

**QUARTERLY REPORT**

**FORM 51-901F**

|   |  |                    |                         |                         |                       |
|---|--|--------------------|-------------------------|-------------------------|-----------------------|
| <b>ISSUER DETAILS</b><br>NAME OF ISSUER |  | FOR QUARTER ENDED  |                         | DATE OF REPORT<br>Y M D |                       |
| Allied Hotel Properties Inc.            |  | September 30, 2002 |                         | 02 11 27                |                       |
| ISSUER'S ADDRESS                        |  |                    |                         |                         |                       |
| Suite 300 – 515 West Pender Street      |  |                    |                         |                         |                       |
| CITY                                    |  | PROVINCE           | POSTAL CODE             | ISSUER FAX NO.          | ISSUER TELEPHONE NO.  |
| Vancouver                               |  | B.C.               | V6B 6H5                 | 604-682-8131            | 604-669-5335          |
| CONTACT PERSON                          |  |                    | CONTACT'S POSITION      |                         | CONTACT TELEPHONE NO. |
| John R. Ellen, C.A.                     |  |                    | Chief Financial Officer |                         | 604-682-2533<br>x 160 |
| CONTACT EMAIL ADDRESS                   |  |                    | WEB SITE ADDRESS        |                         |                       |
| john_ellen@alliedhotels.com             |  |                    | www.alliedhotels.com    |                         |                       |

**CERTIFICATE**

*The three schedules required to complete this Quarterly Report are attached and the disclosure contained therein has been approved by the Board of Directors. A copy of this Quarterly Report will be provided to any shareholder who requests it.*

|                             |                  |                         |
|-----------------------------|------------------|-------------------------|
| DIRECTOR'S SIGNATURE        | PRINT FULL NAME  | DATE OF REPORT<br>Y M D |
| "Ronald G. Erdman" (signed) | Ronald G. Erdman | 02 11 27                |
| DIRECTOR'S SIGNATURE        | PRINT FULL NAME  | DATE OF REPORT<br>Y M D |
| "Peter Y.L. Eng" (signed)   | Peter Y.L. Eng   | 02 11 27                |

Consolidated Financial Statements of

**ALLIED HOTEL PROPERTIES INC.**

Three and nine months ended September 30, 2002 and 2001

(Unaudited)

# ALLIED HOTEL PROPERTIES INC.

## Consolidated Balance Sheets

September 30, 2002 and December 31, 2001  
Expressed in thousands of dollars

|  | 2002              | 2001              |
|--|-------------------|-------------------|
|  | (Unaudited)       | (Audited)         |
| <b>Assets</b>                                |                   |                   |
| Current assets:                              |                   |                   |
| Cash and cash equivalents                    | \$ —              | \$ 179            |
| Accounts receivable                          | 2,873             | 2,281             |
| Due from affiliated company                  | —                 | 72                |
| Inventories                                  | 448               | 482               |
| Prepaid expenses                             | 972               | 506               |
| Future income taxes                          | 74                | 74                |
|  | <u>4,367</u>      | <u>3,594</u>      |
| Income-producing properties                  | 116,283           | 118,059           |
| Investments                                  | 2,567             | 916               |
| Deferred costs, net of amortization          | 366               | 390               |
| Future income taxes                          | 4,786             | 4,566             |
|  | <u>\$ 128,369</u> | <u>\$ 127,525</u> |
| <b>Liabilities and Shareholders' Equity</b>  |                   |                   |
| Current liabilities:                         |                   |                   |
| Bank indebtedness                            | \$ 2,338          | \$ —              |
| Accounts payable and accrued liabilities     | 11,196            | 12,749            |
| Due to affiliated companies                  | 250               | —                 |
| Current portion of deferred revenue (note 5) | 4,359             | 254               |
| Current portion of capital lease obligation  | 387               | 444               |
| Long-term debt (note 2 (a))                  | 97,339            | 3,532             |
|  | <u>115,869</u>    | <u>16,979</u>     |
| Deferred revenue                             | 2,074             | 2,212             |
| Long-term debt (note 2 (a))                  | —                 | 96,623            |
| Capital lease obligation                     | 379               | 557               |
| Non-controlling interest                     | 333               | 819               |
|  | <u>118,655</u>    | <u>117,190</u>    |
| Shareholders' equity:                        |                   |                   |
| Share capital                                | 29,868            | 29,868            |
| Deficit                                      | (20,154)          | (19,533)          |
|  | <u>9,714</u>      | <u>10,335</u>     |
|  | <u>\$ 128,369</u> | <u>\$ 127,525</u> |

