and operational recommendations and any required financing sources. This will help us with our future planning and will be needed if we pursue the IPO.

Alyson: I second that motion.

Derek: All in favour, say yes.

Derek, Jessica, Kelvin, and Alyson: Yes.

Derek: Motion is passed. Are there any operational issues that need to be further discussed at the board meeting?

Jessica: I have a very sensitive and serious issue that has arisen. An employee from the marketing department has come forward, confidentially, accusing Doug Mallette of writing and promoting FCHR reviews. He told me that Doug, his boss, has been writing DHC reviews for FCHR under false names for the past year. This employee also provided evidence that Doug was giving room and restaurant discounts to his friends and other guests in exchange for writing favourable reviews. We need to deal with this as quickly as possible, since there are all kinds of implications. But I am going to need some guidance on how to proceed.

Derek: I cannot believe that Doug would be involved in this! This is of great concern and we need to have it resolved right away. I will ask WCG to provide some suggestions as soon as possible on this matter.

Jessica: I'm also wondering, with all the strategic expansion opportunities that we are considering, whether it might be a good idea to improve our performance measurement system overall. I think we should ask WCG to provide a framework we could use for performance management and the key metrics that should be tracked.

Derek: Good idea. Is there anything else?

Alyson: I have one issue that has arisen at the Nova Scotia hotel. There have been losses of wine, beer, and liquor over the past three months that cannot be accounted for. I always thought we had good controls on this inventory, but perhaps this should be looked at again. I would like WCG to review our existing controls as outlined by Arne. I have been thinking that we should implement a "bottle-for-bottle exchange" system at the bar but need to understand better how it works. I would like WCG to recommend internal controls that we could add to reduce the risk of theft.

Kelvin: And I have another item that I think WCG could help us with. As you know, Alyson and I have been thinking of giving a portion of our shares in DHC to our son. Now that he is finished university and has been working for a while, we are trying to encourage him to come and work for DHC. We thought we would entice him by giving him a piece of the company, say 10%, 5% from each of us, leaving us each with 20%. I am wondering if WCG could give us some ideas on how this could be accomplished from a tax perspective?

Derek: I know a friend of ours just did something similar and used a Section 85 rollover. But he also said that a Section 86 could have been used. Let's have WCG explain the implications of how each of these would work.

Kelvin: I always find numbers easier to follow for tax explanations. I know we don't know what the actual fair value of the shares is, but just for this example, let's ask WCG to assume a 25% ownership in DHC (representing 1,000,000 shares) has an adjusted cost base of $2,543,750 and a fair value of $15,000,000. In addition, assume we would not receive any monetary consideration as a consequence of the transfer.

Derek: That works for me. Is there anything else? If not, I will contact WCG and ask them to meet with me tomorrow morning. I will give them information on our operational issues and the strategic proposals that we have discussed and ask them to prepare a detailed report. I'll request that they complete it within two months and suggest a meeting date in mid-April to have them present their findings. Let's move to adjourn.

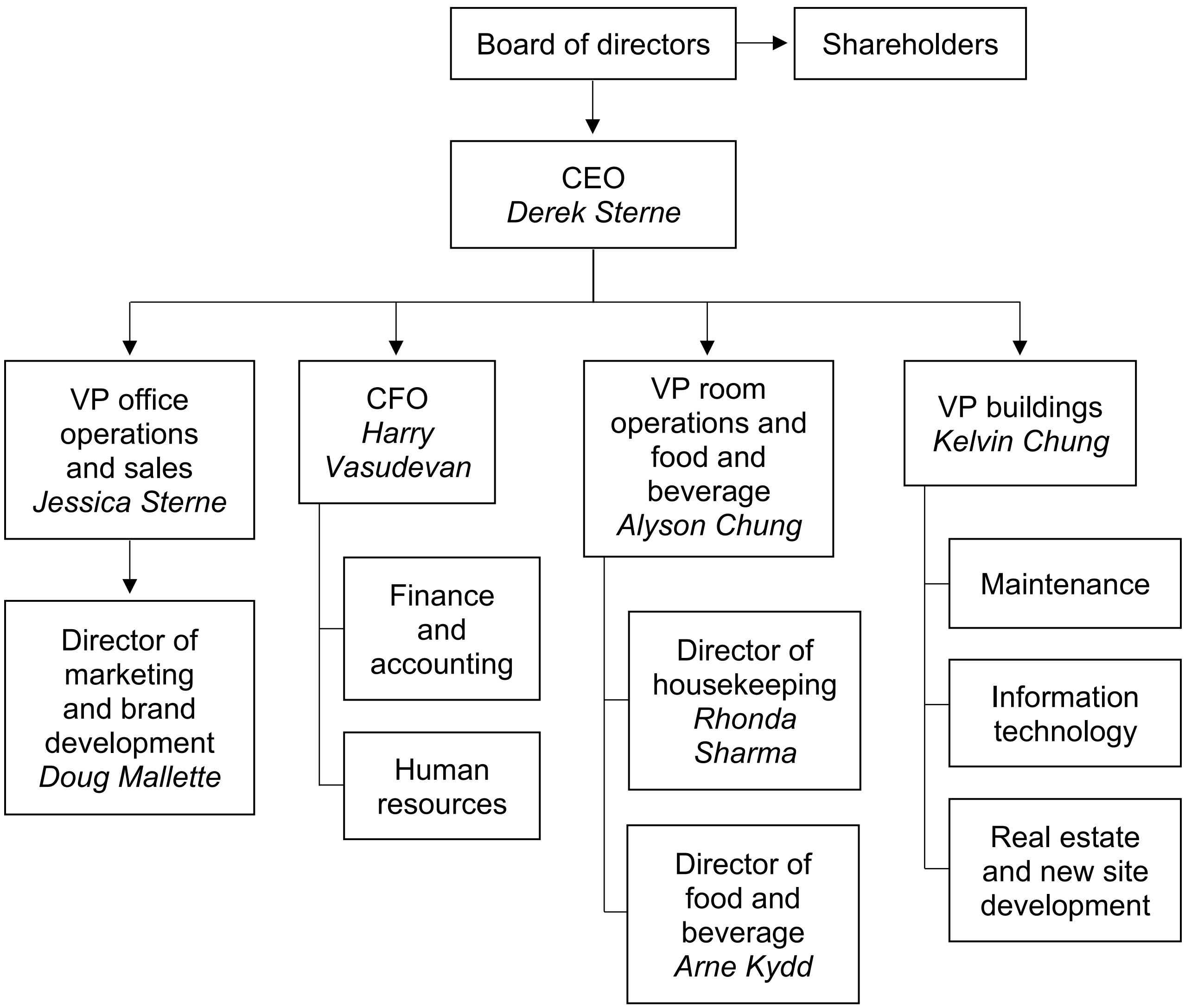
Kelvin: I move to adjourn the meeting.

