CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

CPA Common Final Examination

BOARD OF EXAMINERS' REPORT

PART B — The Day 1 Report

September 2020, May 2021 and September 2021 Examinations

CPA EVALUATIONS

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See Part A for full report on the Sept 2021 Day 2 and Day 3 simulations and marking guides.

THE BOARD OF EXAMINERS' REPORT ON THE SEPTEMBER 2021 COMMON FINAL EXAMINATION

OBJECTIVES OF THE REPORT

The objective of this report is to explain the Common Final Examination (CFE) process and to assist the profession in improving the performance of candidates on the CFE.

The report sets out the responsibilities of the Board of Examiners, the methods used for guide setting and marking the CFE, and the results of the marking process. The report also includes recommendations to candidates from the Board of Examiners.

The September 2021 CFE Report is presented in two parts: Part A is the Day 2 and Day 3 report and Part B is the Day 1 report.

The appendices provide more detailed information on the design, guide setting, and marking of the CFE, as well as the board's expectations of candidates on the simulations. Readers are cautioned that the marking guides were developed for the entry-level candidate and that, therefore, all the complexities of a real-life situation may not be fully reflected in the content. The CFE report is not an authoritative source of GAAP.

RESPONSIBILITIES OF THE BOARD OF EXAMINERS

The Board of Examiners (BOE or the board) comprises a chair, two vice-chairs, and sixteen members appointed by the provincial bodies.

The board's responsibilities, as set out in its terms of reference, include the following:

- Setting the CFE in accordance with the *CPA Competency Map* (the *Map*) and other directions from the Professional Education Management Committee;
- Submitting the CFE and the marking guides to the provincial bodies for review;
- Marking the candidates' responses and recommending to the provincial bodies the pass or fail standing that should be given to each candidate; and
- Reporting annually on the CFE to various CPA committees and the provincial bodies, in such form and detail and at such time as is satisfactory to them.

The chair is responsible for the supervision of the evaluation process. A CFE subcommittee, made up of nine members of the board, is actively involved in the preparation of the CFE simulations, the preliminary marking guides, and the setting of the initial passing profile. The members of that subcommittee participate in the Preliminary Evaluation Centre where the marking guides are tested against candidate responses and finalized, and in the start-up of the marking centre. The BOE chair and vice-chair provide oversight throughout the entire marking process, consulting with subcommittee members as required. The full board is responsible for equating the difficulty of the examination to prior years' examinations and establishing the passing standard.

THE CFE

Preparation and Structure of the CFE

The board staff works in conjunction with authors to ensure that simulations presented to the board achieve the overall intent and design objectives set by the board, while adhering to the competencies and the proficiency levels specified in the *Map*.

The full board provides guidance as to the content and nature of simulations to be included on the examination. The CFE subcommittee reviews and refines these simulations that make up the three-paper evaluation set.

Nature of the Simulations

The CFE comprises a set of simulations that are both essential and effective in evaluating the candidates' readiness to enter the profession:

Day 1 – The first paper is a four-hour examination consisting of a single simulation that is linked to the Capstone 1 group case. There are two versions of the linked cases. Version 1 is linked to the most current Capstone case and is written by first time writers and by repeat writers who chose to attempt the new case rather than Version 2 of the previous Capstone case. Version 2 is written by repeat writers and candidates who deferred and are writing Version 2 as their first attempt. The two versions of the exams are calibrated to ensure the difficulty of both is comparable.

As a result of Covid-19, there have been adjustments made, that have resulted in a version 3 of some Capstone cases.

Day 2 – The second paper is a five-hour case, with four different roles and requirements. Additional information tailored to each role is provided in four separate appendices.

Day 3 – The third paper, is a four-hour paper, consisting of three multi-competency area simulations.

Assessment Opportunities

The board applies competency-based marking procedures that enable it to decide which candidates demonstrate readiness to enter the profession.

Assessment Opportunities are designed to answer the question, "What would a competent CPA do in these circumstances?" To attain a pass standing, candidates must address the issues in the simulations that are considered significant.

Appendix A contains a comprehensive description of the evaluation process.

Marking Guides

Marking centre leaders and assistant leaders provide valuable input during the testing and setting of the marking guides, before live marking begins. The vice-chair, selected member(s) of the CFE subcommittee and senior evaluations staff hold meetings with the leaders and their assistants during both the guide-setting and the marking processes. See **Appendices B to H** for the DHC Day 1 simulations and related capstone case, DHC marking guides, and DHC sample responses. **Appendix I** contains the marking results by assessment opportunity, and **Appendix J** contains the BOE comments. A copy of the Day 1 V2 (WDI), Day 2 and Day 3 simulations can be found in **Part A** of the CFE Report.

Day 1 – The marking guide is designed to assess the candidate on the stages of the CPA Way: 1) situational analysis; 2) analysis of the major issues; 3) conclusions and advice; and 4) communication. Based on these four summative assessments, the candidate's response is then holistically judged to be either a passing or a failing response.

Day 2 and Day 3 – Marking guides are prepared for each simulation. Besides identifying the Assessment Opportunities, each marking guide includes carefully defined levels of performance to assist markers in evaluating a candidate's competence relative to the expectations set out by the board when developing the passing profile for a competent CPA.

Five categories of performance are given for each Assessment Opportunity. The candidate's performance must be ranked in one of the five categories:

- Not Addressed
- Nominal Competence
- Reaching Competence
- Competent
- Competent with Distinction

Setting the Passing Standard

The board chair and vice-chair in charge of the examination monitor the live marking. Near the completion of the marking process, the CFE subcommittee satisfies itself that the markers applied the marking guides as intended by the board.

In determining which candidates pass the CFE, a candidate is judged in relation to the board's pre-established expectations of an entry-level chartered professional accountant. Any changes to the initial profile that were made throughout guide-setting and the marking centre are ratified by the full board. In setting the passing profile, the board considers the following:

- The competency area requirements described in the *Map*
- The level of difficulty of each simulation (set using a scale: Easy, Easy to Average, Average, Average to Hard, or Hard)
- The level of difficulty of each Assessment Opportunity (set using a scale: Easy, Easy to Average, Average, Average to Hard, or Hard)
- The design and application of the marking guides
- Comments from leaders and assistant leaders regarding any marking difficulties encountered or any time constraints noted
- Possible ambiguity of wording or of translation
- Input on critical decision factors from an independent board (i.e., those BOE members not on the CFE subcommittee and therefore not directly involved) who review the fair pass package

The Decision Model

The purpose of the CFE is to assess whether candidates possess the competencies required of an entry-level CPA through a written evaluation that is common to all CPAs. Each day of the CFE is unique and is designed specifically to assess different skills:

- Day 1 is linked to the Capstone 1 group case work. It assesses the candidates' ability to demonstrate professional skills. It is independent from Day 2 and Day 3.

- Day 2 is the **depth** test. It assesses technical **depth** in one of four unique roles (that reflect the four CPA elective choices) and provides **depth** opportunities in the common core competency areas of Financial Reporting and/or Management Accounting. Candidates pre-select one role and respond from that role's perspective.

- Day 3 supplements the **depth** test in the common core areas of Financial Reporting or Management Accounting. It is also the **breadth** test for all common core competency areas.

Candidates must pass all three days in order to qualify for entry to the profession. Those seeking licensure must obtain depth in Financial Reporting and in the Assurance Role.

Day 1

Day 1 is assessed independently from Day 2 and Day 3. A pass or fail decision is made based on a holistic assessment of the candidates' performance in applying the CPA Way to demonstrate essential professional skills.

Day 2 and Day 3

The decision model used by the board is presented in Exhibit I. Four key decision points, or levels, are applied in reaching a pass or fail decision, as follows:

1. The response must be **sufficient**; i.e., the candidate must demonstrate competence in the Assessment Opportunities presented on Day 2 and Day 3 (Level 1).

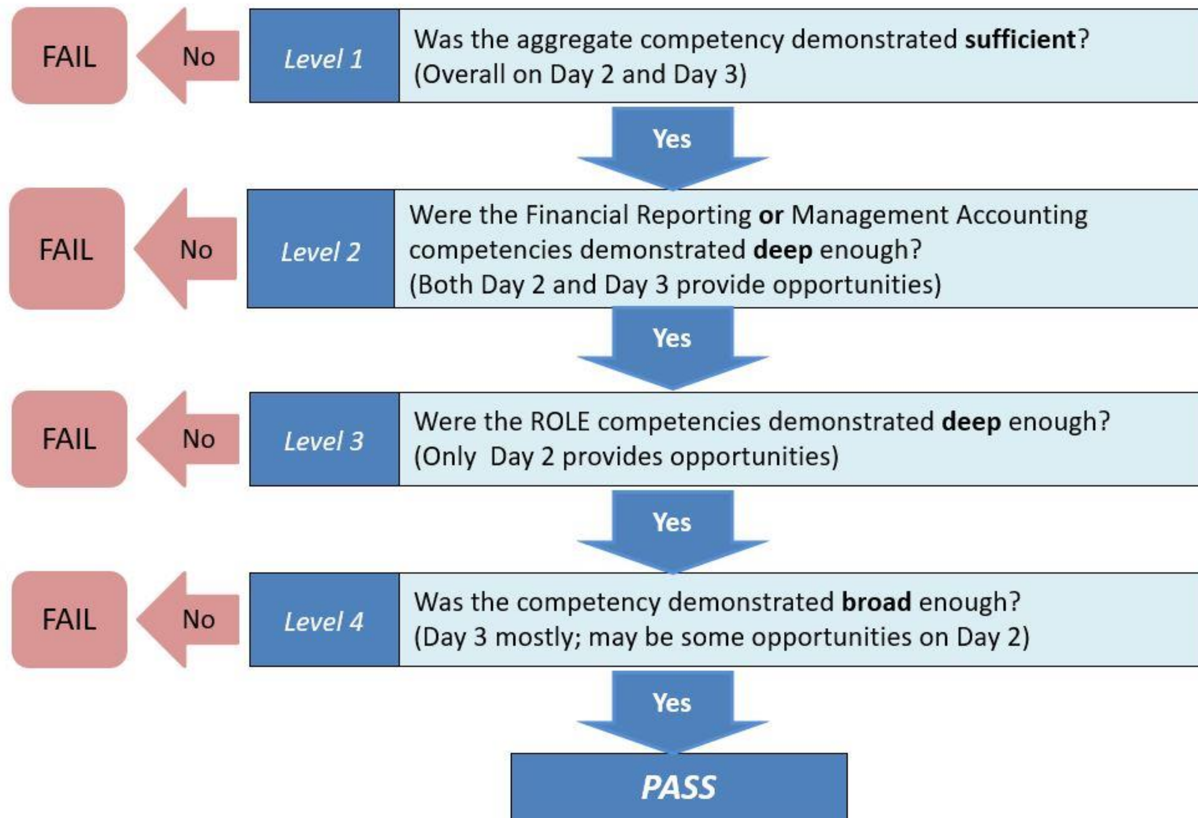
2. The response must demonstrate **depth** in the common core area of Financial Reporting or Management Accounting (Level 2).