See accompanying notes to consolidated financial statements

(signed) "Peter Y.L. Eng" Director

(signed) "Ronald G. Erdman" Director

# ALLIED HOTEL PROPERTIES INC.

Unaudited Consolidated Statements of Deficit

For the nine months ended September 30, 2002 and 2001

Expressed in thousands of dollars

|                                      | 2002      | 2001      |
|--------------------------------------|-----------|-----------|
| Deficit, beginning of period         | \$ 19,533 | \$ 18,937 |
| Deemed contribution by related party | –         | (4,250)   |
| Net loss (income)                    | 621       | (5,595)   |
| Deficit, end of period               | \$ 20,154 | \$ 9,092  |

*See accompanying notes to consolidated financial statements*

# ALLIED HOTEL PROPERTIES INC.

Unaudited Consolidated Statements of Operations

Expressed in thousands of dollars, except per share amounts

|   | Three months ended<br>September 30 |                 | Nine months ended<br>September 30 |                 |
|---|------------------------------------|-----------------|-----------------------------------|-----------------|
|   | 2002                               | 2001            | 2002                              | 2001            |
| <b>Revenues:</b>  |                                    |                 |                                   |                 |
| Rooms   | \$ 10,749                          | \$ 15,939       | \$ 25,306                         | \$ 39,019       |
| Food and beverage   | 3,775                              | 4,605           | 11,706                            | 14,665          |
| Other   | 1,124                              | 1,337           | 3,441                             | 3,891           |
|   | <u>15,648</u>                      | <u>21,881</u>   | <u>40,453</u>                     | <u>57,575</u>   |
| <b>Cost of sales:</b>   |                                    |                 |                                   |                 |
| Rooms   | 3,121                              | 4,419           | 7,928                             | 12,045          |
| Food and beverage   | 3,375                              | 4,230           | 10,181                            | 12,984          |
| Other   | 417                                | 483             | 1,150                             | 1,318           |
|   | <u>6,913</u>                       | <u>9,132</u>    | <u>19,259</u>                     | <u>26,347</u>   |
| <b>Gross profit</b>   | <b>8,735</b>                       | <b>12,749</b>   | <b>21,194</b>                     | <b>31,228</b>   |
| <b>Operating expenses:</b>  |                                    |                 |                                   |                 |
| Selling, general and administrative                                     | 4,267                              | 5,733           | 11,978                            | 17,422          |
| Management fees   | 303                                | 867             | 775                               | 1,614           |
| Taxes and insurance   | 892                                | 1,185           | 2,618                             | 3,705           |
| Depreciation and amortization   | 879                                | 1,417           | 2,578                             | 4,230           |
|   | <u>6,341</u>                       | <u>9,202</u>    | <u>17,949</u>                     | <u>26,971</u>   |
| <b>Operating income</b>   | <b>2,394</b>                       | <b>3,547</b>    | <b>3,245</b>                      | <b>4,257</b>    |
| <b>Other expenses / (income):</b>                                       |                                    |                 |                                   |                 |
| Interest on long-term debt  | 1,448                              | 2,307           | 4,201                             | 7,717           |
| Interest – other  | 193                                | 532             | 563                               | 1,573           |
| Equity in income of investee  | (143)                              | (94)            | (254)                             | (195)           |
| Gain on sale of income producing property                               | –                                  | (9,792)         | –                                 | (9,792)         |
| Gain on sale of land held for resale                                    | –                                  | 2               | –                                 | (153)           |
|   | <u>1,498</u>                       | <u>(7,045)</u>  | <u>4,510</u>                      | <u>(850)</u>    |
| <b>Income (loss) before income tax and<br/>non-controlling interest</b> | <b>896</b>                         | <b>10,592</b>   | <b>(1,265)</b>                    | <b>5,107</b>    |
| <b>Income tax expense / (recovery):</b>                                 |                                    |                 |                                   |                 |
| Current   | 21                                 | 50              | 63                                | 161             |
| Future  | 104                                | 1,066           | (221)                             | 279             |
|   | <u>125</u>                         | <u>1,116</u>    | <u>(158)</u>                      | <u>440</u>      |
| <b>Income (loss) before non-controlling interest</b>                    | <b>771</b>                         | <b>9,476</b>    | <b>(1,107)</b>                    | <b>4,667</b>    |
| <b>Non-controlling interest</b>   | <b>(80)</b>                        | <b>(184)</b>    | <b>(486)</b>                      | <b>(928)</b>    |
| <b>Net income (loss)</b>  | <b>\$ 851</b>                      | <b>\$ 9,660</b> | <b>\$ (621)</b>                   | <b>\$ 5,595</b> |
| <b>Earnings (loss) per share, basic and fully diluted</b>               | <b>\$ 0.01</b>                     | <b>\$ 0.09</b>  | <b>\$ (0.01)</b>                  | <b>\$ 0.05</b>  |