Alyson: I second the motion.

Derek: All in favour? Yes? Motion is passed.

Table of appendixes

Appendix I
Organizational chart



Appendix II
DHC financial statements
Prepared by Harry Vasudevan

Distinct Hotels Corporation
Statement of comprehensive earnings
for the years ended December 31
(under IFRS)
(In thousands of C$)

	DRAFT 2019 $	AUDITED 2018 $	AUDITED 2017 $
Room revenue	77,672	76,850	74,545
Food and beverage	43,496	43,805	40,254
Spa services	1,870	2,140	2,100
Golf revenue	1,396	1,552	1,790
	124,434	124,347	118,689
Expenses			
Room operating costs	39,613	39,194	37,273
Food and beverage costs	29,577	29,787	27,373
Cost of spa services	1,050	1,135	1,110
Golf services costs	1,167	950	975
Administrative and general expenses	19,501	19,108	18,736
Depreciation and amortization	10,850	10,060	9,680
Property tax, utilities, and insurance	8,710	8,704	8,308
Marketing and sales expenses	2,489	1,865	1,543
Total expenses	112,957	110,803	104,998
Operating income	11,477	13,544	13,691
Interest expense	5,690	6,230	6,780
Income before taxes	5,787	7,314	6,911
Income taxes (27%)	1,562	1,975	1,866
Net profit and comprehensive earnings	4,225	5,339	5,045

Appendix II (continued)
DHC financial statements
Prepared by Harry Vasudevan

Reconciliation of equity			
Balance — beginning of year	36,121	32,782	29,737
Net earnings	4,225	5,339	5,045
Dividends	-	(2,000)	(2,000)
Balance — end of year	40,346	36,121	32,782

Property, plant, and equipment			
Opening balance	158,440	163,280	165,880
Capital additions	6,130	5,120	6,980
Depreciation	(10,750)	(9,960)	(9,580)
Closing balance	153,820	158,440	163,280
Amortization of intangible assets	100	100	100
Total depreciation and amortization	10,850	10,060	9,680

Appendix II (continued)
DHC financial statements
Prepared by Harry Vasudevan

Distinct Hotels Corporation
Statement of financial position
as at December 31
(under IFRS)
(In thousands of C$)

	DRAFT 2019 $	AUDITED 2018 $	AUDITED 2017 $
Assets			
Current assets			
Cash and cash equivalents	-	1,642	2,070
Trade receivables	1,210	1,360	1,290
Inventories	1,903	1,650	1,625
Prepaid expenses	1,465	1,280	1,370
Total current assets	4,578	5,932	6,355
Property, plant, and equipment — net	153,820	158,440	163,280
Intangible assets	1,600	1,700	1,800
Total assets	159,998	166,072	171,435
Liabilities			
Current liabilities			
Line of credit	734	-	-
Trade payables and accrued liabilities	6,568	7,820	9,872
Income taxes payable	320	1,526	1,696
Contract liability — revenue	5,455	7,630	7,410
Current portion — Nova Scotia loan	3,000	3,000	3,000
Current portion — Ontario loan	4,000	4,000	4,000
Total current liabilities	20,077	23,976	25,978
Long-term debt — Nova Scotia	39,000	42,000	45,000
Long-term debt — Ontario	40,000	44,000	48,000
Deferred tax liability	10,400	9,800	9,500
Total liabilities	109,477	119,776	128,478
Shareholders' equity			
Share capital (4,000,000 shares outstanding)	10,175	10,175	10,175
Retained earnings	40,346	36,121	32,782
Total shareholders' equity	50,521	46,296	42,957
Total liabilities and shareholders' equity	159,998	166,072	171,435

Appendix II (continued)
DHC financial statements
Prepared by Harry Vasudevan

Distinct Hotels Corporation
Statement of cash flows
for the years ended December 31
(under IFRS)
(In thousands of C$)

	2019 **$**	**2018** **$**
Operating activities		
Net profit	4,225	5,339
Depreciation and amortization	10,850	10,060
Interest expense	5,690	6,230
Income taxes expense	1,562	1,975
Change in working capital balances		
Trade receivables	150	(70)
Inventories	(253)	(25)
Prepaid expenses	(185)	90
Trade payables and accrued liabilities	(1,252)	(2,052)
Contract liability — revenue	(2,175)	220
	18,612	21,767
Interest paid	(5,690)	(6,230)
Income taxes paid	(2,168)	(1,845)
Total cash flow from operating activities	10,754	13,692
Investing activities		
Investment in PP&E	(6,130)	(5,120)
Financing activities		
Repayment on term loan — Nova Scotia	(3,000)	(3,000)
Repayment on term loan — Ontario	(4,000)	(4,000)
Increase in line of credit	734	-
Dividends paid	-	(2,000)
Total cash flow from financing activities	(6,266)	(9,000)
Change in cash	(1,642)	(428)
Opening cash and cash equivalents	1,642	2,070
Closing cash and cash equivalents	-	1,642

Appendix III
Industry benchmarks
Prepared by Harry Vasudevan

Industry benchmarks	Boutique segment
Rev/PAR	$262
Occupancy rate	78.0%
ADR	$335
Revenue year-over-year growth rate	4.8%
Current ratio	0.8
Cash ratio = cash / current liabilities	0.2
Days in receivable	45.0
Total debt to equity	2.6
Total debt to assets	0.7
Return on equity	11.0%
Operating margin	16.0%
Profit margin	8.0%
Room operating costs as a percentage of room revenue	49.0%
Food and beverage costs as a percentage of food and beverage revenue	65.0%
Total wages as a percentage of revenue	26.0%
Administrative and general expenses as a percentage of revenue	15.0%
Marketing as a percentage of revenue	2.0%

Appendix IV
Awani Spa licence fee information
Prepared by Jessica Sterne

The table below summarizes revised revenues forecasted for the period 2020 to 2024. The actual results for 2019 were less than originally budgeted. In addition, the room supplies purchased from Awani Spa before the discount have been revised for the same period. After 2024, revenues are expected to increase 2% annually, and purchases are expected to increase 3% annually. There will be no sale proceeds received at the end of the licence period.