3. The response must demonstrate **depth** in the pre-selected elective role (Level 3).

4. The response must demonstrate **breadth** across all competency areas of the *Map*, at a core level, by not having avoided a particular technical competency area (Level 4).

The BOE is responsible for equating the results from one examination to another to ensure that candidates have an equal chance of passing whichever examination they write. The BOE uses the factors listed above under setting the passing standard, in order to equate the examinations.

EXHIBIT I
DAY 2 AND 3 PASS/FAIL ASSESSMENT MODEL



Approving the Results

The CFE subcommittee reviews and approves the marking results for each simulation. Day 1 is assessed separately from Day 2 and Day 3.

Day 1 – The CFE subcommittee discusses the profiles for both the marginally passing and marginally failing candidates to confirm that the board's pre-established passing profile has been appropriately applied by the markers.

Day 2 and Day 3 – As part of the development process, the CFE subcommittee sets preliminary requirements for the three levels (tests of depth and breadth) being assessed on the Day 2 and Day 3 simulations. After the marking is completed, the board reviews and finalizes those requirements. The board establishes the Level 1 (sufficiency) requirement for the combined Day 2 and Day 3 simulations.

During the approval process, the board continues to consider whether the results could be affected by any inconsistency in the evaluation or the board's processes.

Reporting

In reaching its decision, the board determines which candidates pass on a national basis only, without regard to provincial origin or language. Similarly, the detailed comments are based on analyses of the performance of all candidates.

The board reports the following information by candidate number:

- Overall pass/fail standing and pass/fail standing for each of Day 1 and of Day 2 and Day 3 combined.
- A pass/fail standing for Day 1.
- A pass/fail standing for Level 1, Sufficiency. A decile ranking is provided for failing candidates.
- A pass/fail standing for Level 2, Depth in Financial Reporting or Management Accounting.
- A pass/fail standing for Level 3, Depth in Role.
- A pass/fail standing for Level 4, Breadth in all technical competency areas.

Thank You

All board members wish to express their warm and sincere appreciation for the outstanding energy, support, and commitment of the Board of Examiners staff members whose dedication and talent contributed in large measure to the achievement of our objectives and the fulfilment of our responsibilities.

We also wish to acknowledge the contributions made by the provincial reviewers, markers, authors, translators, and editors. The commitment, energy, and skill demonstrated by all the markers were outstanding, resulting in the sound application of marking procedures and producing an appropriate evaluation of the candidates. Everyone’s commitment to the quality and fairness of the process is appreciated.

Jordan Oakley, CPA, CA
Chair
Board of Examiners

A MESSAGE TO CANDIDATES

To attain a pass standing, candidates needed to achieve a "Pass" on Day 1, and on Day 2 and Day 3 combined, demonstrate sufficient competence in all areas and meet the two depth standards and the breadth standards.

Introduction

The September 2021 CFE Report, Part A and Part B combined, presents detailed information on all candidates' performance for all the examination cases, except for the Day 1 linked case, WDI Version 2. Detailed commentary on the performance of candidates on the WDI cases (Version 1 to Version 3) will only be available after WDI Version 3 is written in September 2022.[1] The simulations, marking guides, marking results, and Board of Examiners' (BOE) comments on the Day 2/Day 3 portion of the examination are found in Part A of the CFE Report. Similar information on Day 1 DHC simulations (Version 1 to Version 3) can be found in Part B of the CFE Report.

The intent of this message from the BOE is to help candidates improve their performance on future CFEs by drawing their attention to the most common detracting characteristics observed in candidate responses to the September 2021 CFE. The BOE's comments are based on the feedback of the marking teams, who see the entire candidate population, and reflect the broad themes noted by the markers that apply to all candidates who wrote this sitting of the CFE. More detailed AO-by-AO commentary on candidates' performance can be found in the BOE's comments in Appendix F of Part A, or Appendix J of Part B, of the CFE Report.

Nature of the CFE

The design of the CFE is such that each day of the examination allows candidates to demonstrate a different skill set. Day 1 allows candidates to demonstrate their high-level professional skills, such as analysis that is relevant and critical to strategic decision-making, professional judgment, and ability to synthesize. Day 2 allows candidates to demonstrate their technical competence in the common Financial Reporting and Management Accounting competencies and in their chosen role, which is tied to one of the four elective areas. Day 2 typically, but not always, directs candidates to the work to be done and is not designed to be time constrained, allowing candidates to demonstrate depth. Day 3 allows candidates to demonstrate depth in the common Financial Reporting and Management Accounting competencies and provides multiple opportunities to demonstrate breadth in all the core technical competency areas. Day 3 is typically time constrained, requiring candidates to prioritize the issues and manage the amount of time spent on each issue. Both Day 2 and Day 3 require candidates to integrate the information found in the simulation in order to demonstrate competence. All three days require candidates to clearly communicate their thought process.

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[1] The profession will offer Version 3 of WDI on the September 2022 CFE.

Strengths and Weaknesses

There were two noticeable areas of improvement on the September 2021 CFE. The first was better time management on the part of candidates. The second was fewer unrelated discussions. However, overall, the BOE observed some of the same patterns in the responses as seen in candidates' performance on recent CFEs, and has therefore highlighted these areas of overall weakness.

Time Management

None of the exam days on the September 2021 CFE was time constrained, although Day 3 required time management on the part of candidates to ensure all three simulations were completed within the four hours allowed. Candidates generally managed their time well, which allowed them to attempt the majority, if not all, of the AOs. The BOE was pleased to see evidence of candidates consciously and deliberately managing their time. Markers observed that the discussion for one required would often end abruptly, and another would begin, suggesting the candidate had spent their budgeted time on that AO and moved on to the next required, to ensure that, overall, they addressed all the requireds. This was observed on Day 2, between the common AOs and the role AOs, and on Day 3, between simulations. Overall, on Day 2 and Day 3, only a few candidates mismanaged their time, and these were generally the weaker candidates who either spent too much time in their quantitative analyses or had difficulty identifying the relevant issues. Day 2 Common noted that the last AO (AO#6 – Operational plan) and Day 2 Finance noted that the last AO (AO#13 – Logistics proposal) had higher percentages of Not Addressed compared to other AOs, but they were not significant percentages. These AOs were considered difficult, and it appears that some candidates simply were not sure how to address them, rather than not addressing them due to mismanagement of time.

For both Day 1 simulations, generally, the amount of time candidates devoted to their situational analysis and their issue analysis was well balanced. However, not all candidates addressed the underlying strategic issues. This was not due to time constraint, but rather a failure to do the necessary step-back to see the broader issues (see later discussion).

Candidates are reminded that the CFE has a minimum sufficiency score that must be obtained, separate from the requirements that are set for the depth and breadth tests. The BOE continues to encourage candidates to take time to identify the relevant issues and attempt a discussion of all the requireds, since their sufficiency score is affected by AOs they do not attempt. The Board also encourages candidates to continue to use the suggested times on each simulation as a guide to help manage the time spent per AO.

Unrelated Discussions

Although done much less frequently on the September 2021 CFE, some candidates inserted discussions that were not relevant, because of either misinterpreting or misreading the requireds or neglecting to consider the specifics presented in the simulation. This often appeared to be the result of applying a templated approach and failing to consider the differences in the facts presented compared to similar issues tested on past exams. Candidates appeared to be trying to fit the answers from their practice exams into the current year's exam, rather than addressing the case facts as presented. The following are some examples of where candidates either misinterpreted the requireds or provided irrelevant discussions:

On Day 3, Simulation 1, AO#2 (Management Accounting – New revenue model – qualitative), some candidates brought in irrelevant points, such as whether the contractors would be considered employees. These discussions were not relevant to the overall analysis, since there was nothing in the case to suggest this was a pertinent issue.

On Day 3, Simulation 1, AO#7 (Strategy and Governance – U.S. expansion), some candidates defaulted to providing management advice. For example, many explained that it would be harder for the Moons to manage an operation in the U.S., given the geographical distance. Others were concerned that foreign exchange would make the accounting more difficult. These discussions did not address whether the expansion met FenceCo's strategic objectives, which is what the required asked candidates to address.

On Day 3, Simulation 3, AO#1 (Financial Reporting – PP&E accounting Issues (IFRS)), there were a multitude of issues to contend with related to the scooters and bikes. Many candidates focused on the wrong issues, believing the discussion revolved around whether the scooters were inventory or capital assets or whether the bikes and scooters met the definition of a capital asset. There was no information in the simulation to suggest these were relevant issues. A few candidates also addressed potential foreign exchange accounting issues, having noted that there was a U.S. supplier; however, there was no accounting issue related to foreign exchange, since there were no case facts to indicate that the accounting treatment was incorrect. Foreign exchange was tested on recent CFEs, though, and candidates appear to have been searching for similar issues.

The BOE reminds candidates that while it is good to practise writing cases and know different approaches to use, they should not automatically assume the task is the same as in previous years. The facts presented are unique to each case and require integration of the pertinent case facts to fully understand what the relevant issues are for a particular case and to decide what form of analysis is appropriate. Rarely is an issue identical to a prior one. Candidates are encouraged to pause and take the time necessary to ensure they have clearly identified what issues and analyses are most relevant, based on the set of circumstances presented, before beginning their response.

Technical Ability

Generally, there were fewer unusual and complex AOs for candidates to contend with on Day 2 and Day 3 than on the September 2020 and September 2019 CFEs. Therefore, unlike on recent CFEs, where some candidates avoided the harder and more complex AOs entirely, candidates generally attempted all the AOs. As has been the pattern for the past few CFEs, candidates generally performed better on the straightforward and commonly tested issues presented throughout Day 2 and Day 3, although that was not always the case, as noted below. Candidates also appeared to perform better compared to recent CFEs on the quantitative AOs, generally showing a better application of the fundamentals, like break-even analysis, WACC, NPVs, and taxable income calculations.