Per share information (note 3)

See accompanying notes to consolidated financial statements

# ALLIED HOTEL PROPERTIES INC.

## Unaudited Consolidated Statements of Cash Flows

Expressed in thousands of dollars

|  | Three months ended<br>September 30 |          | Nine months ended<br>September 30 |          |
|--|------------------------------------|----------|-----------------------------------|----------|
|  | 2002                               | 2001     | 2002                              | 2001     |
| Cash provided by (used in):                              |                                    |          |                                   |          |
| Operations:  |                                    |          |                                   |          |
| Net income (loss)  | \$ 851                             | \$ 9,660 | \$ (621)                          | \$ 5,595 |
| Adjustments for:   |                                    |          |                                   |          |
| Depreciation and amortization                            | 879                                | 1,417    | 2,578                             | 4,230    |
| Future income tax  | 104                                | 1,066    | (221)                             | 279      |
| Non-controlling interest                                 | (80)                               | (184)    | (486)                             | (928)    |
| Equity in income of investee                             | (143)                              | (94)     | (254)                             | (195)    |
| Gain on sale of income producing property                | –                                  | (9,792)  | –                                 | (9,792)  |
| Gain on sale of land held for resale                     | –                                  | 2        | –                                 | (153)    |
| Amortization of deferred revenue                         | (44)                               | (55)     | (318)                             | (203)    |
| Funds from operations                                    | 1,567                              | 2,020    | 678                               | (1,167)  |
| Changes in non-cash operating working capital (note 4)   | (1,966)                            | (2,338)  | (2,577)                           | (1,587)  |
|  | (399)                              | (318)    | (1,899)                           | (2,754)  |
| Financing:   |                                    |          |                                   |          |
| Proceeds from long-term debt                             | –                                  | –        | –                                 | 10,000   |
| Principal repayments on long-term debt                   | (923)                              | (3,825)  | (2,816)                           | (23,726) |
| Due to affiliated companies                              | –                                  | (2,333)  | 72                                | (2,024)  |
| Deferred revenue   | –                                  | 623      | –                                 | 623      |
| Payments received from non-controlling interest          | 250                                | –        | 250                               | 233      |
| Repayment of obligations under capital leases            | (85)                               | (125)    | (273)                             | (370)    |
|  | (758)                              | (5,660)  | (2,767)                           | (15,264) |
| Investments:   |                                    |          |                                   |          |
| Additions to income-producing properties                 | (198)                              | (189)    | (740)                             | (534)    |
| Net proceeds from income producing property              | –                                  | 6,605    | –                                 | 6,605    |
| Net proceeds from sale of land held for resale           | –                                  | (2)      | –                                 | 11,479   |
| Deposits received  | 1,309                              | –        | 2,889                             | –        |
| Deferred costs   | –                                  | (36)     | –                                 | (339)    |
|  | 1,111                              | 6,378    | 2,149                             | 17,211   |
| Cash in investment now accounted for using equity method | –                                  | (152)    | –                                 | (152)    |
| Increase (decrease) in cash and cash equivalents         | (46)                               | 248      | (2,517)                           | (959)    |
| Cash and cash equivalents, beginning of period           | (2,292)                            | 2,431    | 179                               | 3,638    |
| Cash and cash equivalents, end of period                 | \$ (2,338)                         | \$ 2,679 | \$ (2,338)                        | \$ 2,679 |

See accompanying notes to consolidated financial statements

Cash and cash equivalents are defined as cash less bank indebtedness

Supplemental information (note 4)

# ALLIED HOTEL PROPERTIES INC.

Notes to Unaudited Consolidated Financial Statements  
Three and nine months ended September 30, 2002 and 2001  
(in thousands of dollars, except per share amounts)

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## 1. Significant accounting policies

### a. General

The Company's accounting policies are in accordance with Canadian generally accepted accounting principles ("GAAP") and are substantially in accordance with the recommendations of the Canadian Institute of Public and Private Real Estate Companies.

The Company's standards of financial disclosure in these interim financial statements are in accordance with the recommendations in the Canadian Institute of Chartered Accountants' ("CICA") standard on Interim Financial Statements. Certain note disclosures do not fully conform to Canadian GAAP disclosure requirements for annual financial statements, and these financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2001 (the "Annual Financial Statements"). These interim financial statements follow the same accounting policies as the Annual Financial Statements, except as described in Note 2.