	2020	**2021**	**2022**	**2023**	**2024**
Revenue	$1,420,000	$1,380,000	$1,400,000	$1,410,000	$1,420,000
Room supply purchases from Awani, before the 4% discount	$2,500,000	$2,800,000	$2,850,000	$2,890,000	$2,900,000

By paying the upfront licence fee in 2016, DHC saved paying an annual licensing fee equal to 5% of annual gross revenues from the spa services.

In early 2019, a local entrepreneur offered to purchase the remaining Awani Spa licensing rights from DHC for $1,325,000. DHC turned down the offer at the time. If DHC had accepted this offer, it would have incurred legal fees estimated to be $30,000.

Harry was able to provide the following information to calculate the appropriate discount rate to use for spa services, but he does not have time to perform any further analysis:

- Cost of debt is 6%.
- Risk-free rate is 3%.
- Beta is 1.3.
- Market risk premium is 5%.
- Target weighting of debt is 20%, and target weighting of equity is 80%.

Appendix V
Website costs incurred
Prepared by Doug Mallette

During the period February to August 2019, the marketing department, as well as some outside consultants, created a new website for DHC, which went active in September 2019. Prior to these changes, the website showed only pictures of the various hotels, the room rates, and the company's contact information.

The new website allows both internal and external access, with sufficient safeguards to prevent any unauthorized access across the two channels. For external access, customers can peruse an extensive photo gallery showing pictures of the outside and inside of each hotel, the different room configurations, and amenities. Guests can now make reservations for rooms, the restaurant, and the spa; purchase spa products; and book tee times at the golf course. Guests can also research "what-to-do-while-here" suggestions, which are linked to websites of local businesses.

Internally, employees have access to the company's human resource policies, code of conduct and code of ethics, medical and dental coverage, work schedules, and company communications and announcements.

Costs incurred for the reconstruction of the website are as follows:

Feasibility studies and defining the objectives and specifications	$50,000
Purchase of operating software and installation of the appropriate applications	$125,000
Graphic design	$124,000
Content development, including taking and uploading the pictures, typing the text, and designing graphics	$280,000
Testing of the website and transitioning from the old site to the new site	$45,000
Training for employees	$15,000
Ongoing maintenance of the website by marketing staff	$180,000
Total	$819,000

Included in graphic design and content development costs are expenditures totalling $80,000 that relate to promotion and advertising.

Appendix VI
Semi-private golf course proposal
Prepared by Derek Sterne

In Kelowna, the golfing season is from late March to early October. In 2019, 55% of the golfer visits to the DHC golf course were registered hotel guests.

If the golf course becomes semi-private, the following assumptions have been made:

- 150 members will join: 110 principal members and 40 spousal members.
- The initiation fee for a principal member is $20,000.
- The initiation fee for a spousal member is $15,000.
- The initiation fee is payment for a perpetual membership that can be transferred to a spouse or child.
- If a member leaves the golf course, the initiation fee is forfeited.
- DHC agrees to use the initiation fees to make improvements to the golf course and the club house over the next two years.
- Annual fees, due March 1, will be $2,500 for a principal member and $2,250 for a spousal member.
- Members are permitted to bring guests to play at the golf course; these guests will be charged the same rate as that charged for a round of golf for hotel guests.

Of the total operating costs incurred in 2019, $895,000 were fixed. I anticipate that for 2020, fixed costs will increase by $130,000 and variable costs per golfer visit will be the same as 2019. I would like to know what rate should be charged for a round of golf per hotel and member guest to ensure that the golf course makes an operating profit of $350,000 in 2020, ignoring the initiation fees. Assume there will be 11,000 golfer visits by the registered hotel guests and members' guests.

The golf course manager has reviewed rates charged by comparable golf courses in the valley. He believes that with the anticipated improvements and the appeal of playing a private course that is less busy, DHC could easily increase its daily rates by 50% more than the 2019 price.

I would like four different scenarios prepared based on variations of the average number of rounds played (that is, golfer visits) each year by each member being 70, 80, 90, or 100. For each scenario, determine:

- the percentage of capacity utilized assuming the maximum capacity is 35,000 golfer visits
- the golf rate to be charged to the guests to achieve a profit of $350,000
- the operating profit generated, if the price suggested by the golf manager is used

A recommendation should be made on whether DHC should proceed with making the golf course semi-private, based on the quantitative a

Appendix VII
Current procedures for alcoholic beverage controls at the Nova Scotia hotel
Prepared by Arne Kydd

The bar in the restaurant fills orders for alcoholic beverages for both the restaurant and room service.

Storeroom inventory purchases procedures

- All the alcoholic beverages are stored in the storeroom, along with all the food and other supplies.
- The storage clerks are responsible for receiving, maintaining, and issuing the inventory to the various departments in the hotel.
- The senior storage clerk is responsible for ordering when inventory levels reach a minimum quantity. A purchase request is prepared, with one copy kept by the storage clerk and one copy sent to the inventory clerk in the accounting department.
- The inventory clerk agrees, based on the perpetual inventory system, that it is time to order the requested items and prepares a purchase order that will be sent to the supplier. Three copies of the purchase order are made: one copy is retained by the inventory clerk, one copy goes to the supplier, and one copy goes to the storage clerk as proof of order.
- On receipt of the shipment from the supplier, the storage clerk agrees the items received to the original purchase order and signs the supplier packing slip as proof of receipt. The storage clerk specifically matches the item, quantity, size, and expiry dates to the supplier's invoice.
- The signed packing slip goes to the inventory clerk, who will match it to the original purchase order and enter the inventory into the perpetual inventory system. This will also be matched to the supplier's invoice prior to payment.
- In the storage room, each item of inventory is stored in its designated spot, with the closest expiry dates at the front.

Appendix VII (continued)
Current procedures for alcoholic beverage controls at the Nova Scotia hotel
Prepared by Arne Kydd

Storeroom requisition procedures for liquor bottles, house wine bottles for wine sold by the glass, and draft beer kegs

- At the beginning of every shift, the bar manager prepares a requisition for bottles of liquor, house wine, and kegs of draft beer that will be required. This is prepared on the computer and sent to the storage clerk as well as the inventory clerk (in the accounting department).
- The storage clerk prints three copies of the requisition and when the order is filled signs each form as proof. One copy is retained in the storage room, one copy goes to the inventory clerk, and one copy accompanies the inventory on delivery to the bar.
- On receipt of the items, the bar manager checks the inventory received against what was requisitioned and signs the requisition slip as proof of delivery. This signed receipt goes to the inventory clerk in the accounting department.
- The inventory clerk then matches what was requisitioned with what was received by the bar and adjusts the perpetual inventory items accordingly.