Candidates generally performed well on Day 2, Common, AO#2 (Financial Reporting – Revenue recognition) and AO#5 (Management Accounting – Breakeven); Day 2, Assurance role, AO#7 (Risk assessment) and AO#12 (Internal controls); Day 2, Finance role, AO#8 (New product line NPV); Day 2, Performance Management role, AO#7 (SWOT analysis); Day 2, Taxation role, AO#8 (Taxable income – quantitative); Day 3, Simulation 1, AO#1 (Management Accounting – New revenue model – quantitative); and Day 3, Simulation 2, AO#3 (Assurance – Audit procedures).

However, on certain of the remaining AOs, there was more variability in the quality of the responses, with some candidates demonstrating a very poor understanding of the required technical knowledge.

In Financial Reporting, for example, on Day 2, Common, AO#1 (Investment in LOB), some candidates appeared to confuse the concept of significant influence with that of control and incorrectly concluded that consolidation was an acceptable accounting policy choice, when in fact only equity or cost were viable options based on the case facts. Others incorrectly suggested that the cost method was the only policy choice available to FFTY, or concluded that there would be a greater impact on FFTY's net income under the cost method due to the dividends, failing to identify the proportionate income inclusion under the equity method.

On Day 2, Common, AO#3 (Sale and leaseback), some candidates concluded that the lease was an operating lease despite the case facts clearly indicating it was a capital lease, and many did not discuss how to account for the gain on the sale part of the transaction, despite the amount being significant.

On Day 2, Common, AO#4 (Non-monetary transaction), an AO that was rated a higher difficulty by the BOE to reflect the fact that the *Handbook* section is difficult to interpret, most candidates demonstrated performance that was similar to what was seen on the September 2020 CFE, despite the current transaction being a more straightforward exchange of goods (food) and services (web design). Most identified that the transaction was a non-monetary transaction and knew that ASPE section 3831 applied. However, as was the case in September 2020, candidates were confused as to how to apply the section. Many concluded that the transaction lacked commercial substance, but they continued to use the fair values despite the guidance suggesting the use of carrying value, or they concluded there was commercial substance without any further supporting discussion, seemingly not knowing what to provide as support. The impression left on the BOE, based on the analyses observed, was that many candidates did not know how to interpret the requirements of the section or how to apply them to the facts presented.

On Day 2, Performance Management role, AO#12 (Proposed supplier contract), the candidates were asked to assess a proposal for a new long-term supplier contract. Many candidates struggled with the quantitative component of this AO. These candidates were unable to perform a meaningful comparative analysis of the costs for the two options (status quo versus the new proposed contract). Their calculations lacked structure, and the purpose of the calculation was often unclear. The impression left on the BOE, based on the analyses observed, was that many candidates started their calculation without first taking time to clearly identify its purpose.

On Day 2, Performance Management role, AO#13 (Loyalty program), the candidates were asked to assess a proposal for a new loyalty program for the corporate stores. Many candidates demonstrated weaknesses in the application of basic management accounting concepts linked with the calculation of the incremental income arising from a new project. Many, for example, failed to incorporate the cost of the incremental sales generated by the program into their calculation, or they failed to incorporate the reduction of sales generated by the loyalty points being issued.

On Day 3, Simulation 2, AO#6 (Financial Reporting – Lawsuit provision and MD&A), candidates were asked to review the draft Management Discussion and Analysis (MD&A) and discuss the accounting treatment for the lawsuit, under IFRS. Many candidates did not see the need to review and critique the MD&A itself and, therefore, failed to identify the misleading statements included in the MD&A as presented. Instead, they focused solely on the discussion of the lawsuit. Knowing that many candidates may be less familiar with MD&As, the BOE was less surprised by the performance on the MD&A part of the required. However, the number of candidates who had difficulty with the lawsuit discussion was surprising to the BOE, as it was the much easier part of the required. The analysis of the criteria for the accounting treatment of the lawsuit was weak, with many candidates misapplying IAS 37, to conclude that the lawsuit was a contingent liability rather than a provision, or simply stating the criteria were “met” without further explanation, failing to demonstrate their understanding of how the *Handbook* criteria applied in this situation.

Some technical weakness was also noted in the various role AOs. On Assurance role, AO#8 (Approach and materiality), some candidates' discussions contained technical errors, such as basing their choice of materiality percentage on the overall financial statement risk instead of on the sensitivity of the users, or not choosing an appropriate percentage range for the basis they selected for materiality. On Assurance role, AO#11 (Reporting options and procedures), candidates were asked to discuss the various reporting options available for an annual statement of gross sales as part of the AO. Some struggled to provide valid reporting options, often only suggesting options that would not apply to the situation, such as a CAS 800 *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks* report or a CSRS 4200 *Compilation Engagements* report. Some incorrectly suggested that a CAS 805 report could be performed as a direct or attestation engagement. On the Taxation role AOs, those who displayed technical weakness often did so across multiple AOs, such as using incorrect CCA rates, having incomplete or inaccurate income calculations as a result of omitting or making errors, and then failing to separate business and investment income when calculating income taxes. On the PM role, AO#10 (Departmental analysis), some candidates either incorrectly identified the type of responsibility centres when analyzing the case facts or did not know what the basic responsibility centre types were. On Finance role, AO#10 (Equipment purchase F hedge), some candidates confused the forward contract with options or did not understand the mechanics of a natural hedge (i.e., not recognizing that U.S. dollar cash inflows are needed in order to create a natural hedge).

The BOE also noted relatively weak technical ability on the Taxation AOs on Day 3, suggesting an overall weakness in this competency area. For example, on Day 3, Simulation 1, AO#4 (Tax – Taxes payable on sale of ABC), some candidates struggled with how to apply the lifetime capital gains exemption (LCGE) and applied the full LCGE against the taxable capital gain, applied 50% of it against the capital gain, applied it directly against taxes payable, or did not use it at all. They also applied a corporate tax rate against the sale, most often using the 22% tax rate that could be calculated from Appendix III. The second taxation AO on this simulation, AO#6 (Tax – Investment options), was also an issue for many candidates, with some confusing the personal taxation of investment income with the corporate taxation of investment income, noting that each option would be taxed at the highest rate. Others struggled with the RRSP calculation and, for example, included dividends in their calculation of the deduction limit or used the 2020 RRSP deduction limit as the 2021 deduction limit without any adjustments. Some weak candidates omitted the RRSP calculation entirely from their response.

Clarity of Communication/Unsupported Discussions/Failure to Integrate the Information Provided

For the September 2021 CFE, the BOE once again noted that most candidates communicated clearly, with fewer very short, point-form, and generic responses that were hard to interpret. Only a few candidates continued to use the "met" or "not met" approach without providing a supported explanation as to why, when analyzing specific criteria. Also less prevalent were quantitative analyses that were unsupported or not explained in the spreadsheet, although the explanations some candidates provided were quite cryptic and brief, sometimes making it difficult to know where the numbers came from or what the calculations were attempting to do.

However, candidates' level of support still needs improvement, as many continue to list case facts without elaborating on why those points are relevant, or do the opposite by failing to integrate the specific case facts into their analysis to support their position and the application of the relevant criteria. Some candidates continue to cut and paste information or list requirements or criteria, typically *Handbook* or Income Tax Act guidance, without applying that information to the case facts, sometimes jumping to a conclusion based on the criteria alone without supporting it.

For example, on Day 2, Assurance role, AO#8 (Approach and materiality), many candidates provided an audit approach that was quite generic (for example, concluding that a fully substantive approach should be used due to the internal control weaknesses that were present, without recognizing that the internal control weaknesses only affected a limited number of stores or that the nature of FFTY's business, a grocery store, would likely prevent a fully substantive approach). On Day 2, Finance role, AO#11 (Investments), some candidates identified the objectives but did not use them throughout their analysis, or did so at a superficial level (e.g., only discussing the annual return for each investment option). On Day 2, Taxation, AO#11 (Interest and penalties – compliance system), some candidates identified some of the potential reasons for interest and penalties being assessed but struggled to clearly link the case facts to the rules in order to explain precisely which deadlines had been missed and by how much. And, on Day 2, Taxation, AO#12 (Shareholder/employee benefits), some candidates discussed only a few of the employee benefits, often simply stating whether something was deductible by FFTY or taxable to the employees, without considering any of the specific case facts provided or explaining why the benefit was, or was not, taxable or deductible. On Day 2, PM role, AO#8 (Mission and vision), some candidates proposed revised mission and vision statements without referring to the case facts, and they generally provided a generic list of core values that had little connection to FFTY's strategic direction. For example, some referenced "satisfied customers," "happy employees," or other objectives that could apply to any business, rather than focusing on elements specific to FFTY's industry and strategy. And, on Day 2, PM role, AO#11 (Managerial performance) candidates who identified the root causes of the poor performance often made little or no use of the case facts presented, such as the management decisions made in the first store and the sewer backup having occurred in the second store. Rather than attempting to link to the case facts describing events that had taken place during the year, weak candidates relied on their theoretical knowledge of the drivers for these ratios and presented hypothetical reasons for the performance changes.

On Day 3, Simulation 3, AO#1 (Financial Reporting – PP&E accounting issues (IFRS)), some candidates concluded on an accounting treatment without using relevant *Handbook* criteria or case facts to support their recommendation (for example, mentioning that the bikes needed to be componentized but not using the case facts provided to explain what the components would be and what period to depreciate them over). These candidates had difficulty integrating the information contained in the different appendices, where they could have found the information needed to better explain how the componentization should be done.

On Day 3, Simulation 2, AO#2 (Finance – Short-term financing options), candidates provided a list of case facts for each option without discussing them or explaining how they would affect HSE. For example, they stated that LMI had an extensive application process without explaining why this could be an issue. On Day 3, Simulation 3, AO#5 (Assurance – Audit risk and first-time audit considerations), some candidates provided generic audit risks that were often not tied to specific case facts (for example, stating that if there were control weaknesses, it would increase the audit risk, without referring to the actual control weaknesses presented in the case, which the candidate had usually discussed earlier in their response). Others simply defined inherent, control, and detection risks from a technical perspective without further discussion of how these applied in this case. When addressing the first-time audit considerations, some candidates copied considerations straight from the *Handbook* without providing any additional analysis.