### b. Cyclical business

The nature of the hotel business is inherently cyclical such that, in prior years, approximately 60% of the Company's annual revenues were generated in the second and third quarters of the year. With a significant investment in income producing properties, the Company has high fixed costs, particularly for depreciation and interest expense. As a result, the first and fourth quarters have historically recorded lower net operating income than the second and third quarters. These seasonal factors should be considered when reviewing the Company's quarterly operating results.

## 2. Change of accounting policy:

### a. Long-term debt

In the first quarter of 2002, the Company adopted the recommendations of the CICA's Emerging Issues Committee Abstract of Issue Discussed entitled "Balance sheet classification of callable debt obligations and debt obligations expected to be refinanced" ("EIC-122"). EIC-122 requires debt obligations that, by their terms, are due on demand be classified as current liabilities in the balance sheet, even though liquidation of a portion of the obligation may not be expected to occur within one year. In accordance with EIC-122, the accounting treatment has been applied prospectively, and the balance sheet as at December 31, 2001 has not been restated.

# ALLIED HOTEL PROPERTIES INC.

Notes to Unaudited Consolidated Financial Statements  
Three and nine months ended September 30, 2002 and 2001  
(in thousands of dollars, except per share amounts)

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## 2. Change of accounting policy (continued):

### *b. Stock-based compensation*

Effective January 1, 2002, the Company adopted the new recommendations of the CICA in respect of Stock-based Compensation and Other Stock-based Payments. Under this new standard, stock-based compensation awards that can be settled in cash or other assets should be valued at fair market value at the grant date of the award and treated as compensation expense in the period in which the award is granted. The Company had no stock options outstanding during the period and, consequently, the implementation of this standard had no effect on the financial statements for the periods ended September 30, 2002 or September 30, 2001.

### *c. Business combinations, goodwill, and other intangible assets*

Effective January 1, 2002, the Company adopted the provisions of Sections 1581 and 3062 of the CICA Handbook, dealing with Business Combinations and Goodwill & Other Intangible Assets, respectively ("Section 1581" and "Section 3062"). Under Section 1581, intangible assets acquired in a business combination should be identified and recognized apart from goodwill when they arise from either contractual or other legal rights or they can be separated from the acquired enterprise and sold, transferred, licensed, rented or exchanged, either individually or with a group of related assets or liabilities. Under Section 3062, goodwill and intangible assets having indefinite lives are not amortized and are tested for impairment at least annually. Intangible assets with definite lives are amortized over their estimated useful lives. The Company had no unamortized goodwill and, consequently, the implementation of the new standards had no effect on the financial statements for the periods ended September 30, 2002 or September 30, 2001.

## 3. Per share information:

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|  | 2002        | 2001        |
|--|-------------|-------------|
| Weighted average number of common shares outstanding,<br>basic and diluted | 106,327,268 | 106,327,268 |

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# ALLIED HOTEL PROPERTIES INC.

Notes to Unaudited Consolidated Financial Statements  
 Three and nine months ended September 30, 2002 and 2001  
 (in thousands of dollars, except per share amounts)

## 4. Supplementary cash flow information:

Changes in non-cash operating working capital consist of the following:

|                     | Three months ended<br>September 30 |            | Nine months ended<br>September 30 |            |
|---------------------|------------------------------------|------------|-----------------------------------|------------|
|                     | 2002                               | 2001       | 2002                              | 2001       |
| Accounts receivable | \$ (18)                            | \$ (599)   | \$ (592)                          | \$ (2,252) |
| Inventories         | 8                                  | 33         | 33                                | 121        |
| Prepaid expenses    | (234)                              | 58         | (465)                             | (118)      |
| Accounts payable    | (1,722)                            | (1,830)    | (1,553)                           | 662        |
|                     | \$ (1,966)                         | \$ (2,338) | \$ (2,577)                        | \$ (1,587) |

Supplemental disclosures related to the statements of cash flows consist of the following:

|   | Three months ended<br>September 30 |          | Nine months ended<br>September 30 |           |
|---|------------------------------------|----------|-----------------------------------|-----------|
|   | 2002                               | 2001     | 2002                              | 2001      |
| Supplemental information:                       |                                    |          |                                   |           |
| Interest paid                                   | \$ 1,814                           | \$ 3,058 | \$ 4,750                          | \$ 10,721 |
| Taxes paid                                      | –                                  | 9        | 16                                | 190       |
| Non-cash investing and financing activities     |                                    |          |                                   |           |
| Acquisition of equipment under capital lease    | 38                                 | 24       | 38                                | 202       |
| Reduction in note payable to affiliated company | –                                  | –        | –                                 | 4,250     |