Storeroom requisition procedures for wine and beer bottle sales

- When a bottle of wine or beer is ordered, the wait or bar staff enter the sale into the point of sale (POS) system. A POS requisition is then sent to the storeroom.
- The storage clerk prints three copies of the POS requisition and when the order is filled signs each form as proof. One copy is retained in the storage room, one copy goes to the inventory clerk, and one copy accompanies the inventory on delivery to the bar.
- On receipt of the items, the bar manager checks the inventory received against what was ordered and signs the POS requisition slip as proof of delivery. This signed receipt goes to the inventory clerk in the accounting department.
- The inventory clerk then matches what was requisitioned with what was received by the bar and what was sold as per the POS receipts and adjusts the perpetual inventory items accordingly.
- There are times when the storage clerk has had to leave the storeroom. In this case, although the storeroom is locked, the bar and wait staff all have the entry code and can get their own inventory requisitions if no one is there. This reduces the wait time required and ensures that sales are not lost at the bar.

Appendix VII (continued)
Current procedures for alcoholic beverage controls at the Nova Scotia hotel
Prepared by Arne Kydd

Controls at the bar

- The POS system is accessed by the wait and bar staff. Each staff member has their own code, which must be entered before entering orders or finalizing and cashing out sales. If the wait staff are busy, they will often ask the bar staff to enter the drink orders under the wait staff code in order to save time.
- When a customer order is received, it is entered into the POS system at the bar. Each item is entered by inventory type, so the POS system tracks sales of inventory by inventory code. When the account is settled by the customer, the system will print one copy of the receipt for the customer. One copy goes to the accounting department for recording the sales and cost of sales for the day.
- The POS system is tied directly to the perpetual inventory system so that the sale of each inventory item automatically updates the perpetual inventory system. An inventory sold report goes to the inventory clerk to reconcile to the perpetual inventory system. No count is made at the bar.
- For a broken bottle, the bar manager requisitions a replacement during their shift without noting that this is a broken bottle. The bar manager disposes of the broken pieces.
- For spills or items returned due to spoilage, the bar manager replaces the item, free of charge to the customer. There are no changes made to the original POS receipt for these types of items. The bar manager will requisition items from the storeroom with no indication that it is due to spillage or spoilage.
- Bartenders use the “free pour” method to measure the volume of liquid required. This means that they either count while pouring or just “eyeball” to measure the volume required. For glasses of wine sold by volume (six ounces or nine ounces), the bartenders compare the glass they are filling to a wine glass that has a measured fill.

Appendix VIII
Financing proposals
Prepared by Jessica Sterne

I have been in conversation with a local entrepreneur about investing in DHC. Patrick Kuzoff owns several golf courses in eastern Canada and would like to begin investing in hotels. He has been a regular guest in all of DHC's hotels for the past 10 years. DHC has also partnered with Patrick's golf company in the past to market golf and hotel packages at the Nova Scotia hotel. Both Derek and I have always been impressed with Patrick's business acumen and found him extremely co-operative and easy to work with. Patrick has provided two options for an investment he would be willing to make, with the funds being advanced April 1, 2020.

1. Bond with warrants: Patrick will lend DHC $20,000,000. The loan will bear annual interest at 4%, payable quarterly. Attached to this loan are 200,000 warrants. Each warrant gives Patrick the right to purchase a common share in DHC at $8.00 each. The warrants expire in April 2023. The loan matures in April 2025. The loan is unsecured.
2. Convertible bond: Patrick will lend $20,000,000 in the form of a convertible bond. The bond will bear annual interest at 2.5%, payable quarterly. The bond is convertible into 1,000,000 shares at the holder's option but is also mandatorily convertible at maturity if not converted earlier. This means that the principal will be repaid at maturity through the issuance of 1,000,000 common shares and not cash. The bond matures in April 2027.

Appendix IX
Topomo Mountain Ski Resort proposed investment
Prepared by Derek Sterne

TMSR has been in operation for more than 20 years and is situated in Canmore, Alberta, within a 10-minute drive of DHC's Canmore hotel. TMSR has a retail shop and restaurant on its premises, as well as a small ski school. It is currently owned by NGM Inc., a global company. NGM has made the strategic decision to focus operations on its golf courses and casinos and is therefore divesting non-core assets, which includes TMSR. NGM is asking $25,000,000 for all the outstanding shares of TMSR and, to date, there have been two interested parties, both of which are large global ski resort companies.

TMSR is a world-renowned ski resort that opened in 1996, and in 2002 it won the industry award for "Third-best ski resort in Canada for snow conditions." Its ownership changed hands several times until 2010 when it was purchased by NGM. In the past two years, NGM invested very little in the resort due to its lack of interest, causing the quality of service to fall and the incidences of equipment failures to increase, negatively impacting TMSR's status as a world-class ski resort. Skier visits declined from 500,000 visits in 2017 to 350,000 in the past ski season.

Currently, 75% of the skiers at TMSR come from outside Canmore. As a result, the resort is vital to the community, with many businesses relying on the non-local skiers coming to shop, stay, and eat in Canmore.

Four local businesses have come together with a proposal to purchase the resort and have approached me, asking DHC to become the fifth investor. The proposal is for each business to invest sufficient funds to purchase 20% of the outstanding shares of TMSR, giving each business a 20% voting ownership in the resort. Each shareholder will be represented by two directors on the 10-member board of TMSR. Currently Scott Potterman is leading this initiative. Scott firmly believes that it is critical the local community, rather than another large global company, take ownership and control of TMSR. With the local community in control of operating and strategic decisions, he believes that the ski resort will be restored to world-class resort status once again. Scott notes that key success factors for the ski industry include effective cost controls, proximity to key markets, and achieving economies of scale, and that the ski industry is driven, in part, by per capita disposable income, the availability of leisure time, and the number of international travellers.[34]

I have summarized the following information from the formal proposal that Scott prepared to determine the value of the resort. The latest financial statements for TMSR are provided in Appendix X. The company has a June 30 year end. The 2020 statements are projected based on actual to January 31 results, plus estimates for the remaining months.

[34] Ibid.