Notable exceptions, where candidates did a good job of using the case facts to support their discussions or better explained their calculations, include Day 2, Common, AO#2 (Financial Reporting – Revenue recognition), which is the common AO on which candidates performed the strongest. The majority of candidates used ASPE 3400 and focused their discussions on the performance aspect of the various streams, using case facts such as the timing of the services performed for the initial fee to support their discussion. Similarly, on Day 2, Performance Management role, AO#1 (SWOT analysis), candidates generally supported each element in their SWOT analysis with an explanation as to how the element mattered to FFTY. In the Taxation role, there was a noticeable improvement in the taxes payable calculation, AO#10 (Taxes payable, RDTOH, CDA); where in the past a short-cut approach was often applied, candidates in September 2021 took the time to show a supported calculation. Lastly, on Day 3, Simulation 1, AO#7 (Strategy and Governance – U.S. expansion), candidates were able to integrate many of the case facts into their analysis to explain where the expansion met or did not meet the strategic objectives.

Candidates are once again reminded that the role of the CPA is often to advise clients, either on the application of standards and tax rules or on why and how to proceed with certain business decisions. Without a clear explanation, a client would have incomplete information. In the case of responses to CFE simulations, assessing the degree of competence is more challenging without a fully supported explanation. The BOE is interested in understanding the logic used and is looking for evidence of the analysis and professional judgment that was applied in reaching a conclusion. Therefore, it is important for candidates to answer the questions “Why?” or “So what?” when making any point using case facts, and to include the answer in the response. Presenting the rules without applying them to the specific situation, or repeating case facts without further explanation, is insufficient. The BOE is looking for a clearly articulated response.

Higher-Level Integration

There is one additional pattern of performance that the BOE would like to draw particular attention to. Some candidates demonstrated an inability to step back and consider the broader issues presented in some of the simulations. As much as the CFE presents specific requireds and provides information within appendices that is directly related to those requireds, candidates still need to consider the entirety of the situation and integrate the case facts found throughout the simulation to be able to comment appropriately on some of the issues presented or, in some situations, to identify non-directed issues.

On the Day 1 cases in particular, candidates are expected to identify the broader strategic issues, which may be undirected, based on their analysis of the situation and the more specific strategic alternatives they are presented with.

On both Day 1 cases, the BOE noted a tendency to focus too much on the "issue by issue" analysis. Often, candidates recommended proceeding with multiple options, each recommendation being based on an "issue" analysis. Then, in their overall conclusion, they repeated these recommendations rather than stepping back to assess how the individual pieces and recommendations fit together as a whole, while considering the constraints presented in the simulation. As a result, their conclusions were contradictory or of little value, due to their having violated a key constraint or ignored a key objective. This also resulted in a lack of consideration and commentary on the broader overall direction that the company should take. See further explanation on the issues that were specific to the two Day 1 cases below.

Although this pattern was more apparent on the Day 1 cases, it was also noted on the Day 2 and Day 3 cases. On Day 2, candidates were told that the company's objective was to maximize net income. This overriding objective should have been integrated into the recommendation for each of the financial reporting issues being analyzed (for example, by recommending that the equity option was the most appropriate as it would result in greater investment income in the current year). However, many candidates failed to integrate this objective when making their recommendations.

On Day 3, Simulation 1, AO#2 (Management Accounting – New revenue model – qualitative) and AO#7 (Strategy and Governance – U.S. expansion), both AOs required a connection to FenceCo's strategic objectives. Many candidates failed to recognize that there was integration between the issues that required some consistency in the recommendations being made. For example, some candidates supported the new revenue model with the fact that it would grow revenue without any capital investment. Day 3, Simulation 3, was a highly integrative simulation, where candidates needed to pull information from different places in the case to be able to properly analyze the issues. In many instances, candidates used the information presented in one appendix only, failing to consider all of the relevant case facts and how they affected their analysis of the issue. For example, AO#1 (Financial Reporting – PP&E accounting issues (IFRS)) required candidates to pull information from three different appendices and from the scenario information. Many had difficulty integrating the information to identify the right issues and then analyze them.

The BOE emphasizes that the ability to analyze and integrate the information presented in order to identify what is, and isn't, relevant to the issues raised in the case is an essential CPA skill. The BOE continues to place case facts in different places and to intentionally include undirected and broader underlying issues in order to increase the required integration. In addition, the BOE reminds candidates that it is looking for them to present recommendations that are useful, which requires that there be internal consistency in their responses and for the decisions to be consistent with the case facts presented. Candidates are encouraged to take time to step back and consider the constraints, objectives, and overall direction that make the most sense for the company based on the case facts presented before formulating their recommendations.

For more detailed commentary, see Appendix F of Part A of the CFE Report.

Additional Comments Specific to Day 1 WDI (Version 2)

Most candidates dedicated the first section of their response to a relevant situational analysis. Most used this information later in their response, making relevant links back to the company's situation when analyzing the specific strategic issues that were presented, and within their conclusions. However, the links that weak candidates made were typically to the more obvious case facts that related to WDI's key success factors, mission, and vision, rather than being tied to the more important factors, which generally varied for each strategic issue.

Beyond the specific objectives that were set, there were two prominent issues relevant to WDI's internal environment that candidates were expected to highlight as part of their situational analysis: the fact that WDI's limited cash availability and limited access to further debt financing was a constraint that affected the choice of investments, and the need to decide which strategic path WDI should follow in light of the differences emerging between the traditional sector and the new niche services being offered. Candidates were expected to integrate the crucial elements of the company's broader situation, including WDI's cash constraint, within their qualitative and quantitative analyses of each strategic alternative. They were also expected to explain how each available alternative aligned with the company's overall choice of strategic direction.

For each of the strategic options available to WDI, candidates were expected to conclude and recommend a course of action that was consistent with their analyses. Within their conclusions, candidates were expected to address how the company's constrained cash position would restrict its ability to make all of the strategic investments available. They were also expected to provide an overall conclusion that incorporated the company's primary objective of securing WDI's long-term success.

There were four strategic options to be analyzed in this case: whether WDI should sell its Nova Scotia landfills or upgrade them in order to recapture biogas, whether WDI should attempt to expand the company's consulting services through a research collaboration with Nova Scotia University, whether WDI should acquire Pendleson Incorporated (PI) by purchasing all of PI's outstanding shares, and whether WDI should proceed with building an electronic-waste recycling facility in the Town of Devyn. In addition, candidates were expected to discuss how WDI should approach the leachate contamination, from both an ethical and governance standpoint.

Within the analysis of the major issues, three main factors differentiated strong responses from weak responses. First, a strong response identified and provided an in-depth discussion on the most important decision factors for each issue. Weak candidates tended to list case facts, often failing to explain why those elements were important and how they affected the decision-making process. Second, strong candidates provided valuable quantitative analyses to help support their recommendations (such as by linking their calculations to the stated objectives of WDI). On the other hand, weak candidates' quantitative analyses were often unstructured and unclear and, therefore, challenging to follow. Many failed to perform the correct calculation to assess the decision. These candidates often struggled to explain how the results of their quantitative analyses affected the decision at hand. Third, strong candidates routinely linked their analysis of each alternative to the two prevalent entity-level issues presented in the case: the overall strategic direction WDI should take and the cash constraint. Strong candidates incorporated these aspects

into their discussion of each strategic alternative, whereas weak candidates either missed making these links altogether or provided a superficial discussion by listing pros or cons, sometimes in contradictory ways from option to option, and failing to adequately highlight the importance of these aspects to the decision. Strong candidates typically incorporated both entity-level issues to some extent and usually prioritized their strategic recommendations, explaining why one alternative should be pursued over another, drawing on the entity-level decision factors.

Weak candidates tended to only perform an issue-by-issue analysis without stepping back to consider the broader perspective and without integrating the key entity-level issues into their conclusions. Their conclusions were often internally inconsistent or would have been impossible for WDI to act on. For example, many weak candidates suggested upgrading the landfills while also acquiring PI. Given WDI's limited access to investment capital, this recommendation was impossible to pursue. Other candidates mentioned the cash constraint in their situational analysis or in their analysis of the strategic alternatives but then lost sight of the constraint and recommended spending more cash than was available.

Most candidates approached their response in a coherent and organized fashion. Only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax, and an unorganized approach to their response.

Additional Comments Specific to Day 1 DHC (Version 3)

Similar to WDI Version 2, most candidates dedicated the first section of their response to a relevant situational analysis. Most used this information later in their response, making relevant links back to the company's situation when analyzing the specific strategic issues that were presented, and within their conclusions.

In addition to considering the company's overall occupancy rate and average daily rate (ADR), which are key measures in the industry, candidates should have highlighted two prominent issues relative to DHC's internal environment in their situational analysis: the reputational issues surfacing as a result of Doug Malette's actions, and DHC having limited cash resources (and how to use the cash available most effectively). Strong candidates tended to clearly identify the limitations related to the amount available to invest and identified the importance of the reputational issue that DHC was facing. Strong candidates also highlighted the increased significance of Doug's actions given the importance that social media and viral news stories have on the public's perception of a company. Weak candidates tended to simply list information related to key success factors, mission, and vision, taken from either Capstone 1 or this simulation, without identifying which of those items would have the most influence on their decision-making process.

There were five strategic alternatives that candidates were expected to analyze both qualitatively and quantitatively. They were expected to assess whether DHC should purchase 35% of the outstanding common shares of Peak Revie, evaluate the opportunity to purchase all of the outstanding shares of HHH, assess whether DHC would be better off selling the Cape Breton hotel in order to purchase and renovate the castle in Tofino, and analyze whether the renovation of the Cape Breton hotel was a better investment than the castle in Tofino. In addition, candidates were directed to comment on DHC's overall strategic direction. Relative to that specific request, candidates were expected to discuss whether DHC should divest completely from Eastern Canada in order to escape the negative public perception stemming from Doug's actions. Candidates were also expected to evaluate Derek's proposal for the Western Corridor and how the strategic alternatives in the simulation aligned with the potential for building a linked group of luxury hotels.

One of the main differentiating factors between strong and weak candidates was the ability to identify and discuss in depth the most relevant aspects of each strategic option presented as part of their analysis. Rather than discuss the more pertinent implications associated with the case facts, weak candidates' analyses instead tended to contain superficial links to their situational analysis, such as, for example, repeated statements that a case fact linked back to the mission or vision.