## 5. Current portion of deferred revenue:

In February 2002, the owner of a two-thirds interest in the Holiday Inn Vancouver Downtown Hotel ("Holiday Inn") served notice of its intention to exercise an option to acquire the remaining one-third interest owned by the Company. The Company received a deposit from the purchaser. The Company ceased to account for its one-third share in the net income or loss of the Holiday Inn effective February 2002 as the purchaser is entitled to all revenues and is responsible for all expenses beyond such date. The gain on sale of the property has been deferred pending receipt of the balance of the purchase price and the removal of the Company as guarantor of the indebtedness on the property and has been included in current portion of deferred revenue.

**QUARTERLY REPORT**

**FORM 51-901F**

|   |          |                         |                      |                         |  |
|---|----------|-------------------------|----------------------|-------------------------|--|
| <b>ISSUER DETAILS</b><br>NAME OF ISSUER |          | FOR QUARTER ENDED       |                      | DATE OF REPORT<br>Y M D |  |
| Allied Hotel Properties Inc.            |          | September 30, 2002      |                      | 02 11 27                |  |
| ISSUER'S ADDRESS                        |          |                         |                      |                         |  |
| Suite 300 – 515 West Pender Street      |          |                         |                      |                         |  |
| CITY                                    | PROVINCE | POSTAL CODE             | ISSUER FAX NO.       | ISSUER TELEPHONE NO.    |  |
| Vancouver                               | B.C.     | V6B 6H5                 | 604-682-8131         | 604-669-5335            |  |
| CONTACT PERSON                          |          | CONTACT'S POSITION      |                      | CONTACT TELEPHONE NO.   |  |
| John R. Ellen, C.A.                     |          | Chief Financial Officer |                      | 604-682-2533<br>x 160   |  |
| CONTACT EMAIL ADDRESS                   |          |                         | WEB SITE ADDRESS     |                         |  |
| john_ellen@alliedhotels.com             |          |                         | www.alliedhotels.com |                         |  |

**CERTIFICATE**

*The three schedules required to complete this Quarterly Report are attached and the disclosure contained therein has been approved by the Board of Directors. A copy of this Quarterly Report will be provided to any shareholder who requests it.*

|                             |                  |                         |
|-----------------------------|------------------|-------------------------|
| DIRECTOR'S SIGNATURE        | PRINT FULL NAME  | DATE OF REPORT<br>Y M D |
| "Peter Y.L. Eng" (signed)   | Peter Y.L. Eng   | 02 11 27                |
| DIRECTOR'S SIGNATURE        | PRINT FULL NAME  | DATE OF REPORT<br>Y M D |
| "Ronald G. Erdman" (signed) | Ronald G. Erdman | 02 11 27                |

**SCHEDULE B  
SUPPLEMENTARY INFORMATION**

The supplementary information set out below is to be provided when not included in the Company's unaudited consolidated financial statements contained in Schedule A.

*1. For the current fiscal year-to-date and current quarter:*

Breakdown of General and Administrative Expenses  
for the periods ended September 30, 2002

|                          | Three months ended<br>September 30 |                 | Nine months ended<br>September 30 |                  |
|--------------------------|------------------------------------|-----------------|-----------------------------------|------------------|
|                          | 2 0 0 2                            | 2 0 0 1         | 2 0 0 2                           | 2 0 0 1          |
|                          | \$ ('000)                          | \$ ('000)       | \$ ('000)                         | \$ ('000)        |
| Administrative salaries  | 265                                | 306             | 848                               | 1,033            |
| Directors' fees          | 15                                 | 15              | 48                                | 45               |
| Professional fees        | 94                                 | 257             | 248                               | 580              |
| Travel and entertainment | 23                                 | 31              | 69                                | 90               |
| Capital tax              | 26                                 | 57              | 56                                | 216              |
| Charitable donations     | -                                  | -               | 5                                 | 15               |
| Hotel administration     | 1,343                              | 2,004           | 3,615                             | 6,284            |
| Maintenance              | 828                                | 1,087           | 2,214                             | 3,096            |
| Sales and advertising    | 1,149                              | 1,374           | 3,230                             | 4,003            |
| Utilities                | 524                                | 602             | 1,645                             | 2,060            |
|                          | <b>\$ 4,267</b>                    | <b>\$ 5,733</b> | <b>\$ 11,978</b>                  | <b>\$ 17,422</b> |

For the nine month period ended September 30, 2002, the aggregate amount of expenditures made to parties not at arm's length was \$127,000 (2001 - \$112,000). Of this, \$64,000 (2001 - \$45,000) relates to consulting fees paid to a company controlled by a director of the Company, and is included under professional fees above and \$63,000 (2001 - \$67,000) relates to rent paid to a company which is a minority shareholder of the Company, and is included under hotel administration, above.