Appendix IX (continued)
Topomo Mountain Ski Resort proposed investment
Prepared by Derek Sterne

Scott has analyzed the financial statements and viewed all the tangible assets. In 2019, the average lift ticket price per skier visit was $53. This is well below the average price of $63 charged by ski resorts in the surrounding area. This average price takes into account both day tickets, which pay a higher average rate, and season pass holders, which pay a lower average rate. Because the chair lifts and terrain have not been adequately maintained, there will be extra maintenance costs required for the first three years. It appears that NGM has cut costs and reduced investments to achieve short-term profits, which will not be sustainable. Given this conclusion, Scott has prepared forecast assumptions for revenues, expenses, and capital expenditures for building, equipment, and vehicles; these are provided in Appendix XI. The long-term growth rate after 2026 is projected to be 2.5%. Note that working capital investments are expected to be negligible and there are no redundant assets. It is anticipated that ownership will transfer July 1, 2020.

Currently, TMSR has the following undepreciated capital cost (UCC) balances:

Buildings	$10,680,000	Class 1	4%
Equipment	11,590,000	Class 8	20%
Vehicles	4,520,000	Class 10	30%
UCC total	$26,790,000		

The average income tax rate is 27%, and I have determined that an appropriate discount rate is 15% for this venture.

The current resort manager will be relocated and kept as an employee of NGM, but all other employees will remain with TMSR. NGM will be responsible for paying any vacation pay and other benefits owing up to the date of acquisition. In discussions with the staff, Scott noted that the employee morale is very low, and many employees were thinking of leaving prior to the announcement of the sale. They are now waiting to see who the new owner will be and the changes that might ensue.

In addition to the initial contribution for the shares, each shareholder is also being asked to provide monies to fund the capital expenditures required for the first two years, totalling $14,700,000. These additional funds will be provided as an interest-free loan for up to a maximum of eight years. Each shareholder's pro-rata share will be $2,940,000.

Appendix X
Topomo Mountain Ski Resort financial statements
Provided by Derek Sterne

Topomo Mountain Ski Resort
Income statement
For the years ended June 30
(Under IFRS)
(In thousands of C$)

	FORECASTED 2020 $	AUDITED 2019 $
Revenue		
Ski lift ticket sales	18,475	19,570
Ski school fees	3,404	4,320
Retail shop sales	4,878	5,270
Food services	3,875	4,210
Total revenue	30,632	33,370
Cost of sales		
Lifts	7,945	8,416
Ski school	2,454	3,120
Retail shop	3,756	4,040
Food services	2,519	1,640
Total cost of sales	16,674	17,216
Other expenses		
Sales and marketing	1,825	2,590
Insurance	2,775	2,690
Depreciation	3,140	3,450
General and administrative	941	1,640
Total expenses	8,681	10,370
Operating income before interest and income taxes	5,277	5,784
Interest expense	950	1,014
Income before income taxes	4,327	4,770
Income taxes	1,168	1,288
Net earnings for the year (and comprehensive income)	3,159	3,482

Appendix X (continued)
Topomo Mountain Ski Resort financial statements
Provided by Derek Sterne

Reconciliation of equity		
Balance — beginning of year	8,882	5,400
Net earnings	3,159	3,482
Balance — end of year	12,041	8,882

Property, plant and equipment		
Opening balance	37,363	38,173
Capital additions	2,500	2,640
Depreciation	(3,140)	(3,450)
Closing balance	36,723	37,363

Appendix X (continued)
Topomo Mountain Ski Resort financial statements
Provided by Derek Sterne

Topomo Mountain Ski Resort
Statement of financial position
As at June 30
(Under IFRS)
(In thousands of C$)

	FORECASTED 2020 $	AUDITED 2019 $
Assets		
Cash and cash equivalents	150	250
Accounts receivable from corporate events	350	425
Inventories	1,512	1,680
Prepaid expenses	624	670
Total current assets	2,636	3,025
Property, plant and equipment	36,723	37,363
Total assets	39,359	40,388
Liabilities		
Accounts payable	4,725	4,916
Income taxes payable	520	505
Contract liability — prepaid lift tickets	1,908	2,430
Current portion of mortgage payable	3,750	3,750
Total current liabilities	10,903	11,601
Deferred taxes	2,575	2,315
Mortgage payable	12,490	16,240
Total liabilities	25,968	30,156
Shareholder's equity		
Share capital — common shares	1,350	1,350
Retained earnings	12,041	8,882
Total shareholder's equity	13,391	10,232
Total liabilities and shareholder's equity	39,359	40,388

Appendix X (continued)
Topomo Mountain Ski Resort financial statements
Provided by Derek Sterne

Topomo Mountain Ski Resort
Statement of cash flows
For the year ended June 30
(Under IFRS)
(In thousands of C$)

	FORECASTED 2020 $
Operating activities	
Net earnings	3,159
Add back: depreciation	3,140
Interest expense	950
Income taxes expense	1,168
Change in working capital balances	
Accounts receivable	75
Inventories	168
Prepaid expenses	46
Trade payables and accrued liabilities	(191)
Contract liability — revenue	(522)
	7,993
Interest paid	(950)
Income taxes paid	(893)
Total cash flow from operating activities	6,150
Investing activities	
Investment in PP&E	(2,500)
Financing activities	
Repayment of mortgage payable	(3,750)
Dividends paid	-
Total cash flow from financing activities	(3,750)
Change in cash	(100)
Opening cash and cash equivalents	250
Closing cash and cash equivalents	150

Appendix XI
Topomo Mountain Ski Resort forecast assumptions
Provided by Derek Sterne

(July 1st to June 30th)	2021	2022	2023	2024	2025	2026
Number of skier visits	370,000	420,000	440,000	480,000	500,000	500,000
Average lift ticket price per skier visit	$ 55	$ 56	$ 58	$ 60	$ 65	$ 67
Cost of sales — Lifts — as a percentage of lift ticket revenue	47%	47%	47%	47%	47%	47%
Additional maintenance	$2,200,000	$1,800,000	$1,800,000	$ -	$ -	$ -
Other revenues						
Ski school fees, as a percentage of lift ticket revenues	20%	20%	25%	25%	25%	25%
Retail shop sales, as a percentage of lift ticket revenues	26%	27%	28%	28%	28%	28%
Food service sales, as a percentage of lift ticket revenues	21%	21%	21%	21%	21%	21%
Cost of sales						
Ski school costs, as a percentage of ski school fees	70%	70%	70%	70%	70%	70%
Retail shop costs, as a percentage of retail shop sales	75%	75%	75%	75%	75%	75%
Food services costs, as a percentage of food service sales	65%	65%	65%	65%	65%	65%
Sales and marketing	$3,100,000	$3,100,000	$3,200,000	$3,200,000	$3,300,000	$3,300,000
Insurance	$2,850,000	$2,950,000	$3,050,000	$3,150,000	$3,250,000	$3,250,000
General and administrative	$1,250,000	$1,750,000	$1,802,500	$1,856,575	$1,912,272	$1,969,640
Capital expenditures (end of year)						
Building	$1,500,000	$5,000,000	$1,600,000	$1,600,000	$1,600,000	$1,600,000
Equipment	$3,600,000	$3,600,000	$1,700,000	$1,700,000	$1,700,000	$1,700,000
Vehicles	$ 500,000	$ 500,000	$ 500,000	$ 500,000	$ 500,000	$ 500,000
	$5,600,000	$9,100,000	$3,800,000	$3,800,000	$3,800,000	$3,800,000