Regarding the reputational issue, most candidates recommended that DHC hire the public relations firm to combat the negative press, but they failed to conclude on whether DHC should leave Eastern Canada in order to focus solely on Western Canada. Regarding the Western Corridor, most candidates did not provide a separate analysis of the proposal and instead only discussed this strategic proposal within their analysis of the other alternatives available to DHC, and many failed to conclude on whether DHC should proceed with the plan to link their Western Canadian hotels together to create vacation packages. Weak candidates seldom provided a separate discussion of the Western Corridor, usually ignoring this proposal altogether. When it was discussed, it was usually only included as a single pro or con in their analysis of the other strategic alternatives.

Only strong candidates tended to incorporate DHC's cash availability throughout each of their issue-by-issue discussions and within their conclusions and overall recommendations. As well, only strong candidates addressed the Western Corridor within a separate analysis and discussed how best to approach the Doug Mallette issue. Strong candidates also typically explained why their recommendations were the most effective use of DHC's limited available investment capital based on the company's objectives. Weak candidates struggled to provide a useful conclusion that DHC's board could act on, usually ignoring the cash constraint. For example, many weak candidates suggested selling the Cape Breton hotel in order to proceed with all three of the available hotels in Western Canada; however, this recommendation lacked value because DHC lacked the cash necessary to do so. Other weak candidates recommended renovating the Cape Breton hotel while also purchasing and renovating the castle in Tofino, an option that the simulation clearly stated was not possible.

As was the case with WDI Version 2, only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax, and an unorganized approach to their response.

APPENDIX A

EXAMINATION DESIGN, MARKING GUIDE DEVELOPMENT, AND MARKING OF THE COMMON FINAL EXAMINATION

CFE Design

Day 1 is one four-hour case that is linked to the Capstone 1 case, which is worked on in groups for eight weeks prior to the CFE. When writing the Day 1 case, candidates are allowed access to their Capstone 1 case but not their group's answer or any sample response. The Day 1 case is designed to assess the enabling (professional) skills. Candidates are directed to target a "board room and senior management" level of discussion, with high-level analytics and a strategic focus. There are two versions of the Day 1 case. Candidates pre-select the version they will write.

Day 2 is one four-hour case that candidates are given five hours in which to respond. The extra hour gives candidates time to filter and find the information that they need to answer *their* role requirements from within the common information presented. Day 2 is designed to assess the technical competencies in **depth** (Level 2 and Level 3). Candidates pre-select a role (Assurance, Finance, Taxation, or Performance Management). All candidates work with the same case — it has a common section and four sets of appendices containing additional information applicable to each of the four unique roles. The required tasks, regardless of the role, are clearly directed unless there is an undirected/enabling issue in the case that the board expects candidates to identify on their own. Day 2 evaluates the competencies listed in the *CPA Competency Map* mostly in the elective area and in common Financial Reporting and/or Management Accounting areas in **depth**. The role **depth** test (Level 2) may also include coverage of other competency areas from the common core.

Day 3 is a four-hour examination containing a mix of small cases (60 to 90 minutes each[1]) that evaluate the common core competencies only. The Day 3 cases provide additional opportunities for **depth** in Financial Reporting and Management Accounting and all the **breadth** opportunities for all the technical competency areas. Cases are time constrained, and they are designed to cover different competency areas within each case. A higher level of integration and judgment is required on Day 3 of the CFE than in the core modules, although the technical competencies are tested at the common core level of expectation.

The assessment opportunities on the Day 2 case are given mark values such that each of Day 2 and Day 3 are weighted equally.

The Development of Marking Guides and the Provincial Review Centre

Prior to the Common Final Examination booklets being published, provincial reviewers, appointed by each region, meet to examine the simulations and the preliminary marking guides. The provincial reviewers' comments are then considered by the board when it finalizes the examination set and again when the senior markers review the marking guides in the context of actual responses at the Preliminary Evaluation Centre.

[1] The CFE Blueprint allows anywhere between 45 to 90 minutes. The Sept 2021 CFE ranged from 60 to 90 minutes.

The September 2021 CFE Marking Centre

The September 2021 CFE Evaluation Centre was 100% remote due to Covid-19. From the marker applications received, approximately 260 individuals were chosen to participate in the September 2021 CFE marking centre. The criteria for selection included marking experience, motivation, academic achievement, work experience, personal references, and regional representation. The marking was supervised by the CPA Canada CFE full-time board staff.

The Day 1 Version 1 linked case (WDI V2) was marked by a team of 24 people from October 9 to October 22, 2021. The Day 1 Version 2 linked case (DHC V3) was marked by a six-member team from September 24 to October 5, 2021.

The Day 2 Common assessment opportunities were marked by a separate team from the role assessment opportunities by a team of 53 people from October 5 to 19, 2021. Day 2 Assurance was marked by a team of 52 people from October 5 to October 21, 2021. Day 2 Performance Management was marked by a team of 15 people from October 9 to October 19, 2021. Day 2 Finance was marked by a team of seven people from October 2 to October 10, 2021. Day 2 Tax was marked by a team of seven people from September 30 to October 10, 2021. All three Day 3 simulations were marked from October 10 to October 27, 2021. The Day 3 simulations were marked by a total of 96 people.

In advance of the marking centre, the members of the CFE subcommittee, staff, leaders, and assistant leaders participated in a five or six-day preliminary evaluation centre (PEC). Participants reviewed the marking guides, applied them to randomly selected candidate responses, and made necessary revisions to the marking guidelines, taking into account the comments on the marking guides received from provincial reviewers.

All teams followed a set marking centre schedule, which included a start-up phase to train the markers. At the beginning of the marking centre, the leaders and assistant leaders presented the marking guides to their teams, while staff, the BOE vice-chair in charge of the examination, and a selected subcommittee member supervised. The teams undertook a two-phase test-marking procedure prior to actual marking. Phase one consisted of marking guide familiarization, during which markers applied the marking guide to copies of candidates' responses and collectively reviewed their results. Phase one thus ensured that all markers understood the issues in the marking guide and the basis on which to apply each expectation level. Phase two consisted of an expanded test marking of several responses to establish marker congruence.

After the training and test-marking phases, and only when marker congruence was achieved, live marking commenced. All teams, for all days, had a leader, and anywhere from one to eight assistant leaders, and had both French-speaking and English-speaking markers. Each team had one or more markers who marked in both languages.

The board strives for the highest possible marking consistency and quality control. Leaders and assistant leaders, therefore, devoted much of their time to cross-marking and other monitoring activities. Control papers were automatically fed into the system daily to check markers' consistency. Markers' statistics were reviewed to ensure that marking remained consistent throughout the centre. Based on analysis of the statistics, leaders reviewed and, if necessary, re-marked papers to ensure that the assessment opportunities were marked fairly for all candidates. Bilingual markers marked papers in both languages, and their results were compared to ensure that the marking was consistent in both languages. Additional audits were performed at the end of marking on any large differences between markers, or language differences.

Borderline Marking (Day 1)

Each candidate's paper was marked once. All candidates' responses that were assessed as clear fail, marginal fail, and marginal pass were marked a second time by the team leader, an assistant team leader or a senior marker. Clear pass results were also audited to ensure accuracy of marking.

Double Marking (Day 2)

Each candidate's Day 2 paper was marked independently by two different markers. If the two initial markings differed on any assessment opportunity, an arbitrator (the leader, the assistant leader, or a senior marker) compared the two initial markings and determined the final assessment.

As an added measure to ensure that markers were consistently applying the marking guide, a two-day rule exists, which results in the second round of marking not beginning until two days have elapsed since the first marking. Adherence to this rule ensures that any movement in the application of the marking guides due to marker interpretations during the first two days of live marking are stabilized before the second marking and arbitration process begin.

Borderline Marking (Day 3)

Day 3 was marked using a borderline model. All Day 3 responses were marked once and then the Day 2 and Day 3 results were combined. All failing candidates who passed the Day 2 role test, had their Day 3 response marked a second time by an independent marker, and any differences between the first and second markings were arbitrated by a leader or senior marker.

Subsequent Request for Remark of Results and Request for Performance Analysis

Failing candidates may request a remark of their examination results and/or a detailed personalized performance analysis for either Day 1, or Day 2 and Day 3, or for all three days.

In an effort to provide failing candidates with more timely feedback, the Board of Examiners is piloting the creation of an automated feedback report for Day 1 of the CFE. The new report is automatically generated using the marking data collected for each response rather than being based on a personalized review of the response. It is therefore being provided at no cost to all failing candidates. This new report is intended to allow for the identification of the key deficiencies in the candidate's Day 1 response, which then allows the candidate to decide whether to request the more detailed, and personalized performance analysis report noted above, for a fee.

Review and Remarking Approach

Great care is exercised in the original marking and tabulating of the papers and results. The following review and marking procedures are applied to all three papers constituting the Common Final Examination.

Under the supervision of the chair of the Board of Examiners, as well as CPA Canada CFE staff, the responses are reviewed by the leaders and assistant leaders who did the original marking. The leaders and assistant leaders read the responses and compare them to the marking guides used at the marking centre. In reviewing candidates' results, two aspects are considered. First, it must be determined that the basis of marking the papers has been consistent with that accorded other candidates who wrote the examination. Second, all responses reviewed are subjected to a careful check to ensure the markers have indicated that consideration has been given to all material submitted by the candidate.

The results are tabulated, and the decision made regarding whether any candidates have been treated unfairly and should be granted a pass on the examination.

The results are then forwarded to the provincial bodies for notification of the candidates.

APPENDIX B

CAPSTONE 1
DHC BACKGROUND CASE

Capstone 1

Distinct Hotels Corporation — Case

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,

[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,

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[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 I , , and I), the purchase of Artists Warehouse Hotel (Appendixes II and III), the renovation and sale of condos at the Northern Ontario hotel (Appendixes IV and V), and the management fee contract with Huron Heights Hotel (Appendix VI).

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.

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[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.