For the three month period ended September 30, 2002, the aggregate amount of expenditures made to parties not at arm's length was \$50,000 (2001 - \$44,000). Of this, \$34,000 (2001 - \$15,000) relates to consulting fees paid to a company controlled by a director of the Company, and is included under professional fees above and \$16,000 (2001 - \$29,000) relates to rent paid to a company which is a minority shareholder of the Company, and is included under hotel administration, above.

*2. For the quarter under review:*

**a) Summary of securities issued during the quarter:**

There were no securities issued during the quarter.

**b) Summary of options granted during the quarter:**

There were no options granted during the quarter.

**SCHEDULE B**  
**SUPPLEMENTARY INFORMATION (CONT'D)**

3. *As at the end of the quarter:*

**a) Particulars of authorized capital and summary of shares issued and outstanding:**

|                         |   |
|-------------------------|---|
| Authorized:             | Unlimited number of common shares without par value |
| Issued and outstanding: | 106,327,268   |

**b) Summary of options, warrants and convertible securities outstanding:**

i. OPTIONS:

No options were outstanding at the end of the quarter.

ii. WARRANTS AND CONVERTIBLE SECURITIES:

No warrants or convertible securities were outstanding at the end of the quarter.

**c) Total number of shares in escrow or subject to a pooling agreement:**

No shares were held in escrow or subject to pooling agreement at the end of the quarter.

**d) List of directors and officers:**

Directors:

Senator Jack Austin  
Anthony Eng  
Peter Eng  
Ronald G. Erdman  
Dato' Ng Eng Tee  
Tuan Syed Abu Bakar Bin Syed Mohsin Almohdzar  
Andrew E. Saxton  
Edward Woo

Officers:

President and Chief Executive Officer – Ronald G. Erdman  
Vice-president and Chief Financial Officer – John R. Ellen  
Vice-president, Corporate Development and Secretary – Michael Chan  
Vice-president, Development & Portfolio Strategy – Sam Ng  
Vice-president, Hotel Operations – Nash Rajan

## SCHEDULE C

### MANAGEMENT'S DISCUSSION AND ANALYSIS

#### BASIS OF PRESENTATION

The following discussion and analysis should be read in conjunction with the consolidated financial statements of the Company for the three and nine months ended September 30, 2002 and 2001 and the notes pertaining thereto.

#### RESULTS OF OPERATIONS

Operating revenues decreased to \$40.5 million for the nine months to September 30, 2002 from \$57.6 million for the nine months to September 30, 2001. For the three months then ended, revenues decreased from \$21.9 million to \$15.7 million. As stated in the first and second quarter MD&A, the main cause for the decrease was the sale of two properties during 2001, the results of which were included in the first nine months last year.

Comparing revenues only from properties owned in both periods shows a decline of \$2.1 million, or 7.5%, in room revenues for the nine months ended September 30<sup>th</sup>, from \$27.4 million to \$25.3 million. Occupancy for the nine months, at 60.9%, was behind 2001 levels of 61.8%. RevPAR (revenue per available room) across the portfolio fell by \$5.33. While some properties have maintained or even increased RevPAR compared to 2001, the Company's property in Richmond, B.C. has suffered a decline of over \$12 in RevPAR. The Company is reviewing a number of options to improve occupancy and average rate at this hotel. However, under the terms of the management contract for the Richmond property, certain companies and individuals have guaranteed a certain minimum level of net operating income at the hotel level, to be calculated and paid after the year-end. For the three months ended September 30<sup>th</sup>, occupancy increased by 2.0% while RevPar fell by \$5.47, resulting in a decline in room revenue for the quarter of \$0.7 million.

Selling, general and administrative expenses ("SG&A") decreased from \$17.4 million to \$12.0 million for the nine month periods ended September 30<sup>th</sup>. SG&A expense for 2002 represents 29.6% of revenues, down from 30.3% in 2001. SG&A from properties owned in both periods was \$13.6 million in 2001, representing 32.0% of revenues. The 2002 reduction is the result of cost controls put in place following the events of September 11<sup>th</sup>. Other major operating expenses included property taxes and insurance of \$2.6 million (2001 - \$3.7 million) and depreciation and amortization of \$2.6 million (2001 - \$4.2 million). For properties held in both periods, property taxes and insurance expense was \$2.8 million in 2001. The net saving of \$0.2 million in 2002 reflects a combination of significant increases in insurance premiums for all policies renewed during the year, coupled with reductions in property tax expense at several properties as a result of successful appeals.