Appendix XII
Artists Warehouse Hotel proposed purchase
Prepared by Jessica Sterne

Artists Warehouse Hotel (AWH) is situated in a trendy district in downtown Toronto. It is a renovated warehouse that was used by the artists' community in Toronto in the early 1900s. In fact, some of the early artists in residence used the inside walls of the building as their canvases to paint landscapes of the city. The paintings have since been preserved, and guests come and stay at the hotel primarily to see this historically significant artwork. AWH also opens its doors to local art groups to come view and study the paintings, at no charge.

The building was renovated into a hotel with 150 rooms in 1980 and today is rated as a four-star upscale hotel with a retro feel and look. Most guests stay only one or two nights, and 25% of the guests are business travellers. Isabelle Logan is the sole shareholder and a descendant of one of the original artists who lived and worked in the warehouse. Isabelle has been a driving force behind the success of her hotel, having been manager for the past 35 years. She is heavily involved in the arts community in Toronto, and this work has helped the hotel grow and gain the reputation that it has today. Isabelle is looking to sell the hotel and retire on the proceeds.

I was in Toronto last month and stayed at the hotel at the request of Isabelle, whom I have known for many years. I enjoyed staying at AWH and was particularly fascinated by its unique blend of quirkiness and charm. While having afternoon tea with Isabelle, she mentioned that she was looking to sell. I expressed some initial interest and was given the full tour. She also recently sent me the financial statements to review (Appendix XIII). The hotel looks to be well maintained, and the rooms were last renovated in 2014.

The hotel has 125 employees, of which 40 are full-time, including five managers. There are no other facilities or amenities offered other than room accommodations. In 2019, the ADR was $280 per room and the occupancy rate was 90%. The company has no debt except for an interest-free shareholder loan. I think the hotel likely has operating ratios above industry standards, but this should be confirmed by WCG.

The fair values of all the assets and liabilities are equal to their book values except for the land, building, and furniture and fixtures. The table below summarizes the estimated fair market values for these assets based on recent appraisals. If sold, commission rates would be 4% of the gross sale proceeds. Additional relevant information is provided below.

Appendix XII (continued)
Artists Warehouse Hotel proposed purchase
Prepared by Jessica Sterne

	ACB	UCC	Fair market value	CCA rate
Land	$ 680,000	-	$ 5,900,000	-
Building	$24,650,000	$19,820,000	$39,000,000	4%
Furniture and fixtures	$ 8,740,000	$ 3,620,000	$ 4,210,000	20%

I have determined that an appropriate cost of capital is 12% for the asset-based approach to value the net assets. The company's average tax rate is 27%. In addition, I have done some research on recent sales made in downtown Toronto for similar-sized hotels and found the following information to use for a market-based valuation approach:

Company name	Date of sale	Number of rooms	Additional amenities and other comments	Multiple: Price/EBITDA
Hotel A	Sept 2019	120	Historical site with restaurant and bar lounge	9.2 x
Hotel B	Dec 2018	205	Historical site with restaurant and health club	10.9 x
Hotel C	Apr 2019	180	Primarily long-term stays of a minimum of two weeks	11.3 x
Hotel D	Jul 2018	160	No additional amenities	7.5 x
Hotel E	Feb 2017	220	Bar lounge and spa facilities	8.9 x
Hotel F	Aug 2019	180	Historical site with no additional amenities	8.5 x

Appendix XII (continued)
Artists Warehouse Hotel proposed purchase
Prepared by Jessica Sterne

Isabelle works as the manager of the hotel and pays herself a salary of $450,000, plus benefits approximating 30% of salary each year. This manager's position has a comparable market salary of $250,000, plus 30% benefits. In 2018, the company spent $100,000 on additional professional and legal costs related to pursuing a potential investment in another hotel. In 2019, AWH received a one-time government grant of $120,000 for hiring students to work in the hotel.

I suggest that DHC purchase the outstanding shares of AWH and keep it as a separate subsidiary. Isabelle has agreed to sell her shares for $32,000,000, though she has implied this price may be open for negotiation, taking $7,000,000 in cash up front and a mortgage payable (secured by the land and building) for $25,000,000, bearing interest at 7%, and payable in blended monthly payments of $223,312 for 15 years. Alternatively, instead of the mortgage take-back, Isabelle would consider taking back non-voting preferred shares in DHC that would be retractable at her option and pay a cumulative annual dividend of $1,500,000. Finally, Isabelle will want the shareholder loan repaid within the first year post-acquisition.

Appendix XIII
Artists Warehouse Hotel financial statements
Provided by Jessica Sterne

Artists Warehouse Hotel
Income statement
for the years ended December 31
(under ASPE)
(In thousands of C$)

	AUDITED 2019 $	AUDITED 2018 $
Room revenue	13,797	12,100
Expenses		
Room operating costs (excluding wages)	3,595	2,937
Wages	2,890	2,750
Amortization	2,083	1,910
Marketing and sales expenses	710	690
Property tax, utilities, and insurance	1,518	1,331
Administrative and general expenses	650	625
Total expenses	11,446	10,243
Operating income	2,351	1,857
Interest expense	-	-
Income before taxes	2,351	1,857
Income taxes	635	501
Net earnings	1,716	1,356
Statement of retained earnings		
Balance — beginning of year	5,946	4,590
Net earnings	1,716	1,356
Balance — end of year	7,662	5,946

Property, plant, and equipment		
Opening balance	24,823	24,503
Capital additions	2,170	2,230
Depreciation	(2,083)	(1,910)
Closing balance	24,910	24,823

Appendix XIII (continued)
Artists Warehouse Hotel financial statements
Provided by Jessica Sterne