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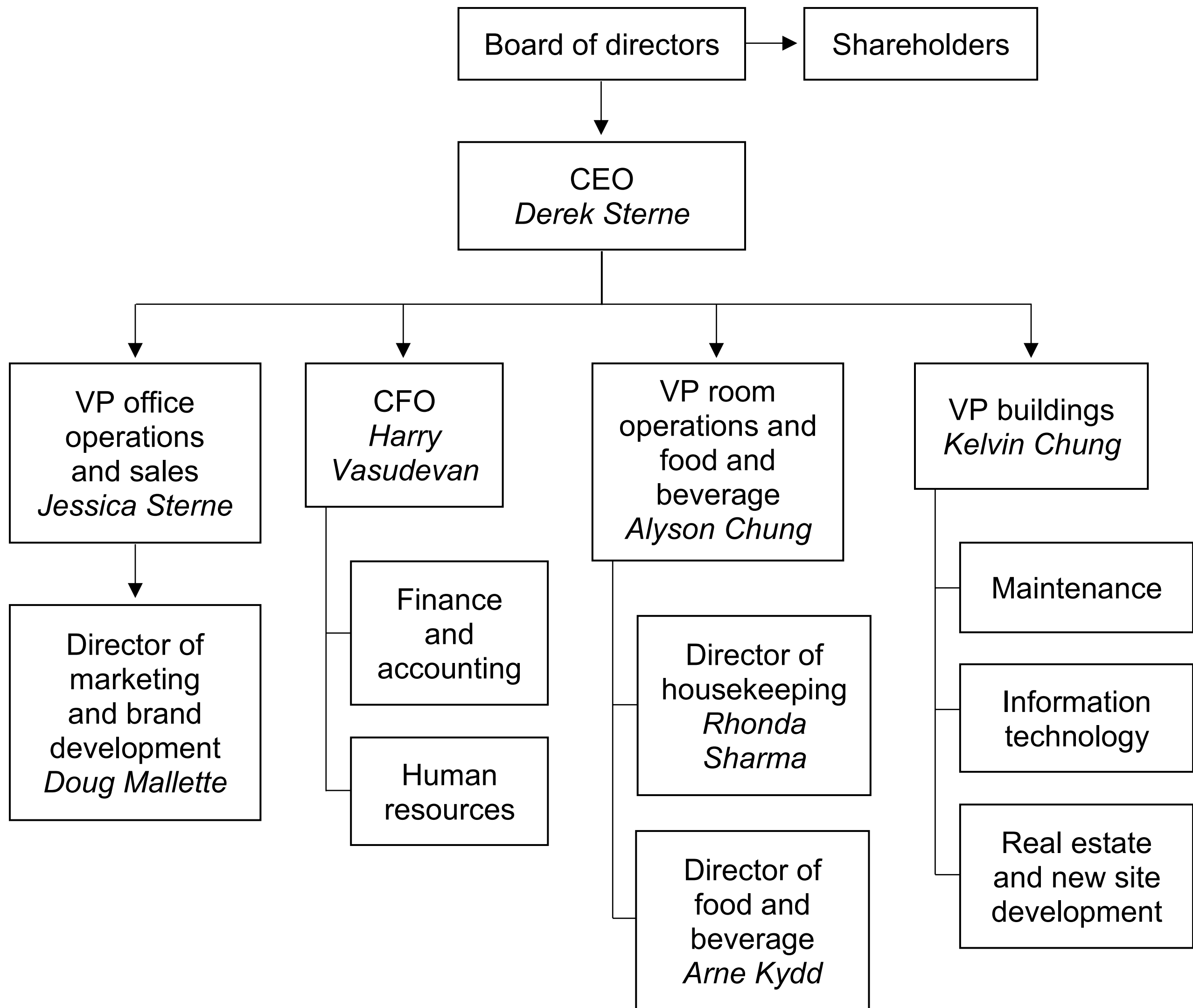
Appendix I
Organizational chart



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 analysis.

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 . 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 I. 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 III). 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.

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[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 V). 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.

APPENDIX C

THE COMMON FINAL EXAMINATION
DAY 1 DHC VERSION 1 BOOKLET – SEPTEMBER 9, 2020

COMMON FINAL EXAMINATION
SEPTEMBER 9, 2020 – DAY 1

Case (DHC-Version 1) **(Suggested time: 240 minutes)**

It is April 2023, and Irene Mallik, your boss at Wilson Consulting Group, assigns you to another engagement with Distinct Hotels Corporation (DHC).

Canada was recently ranked as the fifth best tourist destination. Domestic travel within Canada is increasing due to increases in per capita disposable income and a high-level of consumer confidence. International visitors to Canada have also increased due to the decline in the Canadian dollar relative to other currencies.

With this favourable outlook, many international chains are expanding into the Canadian boutique hotel segment. Because these chains primarily use the franchise business model, the number of independently owned hotel operators has declined.

In 2021 and 2022, the boutique hotel industry achieved higher-than-expected annual growth rates. Beginning in 2023 and for the next four years, a higher than originally anticipated annual growth rate of 4% is expected.

Although many travellers choose short-term rentals through sites such as Airbnb and VRBO, the boutique hotel segment continues to appeal to travellers who want access to premium amenities or unique experiences, both inside and outside the hotel. These travellers are typically between 35 and 45 years old, fairly affluent, and willing to pay a premium for new experiences. Growth has already been seen in the sale of high-end ski and golf packages, and significantly more growth is predicted for at least five years. Increasingly, hotel operators are offering all-inclusive vacation packages that include activities such as painting, cooking and photography.

Larger hotel operators are vertically integrating either through the acquisition of suppliers or of intermediaries, such as travel agents. This allows for better cost control and improved margins, as well as diversification of revenue sources.

Business travel is forecast to increase by 2% annually, which compares to a 5% increase in leisure travel. Conference revenue has historically been 10% of room revenues. Although conference attendees increase occupancy rates, the group room rates provided are generally lower than the average daily rate (ADR).

Due to Doug Mallette's unethical behaviour, DHC lost its gold rating in March 2020 and was ineligible for the Travellers' Choice Awards from First Canadian Hotel Reviews for two years. Room revenues in 2020 and 2021 were consequently lower than forecast. Sarah MacAllister replaced Doug, who was fired. In 2022, room revenues increased, and DHC had an overall ADR of $420 with a 72% occupancy rate. The mix of business and leisure travellers has stayed consistent.

To reflect its involvement in ski and golf resorts, DHC's Board of Directors (board) updated its vision statement:

"*We make guests feel special by providing exceptional services and experiences at our hotels and resorts.*"

The mission statement was also updated:

"*We operate unique luxury hotels and resorts, providing each guest with attentive service and experiences beyond expectations*."

DHC's core values remain unchanged.

Interest rates have been increasing. DHC reached the limit on its line of credit in December 2022. The primary objectives for 2023 are to concentrate on the core hotel business and achieve a minimum occupancy rate at each hotel of 75% and an overall ADR of $430. DHC only wants to invest in projects that will earn a minimum of 12%. The board would eventually like to have enough cash available to resume paying dividends.

DHC is in the process of making more changes and has some major decisions to make. Irene asks you to review the information she has gathered, and to draft a report for her to present to DHC's board. The report should highlight significant changes in DHC's situation and analyze the alternatives presented, focusing on the strategic considerations. If there are other significant issues that should be addressed, she asks that you let her know.

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APPENDIX I
TRANSCRIPT OF PREVIOUS BOARD MEETING

Derek: Thank you for attending our board meeting, Irene.

Here is a summary of the events that have occurred since early 2020:

Date	Event
April 1, 2020	Announced that our golf course would be semi-private.
April 1, 2020	Signed a management contract with Huron Heights Hotel (HHH), which corresponds with the original proposal except for the: • addition of penalties of $50,000 per year remaining on the contract, for cancellation with cause, to be paid by the party in breach. • removal of the clause requiring DHC to share in any losses with HHH.
May 1, 2020	Patrick Kuzoff invested $20 million in DHC in return for a convertible bond, with terms and conditions as originally outlined. He is now a director of DHC.
July 1, 2020	Purchased 20% investment in Topomo Mountain Ski Resort (TMSR), with the same terms as originally proposed.
October 19, 2020	Completed renovations of $11 million to the Nova Scotia hotel and total renovations of $4 million to the other three hotels.
November 2, 2020	Finalized new loan arrangements with Northern Land Loans. The new loan for $39 million is repayable in annual payments of $2 million on June 30, bears interest at 7.2% and matures in 13 years.
May 3, 2022	Completed renovations and repairs of $10 million to the Kelowna hotel.
July 2, 2022	Renewed line of credit, with the same terms and conditions except that payment of any dividends now requires prior approval by the lender.

Derek: We have decided not to take the company public. The past two years have strained DHC's resources, primarily because TMSR's upgrades required significantly more than was budgeted. The upgrades are now complete. We need to keep in mind that our account manager at H&A Bank is monitoring our account closely as we are close to our maximum borrowing capacity.

Patrick, please start with the first proposal.

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Patrick: DHC has been working with Holiday Tours Inc. (Holiday), which offers vacation packages with skiing, meals, and accommodation at the Canmore hotel, and golfing, meals, and accommodation at the Kelowna hotel. Holiday is being sold and the likely buyer plans to decrease room rates from $395 to $310 on average next year. The sale is still in the negotiation stage and Derek and I have discussed the option of DHC making an offer.

Kelvin: Why hasn't the board heard this before? Doesn't buying Holiday take us away from our core business?

Jessica: Holiday sold approximately 10,000 room nights for us last year and we expect to do the same or better this year. The number of travellers using vacation packages has been increasing annually, as has the length of stays. Without them, DHC's revenues from both hotels would have declined during the past three years.

Patrick: Holiday's coordinator anticipates that the market of young and affluent travellers will continue to grow. With the expected decrease in rates and, based on inquiries and reservations for 2024, the coordinator predicts a 25% increase in the number of room reservations for these packages. DHC should benefit directly from this growth. I did a rough calculation that factored in the reduced room rates and increase in occupancy, and estimate that our room revenue, net of operating costs, will decrease by about $40,000 for the year.

Derek: Holiday has the expertise and acquiring it is the way to grow DHC. With 15 years of experience, Holiday has an excellent reputation and is good at selling its packages to both international and domestic travellers. Holiday not only provides accommodations and lift tickets or green fees but also transportation, meals, and other services, tailoring them to the travellers. Holiday could develop and sell packages for our other hotels.

Alyson: Maybe we could take our chances with the new owners and re-evaluate our relationship after a year or two.

Patrick: I have a better idea. My company, Kuzoff Golf Inc. (KGI), has been putting golf packages together for years. We could make an offer where KGI takes a 60% ownership in Holiday, and DHC gets 40%. I believe it would be positive for both companies. I already use Holiday for some of my golf course packages.

Derek: You have my full support, Patrick. A 60/40 split will allow DHC to invest at a lower initial cost.

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Kelvin: Who decided that we invest with KGI, or that 40% is acceptable to us? Derek, don't you own a percentage of KGI?

Derek: Yes, but it is small. It doesn't influence our decision to accept Patrick's offer to invest in Holiday with DHC. He has already invested in DHC and our interests are aligned.

Kelvin: We need to discuss the ownership split.

Derek: We can do that later. Patrick and I are comfortable with a 60/40 split.