Earnings before interest, tax, depreciation and amortization ("EBITDA") for the nine months ended September 30, 2002 of \$5.8 million decreased by 31% or \$2.7 million over 2001. EBITDA for the third quarter was \$3.3 million, down 34% from \$5.0 million for the third quarter of 2001. The fall in EBITDA for the nine and three month periods was primarily attributable to lower average rates at the hotel properties held in 2002, with the hotels sold during 2001 recording higher gross margins than the remaining properties. For properties held in both 2001 and 2002, EBITDA for the nine months ended September 30, 2002 increased by \$0.8 million over the same period in the prior year.

Interest on long-term debt decreased 45% or \$3.5 million in the nine months ended September 30, 2002. This decrease reflects lower borrowing rates for the Company's floating-rate debt, combined with a net repayment of \$53.9 million in long-term debt outstanding since the beginning of 2001.

The sale of a two-thirds interest in the Holiday Inn Vancouver Downtown Hotel ("Holiday Inn") in the third quarter of 2001 resulted in a gain of \$9.8 million in the quarter, contributing significantly to the income for the nine months ended September 30, 2001 before non-controlling interest and income tax of

\$5.1 million. For the nine months ended September 30, 2002 the Company recorded a loss before non-controlling interest and income tax of \$1.3 million. In the three months ended September 30, 2002, the Company recorded income of \$0.9 million before non-controlling interest and income tax, compared to income of \$0.8 million for the third quarter of 2001 (excluding the gain on sale of \$9.8 million).

## **FINANCIAL POSITION**

### **Income-Producing Properties**

The net book value of income-producing properties at September 30, 2002 was \$116.3 million, compared to \$118.1 million at December 31, 2001. This net decrease represents additions during the year of \$0.7 million, less depreciation of \$2.5 million.

The acquisition of the Company's initial hotel portfolio was, for accounting purposes, treated as a related party transaction. Canadian generally accepted accounting principles require that the properties acquired be reflected in the balance sheet at the book value of the seller. In certain instances this is significantly less than management's estimate of the fair market value of the property.

### **Working Capital**

The Company had a net working capital deficiency (excluding the effects of reclassifying long-term debt as a current liability) at the end of the quarter of \$13.9 million, an improvement from \$14.7 million at the start of the quarter. Accounts payable decreased by \$1.5 million from \$12.7 million as at December 31, 2001 to \$11.2 million at September 30, 2002, while accounts receivable increased by \$0.6 million over the same period. In the hospitality industry it is common practice for customers to pay by credit card whereas operating supplies are purchased on credit and are more frequently carried on account, resulting in higher accounts payable than accounts receivable balances at month end. Included in current liabilities is deferred revenue of \$4.3 million relating to the unrealised gain on sale of the Company's remaining one-third interest in the Holiday Inn.

### **Debt**

Total current and long-term debt decreased by \$2.8 million, from \$100.2 million at December 31, 2001 to \$97.4 million at September 30, 2002. This represents a significant reduction from the position two years ago, when the Company had long-term debt of \$150.4 million (with an additional \$11.4 million due to a major shareholder).

Approximately 65% of the company's long-term debt bears interest at floating rates, based on the bank prime lending rate. While current rates are marginally lower than at this time last year, rates have increased from the historically low rates seen in the first quarter. The Company regularly reviews this exposure to fluctuating interest rates, and believes that it continues to be in the Company's interest to finance a significant portion of its long-term debt through floating rate loans.

The Company has unconditionally guaranteed the indebtedness of the Delta Vancouver Airport hotel, to a maximum amount of \$3.5 million, in proportion to its 26.67% interest in this property.

The Company has unconditionally guaranteed the indebtedness of the Holiday Inn. At September 30, 2002, the indebtedness of the Holiday Inn amounted to \$15.2 million (December 31, 2001 - \$15.7 million).

## Liquidity and Capital Resources

The Company's cash flows for 2002 and 2001 are summarized as follows:

|  | 2002                   | 2001     | Change   |
|--|------------------------|----------|----------|
|  | (thousands of dollars) |          |          |
| Cash flow used for operations              | (1,900)                | (2,754)  | 854      |
| Cash flow used for financing activities    | (2,767)                | (15,264) | 12,497   |
| Cash flow provided by investing activities | 2,149                  | 17,211   | (15,062) |
| Cash of properties sold during the year    | -                      | (152)    | 152      |
| Decrease in cash                           | (2,518)                | (959)    | (1,559)  |

In the normal course of business the Company has capital requirements to repay the principal portion of debt and to finance capital expenditures in its hotel properties. In the long term these requirements must be funded from operations or new capital such as equity or increased borrowings. In 2002, operations absorbed \$1.9 million of cash whilst \$2.9 million was provided from deposits related to the sale of assets.