Artists Warehouse Hotel
Balance sheet
as at December 31
(under ASPE)
(In thousands of C$)

	2019 $	2018 $
Assets		
Current assets		
Cash and cash equivalents	25	30
Inventories	350	345
Prepaid expenses	290	310
Total current assets	665	685
Property, plant, and equipment — net		
Land	680	680
Building	18,540	19,640
Furniture and fixtures	5,690	4,503
	24,910	24,823
Total assets	25,575	25,508
Liabilities		
Current liabilities		
Trade payables and accrued liabilities	7,263	7,520
Total current liabilities	7,263	7,520
Shareholder's loan	10,000	11,392
Total liabilities	17,263	18,912
Shareholders' equity		
Share capital	650	650
Retained earnings	7,662	5,946
Total shareholders' equity	8,312	6,596
Total liabilities and shareholders' equity	25,575	25,508

Appendix XIII (continued)
Artists Warehouse Hotel financial statements
Provided by Jessica Sterne

Artists Warehouse Hotel
Statement of cash flows
for the year ended December 31
(under ASPE)
(In thousands of C$)

	2019 **$**
Operating activities	
Net earnings	1,716
Amortization	2,083
Change in working capital balances	
Inventories	(5)
Prepaid expenses	20
Trade payables and accrued liabilities	(257)
Total cash flow from operating activities	3,557
Investing activities	
Investment in property, plant, and equipment	(2,170)
Financing activities	
Repayment of shareholder's loan	(1,392)
Change in cash	(5)
Opening cash and cash equivalents	30
Closing cash and cash equivalents	25

Appendix XIV
Condo sales proposal
Prepared by Kelvin Chung

I have had a variety of discussions with developers in Northern Ontario and am proposing that DHC take the Northern Ontario hotel and convert some of its rooms into condos. I selected this hotel because it currently has the highest number of rooms, the lowest occupancy rate, and a lower ADR than the company's average, and it has not been recently renovated. My plan is to convert 60 existing rooms to luxury condos: 15 one-bedroom and 15 two-bedroom condos. The ownership to these condos will be sold as fractional ownerships, each fraction equal to four annual weeks. Therefore, there will be 13 fractional ownerships sold per condo.[35] Each condo will come fully furnished with a fully equipped kitchen.

Based on some discussions with condo hotel operators in Ontario, I am suggesting that the amounts and conditions of sale include the following:

- Each fractional ownership in a one-bedroom condo will be sold for $90,000.
- Each fractional ownership in a two-bedroom condo will be sold for $150,000.
- A deposit equal to 10% will be received at the time the contract is signed, and final payment (90%) is due when legal title transfers.
- DHC will maintain ownership of the condo until the renovations are completed and the condo is ready for sale. DHC will also choose all the decorating and furnishings required for the condo. The buyer will have no say in this. When legal title transfers, the sale is complete.
- For a single fractional ownership, each owner will be entitled to use the property for four weeks each year. The four weeks in the year will be spaced as one week in each quarter. The week within each quarter will rotate annually between all the owners of the condo, allowing all owners to participate in peak period vacation times every few years.
- Each owner will pay annual maintenance fees to DHC equal to $2,100 for managing the property and other administration costs. At the time of the sale, this fee will be payable on closing. Subsequently, the fee will be paid at the beginning of each year. These fees are expected to increase 3% annually after all of the sales are completed.
- Each owner will also be allowed to exchange their week usage with Vacation Property Exchange Inc. (VPEI). VPEI is a global vacation property exchange company that specializes in luxury properties in North America and Europe. DHC will manage this exchange at the owner's request for a small additional fee. In addition, it will be the owner's responsibility to pay the annual fee required to be a member of VPEI.

[35] 52 weeks / 4 weeks for each unit.

Appendix XIV (continued)
Condo sales proposal
Prepared by Kelvin Chung

- Each owner will be required to pay an annual amount into a reserve account that will be maintained by a third party. This cash will be accumulated to pay for future capital expenditures related to painting and replacing worn furnishings and fixtures. DHC will have control over the colours and the selection of furniture and fixture replacements.
- Each owner also has the right to allow DHC to rent their condo for the week usage assigned. In return, DHC will pay 50% of the room rental received to the owners and retain the remaining 50%. The owners must provide at least 60 days' notice of this intention.
- During their stay, each owner will be entitled to the same level of service as provided in the regular hotel rooms; that is, the condos will be cleaned daily, with bedding and towels and all other room amenities supplied.

Working with Harry, I have made some assumptions about incremental revenues and expenses related to this proposal (Appendix XV). I have estimated that it will cost $7,000,000 to complete the renovations to convert the 60 hotel rooms into 30 condos. Harry has suggested that the proceeds received from the condo sales will be taxed as normal income and that the $7,000,000 will be deductible as a related cost of sale. Legal and other professional fees incurred to transfer the ownership on sale are estimated to be $2,000,000 in total. I have also assumed that there will be little change in room operating costs for cleaning and supplies that will still be provided.

The extra fees earned on exchanges or rentals as allowed under the contract are assumed to be negligible.

Harry has recommended that 11% is a reasonable rate of return for this project. I suggest using a 10-year planning horizon, up to and including year 2030, but I also want to understand at what future date the project has a net present value equal to zero.

Appendix XV
Condo sales forecast assumptions
Prepared by Kelvin Chung

(in thousands of C$)		2020	2021	2022	2023	
Revenue from condo sales						
One-bedroom — Number sold in the year	Note 1	-	60	90	45	
Price per fractional ownership		$90,000	$90,000	$90,000	$90,000	
Two-bedroom — Number sold in the year	Note 2	-	60	90	45	
Price per fractional ownership		$150,000	$150,000	$150,000	$150,000	
Loss of contribution margin from the rooms						
Loss of contribution margin from rooms during construction	Note 3	(1,970,000)				
Opportunity cost on room rentals	Note 4	-	(2,337,000)	(2,407,110)	(2,479,323)	Increase 3% annually thereafter
Additional administration costs	Note 5	-	(1,000,000)	(1,000,000)	(790,000)	Increase 3% annually thereafter
Additional marketing costs		(1,400,000)	(1,740,000)	(1,740,000)	(1,740,000)	No further marketing costs since all fractional ownerships sold

Note 1: 195 fractional ownership units in total: 13 fractional ownership units per condo × 15 one-bedroom condos for sale.

Note 2: 195 fractional ownership units in total: 13 fractional ownership units per condo × 15 two-bedroom condos for sale.