Alyson: But we haven't even decided to make an offer We first need to understand the impact of investing in Holiday compared to continuing our relationship with a new owner.

Patrick: I obtained some information from the current owners of Holiday. Irene, can you estimate what the shares will cost and calculate the expected rate of return?

Derek: Let's move on to the Northern Ontario hotel, which continues to struggle. Its ADR and occupancy rate are well below DHC's other locations, reducing our corporate-wide metrics. In fact, the occupancy rate has been at 60% since 2020, although the ADR has increased to $350. And, as we feared, the spa is not doing well. Yesterday, I received a phone call from Global Stay N Play Corp. (Global), asking if DHC would be interested in becoming a franchisee. They are looking for a resort in Northern Ontario.

Alyson: Global has ten different brands of hotels in countries all over North and South America, Europe and Asia, ranging from three to five stars. What are they proposing for the Northern Ontario hotel?

Derek: The hotel would be rebranded and called "FitzGeralds North." It would fit into Global's five-star category of boutique hotels, called "FitzGeralds," which targets leisure travellers. Global proposes to provide an interest-free loan for the necessary upgrades. We were expecting to make some major renovations to this hotel in 2024 anyway. I see this as a good move.

Jessica: Last year, DHC spent over one million dollars on marketing, website costs and promotions for this hotel with no noticeable improvements. Perhaps becoming a franchisee benefits us. However, it would mean giving up our autonomy. I am not sure I support this change.

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Alyson: Will the hotel retain its key managers?

Jessica: DHC would keep its own staff but Global would assist with future recruitment, which might be helpful. DHC has struggled to keep managers at this location, with most leaving after approximately eight months. Since they could potentially work for other Global hotels, it might help attract managers.

Alyson: Will customers think that DHC's other hotels might also be franchised? While Global has a good reputation, that can quickly change and DHC's other hotels might suffer.

Derek: Global provided me with the names of some of its franchisees as references. When I contacted them to ask about their experiences, I got glowing reports. They all said that Global's targets are achievable. I have summarized the terms of the franchise proposal and I had our accounting department prepare some estimates. If we continue to operate as is, we can expect room revenue net of room operating costs and marketing costs to be $6.7 million. If we operate as a franchisee, room revenue net of room operating costs, franchisee fees and marketing, reservation, and technology fees should be around $9.2 million. Provided that the hotel meets the targets and standards that Global has set, it appears that DHC would be ahead financially and still have a lot of autonomy.

Patrick: This sounds like a great opportunity.

Kelvin: I have another proposal. The chef at our Northern Ontario hotel, Chef Norman, wants to offer cooking retreats. He thinks this would attract travellers interested in experiences while on vacation and help fill our empty rooms. As you know, he is a renowned chef who operated a successful restaurant in Toronto, Ontario, before joining DHC. Over the years, he has visited culinary schools around the world.

Alyson: This might improve the hotel's metrics. DHC could offer cooking classes in a luxury setting while maintaining an exceptional and unique atmosphere.

Kelvin: I could design a state-of-the-art facility in which travellers would enjoy cooking. It might even be recognized by other designers if we do it right.

Jessica: Are there enough travellers who would be interested to make this viable? The attraction might be short-lived.

Derek: I am also wary of this idea. Who would want to travel to Northern Ontario to cook?

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Alyson: The draw would be Chef Norman. He has an excellent reputation, everyone loves his food, and he is very personable. It would help build DHC's reputation.

Patrick: I agree with Derek. It's too risky.

Derek: Let's have Irene take a look, just to be sure. Next is the management contract with HHH.

Alyson: As you know, HHH's revenue has been falling because competitors have entered into franchise agreements with, or been bought by, international hotel chains. Since it is having difficulty competing for leisure travellers, Martha thinks adding a conference facility to the hotel would attract more business travellers. She wants DHC to manage the conference centre as part of its management contract.

Jessica: Martha did not renovate the rooms and lobby when DHC previously asked. And she recently stopped contributing the 4% to the reserve fund for renovations. Is Martha now willing to add money to the reserve fund and do the renovations, in addition to a new conference centre?

Alyson: She says renovating was delayed on purpose until a decision was made on the conference centre. She plans to complete the work at the same time.

Kelvin: Unless the number of rooms is reduced, I don't see where there is room for a conference centre.

Alyson: Martha plans to reduce the size of the lobby and use other available space instead of reducing the number of rooms. Since the conference centre will be relatively small, the number of rooms will remain the same.

Kelvin: If I can participate in its design, I could make it unique and appealing, to help attract our loyal DHC customers. For example, it could appeal to leisure travellers for weddings.

Derek: The Rev/PAR target was not met last year for the first time. Based on our analysis, this was due to increased price competition from chain hotels and the related loss of leisure travellers.

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Jessica: I think it was also due to the hotel's outdated appearance because Martha did not do any renovations. I worry that it reflects poorly on DHC.

Alyson: Actually, Martha thinks building the conference centre and targeting business travellers will improve the Rev/PAR, and I agree.

Martha has proposed revising the existing contract to include management of the conference centre, and a revised fee structure that is more favourable to DHC. We need to understand her reasoning.

Jessica: It is becoming very difficult to work with HHH. For the past year, HHH has not given final approval of the managers we selected. I am not sure why this is happening, but I suspect it will cause problems in the long run, since the right people aren't being hired.

Derek: Given the problems with HHH, perhaps we should refuse the modified contract.

Patrick: Good point, Derek. I agree.

Kelvin: It would be helpful to hear why you agree with Derek, not just that you agree

Derek: In the interest of saving time, that's not necessary. Irene, please critically review Martha's proposal and forecast and advise whether DHC should accept the proposed modifications. I think that is all for now. Do you have everything you need, Irene?

Irene: Yes. My staff and I will start on this immediately and prepare a report for the board.

Derek: Thank you. Meeting adjourned.

APPENDIX II
INTERNAL FINANCIAL STATEMENTS

Distinct Hotels Corporation
Statement of Comprehensive Income
For the year ended December 31, 2022
(in thousands of Canadian dollars)

Revenues	
Rooms	$ 83,886
Food and beverage	48,654
Spa services	1,500
Golf – annual membership fees	365
Golf – green fees	1,630
Management fees from HHH	1,426
	137,461
Expenses	
Rooms	44,460
Food and beverage	33,085
Golf services	1,523
Spa services	1,050
Management salaries and benefits related to HHH contract	898
Depreciation and amortization	11,500
Marketing and sales	4,124
Property tax, utilities and insurance	9,622
Administrative and general	20,341
	126,603
Operating income	10,858
Equity income from TMSR	356
Interest on the line of credit	(120)
Interest on the long-term debt	(5,000)
Income before taxes	6,094
Income taxes (27%)	1,645
Net income and comprehensive income	$ 4,449

APPENDIX II (continued)
INTERNAL FINANCIAL STATEMENTS

Distinct Hotels Corporation
Statement of Financial Position
As at December 31, 2022
(in thousands of Canadian dollars)

Assets	
Cash and cash equivalents	$ 560
Trade receivables	1,030
Inventories	1,760
Prepaid expenses	1,490
	4,840
Property, plant and equipment, net	153,820
Equity investment in TMSR	5,459
Interest-free loan to TMSR	8,617
Intangible assets	1,300
Total assets	$ 174,036
Liabilities	
Line of credit	$ 4,000
Trade payables and accrued liabilities	6,950
Income taxes payable	114
Contract liability – revenue	5,420
Current portion – Nova Scotia loan	3,000
Current portion – Ontario loan	2,000
	21,484
Long-term portion – Nova Scotia loan	30,000
Long-term portion – Ontario loan	33,000
Convertible bond	1,938
Deferred tax liability	6,810
Total liabilities	93,232
Shareholders' equity	
Share capital (4,000,000 shares outstanding)	10,175
Contributed surplus – conversion option	17,252
Retained earnings	53,377
Total shareholders’ equity	80,804
Total liabilities and shareholders’ equity	$ 174,036

APPENDIX III
COMPARISON TO INDUSTRY BENCHMARKS

For the year ended December 31, 2022

Boutique Hotel Industry

	DHC		Industry Benchmarks	
	2022	2019	2022	2019
Rev/PAR (Occupancy rate × ADR)	$302	$280	$328	$262
Occupancy rate	72%	70%	80%	78%
ADR	$420	$400	$410	$335
Current ratio	0.2	0.2	0.8	0.8
Debt to equity	1.2	2.1	1.9	2.6
Total debt to assets	0.5	0.7	0.6	0.7
Return on equity	6%	8%	12%	11%
Operating margin	8%	9%	17%	16%
Profit margin	3%	3%	9%	8%

APPENDIX IV
HOLIDAY TOURS INC.

The following information has been gathered regarding Holiday:

- Holiday has historically achieved operating margins of 20%.
- For the year ended December 31, 2022, Holiday reported EBITDA of $2.25 million.
- Holiday's share capital has not changed since its incorporation; it has two million common shares outstanding.
- The standard industry valuation of private companies specializing in vacation packages is six times EBITDA.

APPENDIX V
FRANCHISE PROPOSAL SUMMARY FROM GLOBAL STAY N PLAY CORP.

Terms

- The contract will take effect on June 1, 2023, for a 20-year term.
- On each five-year anniversary, either party can terminate the contract without penalty.
- If DHC's responsibilities, as set out below, are not met, Global can terminate the contract at any time.

Fees

- DHC will pay a franchise fee of $200,000 upfront.
- DHC will pay a monthly franchise fee of 10% of room revenue plus a yearly marketing, reservation and technology fee of 3.5% of room revenue.

As part of its responsibilities, Global will:

- pay all marketing, reservation and technology costs, including upgrade and website maintenance costs, and provide signage, materials and supplies with the FitzGeralds logo.
- spend 50% of the 3.5% marketing, reservation and technology fee specifically on this hotel.
- provide an interest-free loan to DHC for required capital expenditures up to $8 million (subject to Global's approval), due in 10 years' time or due upon termination of the agreement.
- provide the lead in hiring management for the hotel.

As part of its responsibilities, DHC will:

- renovate and maintain the hotel to Global's standards; any future changes to the property will require Global's approval.
- permit property inspections by Global without advance notice.
- purchase all room supplies and amenities from Global.
- assist with the hiring of management for the hotel.
- implement appropriate internal controls, including providing training for all employees.
- attend hotel management conferences on industry trends and issues, as Global directs.
- set room rates, subject to Global's approval, and use Global's central reservation system for all reservations, including group reservations.
- participate in Global's customer loyalty program.
- prepare and deliver quarterly financial statements for the Northern Ontario hotel within 30 days of the end of each quarter.