Approximately \$21 million of long-term debt matures in the second quarter of 2003. The Company is actively seeking alternative financing sources for this debt, which is secured against one of its hotel properties. Approximately \$65 million of the Company's long-term debt matures in the third quarter 2003 and the Company intends to refinance this debt with existing lenders.

As of September 30, 2002 the Company did not have any off-balance sheet financing or special purpose entities which were not fully consolidated into the financial statements. Several hotel properties have entered into capital leases to purchase equipment, and the liability attached to the leases is disclosed in these financial statements.

## RISK MANAGEMENT

The Company faces several areas of risk. These are summarized below, along with management's approach to mitigating these risks.

### Hospitality Industry

The Company's hotel properties are subject to the normal operating risks common to the hotel industry, including seasonal and cyclical business fluctuations.

Approximately 60% of the Company's annual revenues are generated in the second and third quarters. Management of the individual hotel properties are aware of the seasonal nature of their own markets, and sales initiatives are planned to offset times of low demand as required. These seasonal factors should be considered when reviewing the Company's quarterly operating results.

The hotel industry has, historically, been subject to significant economic cycles. Industry reports indicate that the hotel industry in Canada is operating in a weak economic environment, although performance indicators suggest a recovery is underway. A stronger market should allow for continued improvements in the occupancy levels and average room rates at the Company's properties. Economic risk can be further mitigated by limiting reliance on one particular market, a policy actively pursued by management during the prior year through the divestment of interests in two of its five properties in the Greater Vancouver area.

### Interest Rate Risk

Interest rate volatility in the marketplace cannot be predicted with certainty. At December 31, 2000, 75% of the Company's long-term debt was charged interest at rates based on the bank's prime rate, which may be subject to change at short notice. By September 30, 2002 this exposure had been reduced to 65%

through the repayment of floating rate loans on sale of assets, and the refinancing of a facility from floating to fixed rate. Increases in the bank's prime rate would have a negative impact on the Company's future operating results by virtue of higher interest expense. The Company generally has the right to convert floating rate debt to fixed rate debt at its option, which helps mitigate the impact of prospective increases in the bank's prime rate.

### **Labour Risk**

As at September 30, 2002, the Company employed approximately 790 full and part-time employees at its properties. Approximately 79% of the Company's employees are represented by labour unions. Labour relations with these unions are governed by four collective agreements which expire at various times between December 31, 2002 and May 31, 2006.

There can be no assurance that the Company will not experience job action including strikes and / or labour stoppages, or any other type of conflict with unions and employees, which could have a material adverse effect on the Company's business, operating results and financial condition.

The Company believes its labour relations are good and management does not anticipate any events which may significantly impact the day-to-day operations of its hotel properties.

### **Environmental Risk**

Under various federal and provincial laws and regulations, a current or previous owner of real property may be held liable for the costs of removal or remediation of certain hazardous or toxic substances that could be located on, in or under such property. Such laws and regulations may impose liability whether or not the owner knew of, or was responsible for, the presence of the hazardous or toxic substances. The costs of any required remediation or removal of these substances could be material and the liability of an owner as to any property is generally not limited under such laws and regulations and could exceed the property's value and the aggregate assets of the owner.

The presence of hazardous or toxic substances, or the failure to remediate such substances properly, may also adversely affect the owner's ability to sell the property, or to borrow using the property as collateral. In connection with the ownership and operation of its properties the Company could be liable for these remediation costs, as well as other costs such as governmental fines or compensation for personal injury. As a result, the presence, with or without the Company's knowledge, of hazardous or toxic substances at any property owned by the Company could have an adverse effect on the Company's business, operating results and financial condition.

The Company conducts Phase I environmental assessments and, where indicated, Phase II environmental assessments on any property it is considering acquiring prior to acquisition. The results of these assessments have disclosed no material remediation or other expenditure requirements. Minor mitigation and remediation measures have been performed. The assessments did disclose the presence of asbestos at three properties acquired by the Company. The reports concluded that no remedial action would be required unless renovations were undertaken that would disturb the asbestos. The Company has no plans to renovate the relevant properties at present, and if any renovations are made they will be conducted in compliance with applicable environmental regulations.

### **Investor Relations**

There were no investor relations activities undertaken on behalf of the Company in the quarter.