Note 3: Lost contribution margin will be due to the 60 units under construction, as well as an anticipated decrease in hotel occupancy due to construction noise and disruption.

Note 4: The opportunity cost relates to the expected lost revenue on the converted rooms, less related variable costs except room operating costs, which would still be incurred (since owners and occupants are entitled to the same level of service as guests, with daily room cleaning, amenities in the room, and so on). The lost revenue takes into account the historically lower occupancy rates of the hotel, as well as the expected increase in demand due to the completion of the new sports stadium.

Note 5: The additional administrative costs are high in 2021 and 2022, as DHC becomes familiar with this type of operation and the initial glitches are worked out; settle to the expected norm in 2023.

Appendix XVI
Management contract proposal with Huron Heights Hotel
Prepared by Alyson Chung

Huron Heights Hotel (HHH), located in a trendy district in downtown Vancouver, is an upscale, independently owned hotel. HHH is currently owned by Martha LaVoie. Four months ago Martha's husband died, and she is now left owning and operating the hotel. Previously, the hotel had been managed solely by her husband and she was not involved. She is now struggling to decide what to do with it, and her lawyer suggested that she consider entering into a hotel management contract with a well-known hotel operator. Since Martha and I have been friends since university, she contacted me to see if DHC might be interested in this type of arrangement.

I met with Martha and was able to gather the following information, and she gave me a draft hotel management agreement prepared by HHH's lawyer.

HHH has 170 rooms with a full-service restaurant, bar lounge, and fitness facility, with an occupancy rate of 70% and an ADR of $250. Although HHH currently operates as a four-star hotel, Martha would like to renovate the existing hotel and upgrade it to a luxury, five-star level, branding it as a DHC hotel.

The important points from the draft hotel management agreement are as follows:

- Asset ownership and capital improvements:
  - HHH continues to own the land, building, and all the equipment, furniture, and fixtures.
  - HHH is responsible for funding all capital improvements, but DHC has control over how the monies will be spent.
  - HHH agrees to deposit 4% of the hotel's gross annual revenues into a reserve fund to finance future capital asset replacements and upgrades. Although HHH will own these funds, DHC will decide when upgrades are necessary and how these funds will be used.
  - HHH must ensure that the building and furniture, fixtures, and equipment are kept up to the standards required by DHC.
  - HHH will be responsible for paying all insurance costs and property taxes.
- Operating costs, other than employees:
  - HHH will pay all the operating costs incurred by the hotel operations.
  - HHH will also reimburse DHC (with no added profit) for any corporate expenses incurred by DHC that benefit HHH, such as national marketing and use of the guest reservation system.

Appendix XVI (continued)
Management contract proposal with Huron Heights Hotel
Prepared by Alyson Chung

- Employees:
    - The hotel employees, excluding senior and executive management, will be employed by HHH. DHC will be responsible for managing, training, hiring, and terminating these employees, with input from HHH.
    - DHC will be responsible for providing (and paying for) all executive and senior managers for all divisions, including housekeeping, maintenance, food and beverage, marketing, and accounting. HHH has the right to assist with interviewing candidates for these positions and giving final approval for hiring.
- Management fees and licence fees:
    - In return for managing the operations, HHH will pay monthly fees as follows:
        - 5% of the gross revenues earned by the hotel operations, plus
        - 8% of the gross operating profit generated by the hotel operations. The gross operating profit is determined as revenue less room operating costs, food and beverage costs, depreciation, marketing and sales, utilities and administration costs. Management salaries and benefits are excluded, as well as insurance and property taxes.
    - HHH will also pay a licensing fee for the right to use the DHC brand name for the period of the contact. For this right of use, HHH will pay a monthly fee equal to 3% of the hotel's gross revenue.
    - These fees will be calculated based on monthly actual reports and will be paid within 15 days of month end. At year end any final adjustments to reflect actual results will be made and the fee for the year will be adjusted accordingly.
- Degree of control:
    - HHH will approve the annual budgets prepared by DHC.
    - DHC will provide HHH with monthly statements showing a comparison of actual to budgeted results.
    - HHH will be invited to attend all management meetings.

Appendix XVI (continued)
Management contract proposal with Huron Heights Hotel
Prepared by Alyson Chung

- Contract term and termination:
  - The initial contract will be for 20 years, commencing July 1, 2020.
  - Contract renewal terms will be renegotiated six months prior to the initial contract expiring.
  - The contract can be terminated by HHH if DHC fails to meet both the following performance metrics for two consecutive years:
    - The actual gross operating profit must be at least 90% of the budgeted amount.
    - The Rev/PAR must be 85% of the average Rev/PAR of similar-sized competitors operating in the surrounding area. The group of competitors to be used for this comparison will be agreed to at the beginning of each year by both HHH and DHC.
- Sale of the property:
  - HHH has the right to sell the property to any buyer.
- Geographic exclusivity:
  - DHC agrees not to operate another hotel within a 100-kilometre radius of HHH while they are party to this agreement, and for a three-year period after termination of this agreement.
- DHC will share in any losses incurred by HHH. In cases where DHC is found to be negligent or fraudulent, DHC will be solely responsible for losses incurred by HHH.

From the financial statements and other detail provided by Martha, Jessica and I prepared the following information relevant to this contract:

- HHH has agreed to pay for renovations totalling $8,000,000 to upgrade the hotel to a luxury standard as required by DHC. This amount may be revised based on discussions with DHC.
- DHC will provide consulting services on these renovations (July 1 to November 30, 2020) to ensure that the renovations are completed in compliance with DHC's standards, on time and on budget. For these services, DHC will be paid $700,000 for its expertise. There will be penalties up to $90,000 deducted from this fee if there are cost overruns or the project is not completed by November 30.
- During the renovation period, DHC will incur salary and benefit costs of $330,000 for personnel involved in the renovations.
- Hotel operations will commence December 1, 2020.

Appendix XVI (continued)
Management contract proposal with Huron Heights Hotel
Prepared by Alyson Chung

- Based on a review of five-star competitors operating near HHH and offering luxury service, HHH's expected ADR and occupancy rate for each of the next four years is provided in the table below:

	2020	2021	2022	2023
ADR	$310	$315	$320	$320
Occupancy rate	70%	70%	75%	80%

- The gross operating profit for HHH's hotel operations is expected to be 32% of gross hotel revenue.
- DHC's management salaries and benefits related to HHH operations will total $875,000 annually, starting in 2021, and increase at 3% annually. DHC's management salaries and benefits related to December 2020 will total $70,000.