APPENDIX V (continued)
FRANCHISE PROPOSAL SUMMARY FROM GLOBAL STAY N PLAY CORP.

By the end of 2024, Global requires its franchisees to meet the following targets and expects the ADR and occupancy rate targets to increase each year thereafter.

ADR	$420
Occupancy rate	70%
Room operating costs as a maximum percentage of gross room revenues	50%

APPENDIX VI
PROPOSAL AND FORECAST FOR COOKING RETREATS

After conducting considerable research on cooking retreats, Chef Norman provided the necessary information to the accounting department, for it to prepare the following forecast.

	June to Dec. 2023 (7 months)	Jan. to Dec. 2024 (12 months)
Revenues	$ 504,000	$ 864,000
Incremental costs for food and room cleaning	(56,000)	(96,000)
Additional costs for kitchen staff	(70,000)	(120,000)
Marketing costs	(40,000)	(40,000)
Depreciation	(58,000)	(100,000)
Additional operating profit	280,000	508,000
Less taxes (27%)	(75,600)	(137,160)
Additional net (after-tax) profit	204,400	370,840
Add back depreciation	58,000	100,000
Net cash flow	$ 262,400	$ 470,840
Operating margin	56%	59%
Profit margin	41%	43%

- DHC will offer a one-week cooking retreat each month, with a maximum of 20 participants per retreat.
- Each participant will pay an all-inclusive price of $3,600.
- Cooking will focus on the use of natural and local ingredients.
- The costs for accommodations and meals are estimated to be $400 per person.
- Additional cooking staff will be required, at a cost of $120,000 per year.
- Additional marketing costs of $40,000 will be spent in 2023 to launch the program, and the same amount will be spent in 2024.
- The necessary kitchen renovations are estimated to cost $1 million and could be completed by May 2023, with the first retreat held in June 2023.
- The renovations will have an expected life of 10 years.

APPENDIX VII
PROPOSAL AND FORECAST FOR HURON HEIGHTS HOTEL CONFERENCE CENTRE

Construction of the conference centre and the renovations will be completed by no later than January 1, 2024. Martha prepared the following forecast.

The proposed new rates, and the fees for management of the conference centre, are shown below. All other terms would remain as per the current agreement[1], except that there will be no Rev/PAR targets for DHC to meet.

Distinct Hotels Corporation

	2024	2025	2026
Management fees – 7% of gross room revenue[2]	$ 938,196	$ 955,570	$ 1,033,753
Management fees – 10% of gross conference revenue[3]	402,084	409,530	443,037
Licensing fee – 4% of gross room revenue[2]	536,112	546,040	590,716
Total gross revenue	1,876,392	1,911,140	2,067,506
Less: management salaries and benefits	(950,000)	(978,500)	(1,007,855)
Net operating income	$ 926,392	$ 932,640	$ 1,059,651
Operating margin	49%	49%	51%

[1] The current agreement rates are: management fees of 5% of gross room revenue and 8% of gross operating profit, and a licensing fee of 3% of gross room revenue.

[2] Room revenue estimates are based on an ADR of $270, $275 and $280 and an occupancy rate of 80%, 80% and 85% for 2024, 2025 and 2026, respectively.

[3] Gross conference revenue includes room rental and food and beverage from conferences, which is estimated to total 30% of gross room revenue.

APPENDIX D

DAY 1 (DHC VERSION 1) – SEPTEMBER 9, 2020
MARKING GUIDE AND SAMPLE CANDIDATE RESPONSE

MARKING GUIDE
DISTINCT HOTELS CORPORATION (DHC)
VERSION 1

Summative Assessment #1 – Situational Analysis

For Summative Assessment #1, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate used a reasonable situational analysis when analyzing the major issues facing DHC.

Unsure – The candidate attempted to use a reasonable situational analysis when analyzing the major issues facing DHC.

No – The candidate clearly did not use a reasonable situational analysis when analyzing the major issues facing DHC.

Based on 2019 CPA Competency Map:

Technical Competencies
2.3.2 Evaluates the entity's internal and external environment and its impact on strategy development.

Enabling Competencies
1.2.2 Performs work competently and with due care.
2.1.1 Defines the scope of the problem.
2.1.2 Collects and verifies relevant information.
2.1.3 Performs appropriate analyses.
2.1.4 Integrates information to investigate each potentially viable solution.

A competent candidate will complete a sufficient situational analysis. The focus should be on describing the factors that have changed since Capstone 1 that will affect the decisions at hand (e.g., the relationship between Patrick and Derek, a recognition of the tight financial position, etc.).

The candidate will draw upon their situational analysis when analyzing the major issues facing DHC (Holiday, franchise with Global, Huron Heights Hotel (HHH) management contract and Northern Ontario cooking retreats).

Stakeholder Analysis (Changes)

Patrick Kuzoff, a local entrepreneur, has invested $20 million in DHC for a convertible bond and is now a director *(from Capstone 1)*. The bond bears interest at 2.5%, payable quarterly, and is convertible into 1 million shares at the holder's option but is also mandatorily convertible at maturity (April 2027) if not converted earlier. On the maturity date, the principal due will be repaid by issuing 1 million common shares, and no cash will be disbursed by DHC; $17,251,631 will be recognized as share capital. On conversion, Patrick will own 20% (1 million / 5 million), with each of Jessica, Derek, Alyson and Kelvin owning 20% (1 million / 5 million) of DHC. This change is important, given how Patrick and Derek (and likely Jessica) appear to be voting together, giving this group control of DHC. Patrick owns several golf courses in eastern Canada and is interested in investing in hotels *(link to Capstone 1)*. He had been a regular guest in all of DHC's hotels. In the past, DHC has partnered with Kuzoff Golf Inc. (KGI), Patrick's company, to market golf and travel packages *(link to Capstone 1)*. Prior to Patrick providing DHC with financing and joining the board, both Derek and Jessica were impressed with Patrick's business acumen and had found him to be extremely cooperative and easy to work with.

Derek now owns a small part of KGI (amount not provided). As a result, Derek could have a conflict of interest when making decisions that could impact KGI and DHC (refer to discussion regarding acquisition of Holiday Tours Inc.).

Mission/Vision

The board has changed its vision and mission statements to incorporate its investments in the ski and golf resorts.

In the vision statement, "welcome," "attentive and personalized" and "unique and luxurious historical setting" have been removed, and "experiences" and "resorts" have been added.

The revised vision is: "*We make guests feel special by providing exceptional services and experiences at our hotels and resorts*."

The mission statement was also changed: the word "boutique" has been removed and "luxury," "resorts" and "experiences" have been added. Additionally, "in noteworthy historical sites," "welcoming and luxurious atmosphere" and "caring" have been removed.

The revised mission statement is: "*We operate unique luxury hotels and resorts, providing each guest with attentive service and experiences beyond expectations*."

One of the main objectives is to continue to concentrate on being a unique hotel or resort that provides exceptional service to its customers.

The changes are important because:

- by removing "historical setting" and "boutique" while adding "resorts," the revised vision and mission statements allow for an increase in the scope of hotels that DHC will operate.

- DHC has widened the scope of what could make the hotel unique, since it does not have to be a historical site.
- DHC still wants to provide exceptional services, which can come in many forms. Changing the wording from “personalized services” to “experiences” has broadened the scope of which services apply.

Revenue and Comparison with 2019

The following is a comparison of revenues for the year ended December 31, 2022, with revenues for the year ended December 31, 2019.

	2022	**2019 (Draft Info)**	**Change**
Room revenue	$83,886	$77,262	9%
Food and beverage revenue	$48,654	$43,496	12%
Spa services revenue	$1,500	$1,870	-20%
Golf revenue – annual membership fees	$365	NA	NA
Golf revenue – greens fees	$1,630	$1,396	17%
Management fees from HHH	$1,426	NA	NA

- Room revenue has increased by 9%.
- Food and beverage revenue has increased by 12%.
- Spa services revenue has decreased by 20%. This decline is consistent with expectations, after a large, well-known spa operator opened in the local area in 2018 (*link to Capstone 1*).
- Golf revenue – annual membership fees were not earned in 2019; however, in 2020, the golf course went semi-private (*link to Capstone 1*). Golf revenue in total (membership fees and greens fees) has increased by 43%; it appears that this was a good decision.
- Management fees from HHH were not earned in 2019 and relate to the management contract signed with HHH (*link to Capstone 1*). It should be noted that the management fees revenue is less than was forecast for 2022 in Capstone 1.

	2022	**2019**
Room operating costs	$44,460	$39,613
	53%	51%
Food and beverage costs	$33,085	$29,577
	68%	68%
Cost of spa services	$1,050	$1,050
	70%	56%
Cost of golf services	$1,523	$1,167
	76%	84%

- Despite the 20% decrease in revenue at the Awani spa, the cost of spa services has not declined.
- The cost of golf services as a percent of revenue has decreased substantially; it appears that going private was a good decision from a financial perspective.

Other:

- Net revenue management fees for the HHH contract are $1,426 - $898 = $528 (37% margin). When we compare this net revenue to the potential revision to the management contract with HHH, we find that this is lower than the new proposal by Martha.
- Marketing and sales costs increased by $1,635 (from $2,489 to $4,124), which is a 66% increase, and is an increase from 2% of revenue to 3% of revenue, excluding the management contract.

Financing

- The line of credit is at its maximum limit of $4 million. It now has the following covenants:
  - Lender approval is required prior to any payment of dividends; previously, dividends in excess of $2 million required lender approval *(link to Capstone 1).*
  - Maximum debt-to-equity of 2.5 *(link to Capstone 1):*
    - The current debt-to-equity is 1.15 ($93,216/$80,804), so DHC remains in compliance with this requirement. This is generally the result of the repayments on the long-term debt, as well as the accounting for the convertible bond, which resulted in most of the proceeds being recognized as equity rather than as debt *(link to Capstone 1)*.
    - One significant issue that could impact the debt-to-equity ratio is the potential loan that could be obtained from Global Stay N Play Corp. This is an important decision factor in assessing whether to go ahead with the franchise option.

New Objectives

DHC's primary objectives are to achieve a minimum occupancy rate at each hotel of 75% and an overall ADR of $430. Additionally, DHC wants to only invest in projects that will earn a minimum of 12%. While it is not specifically stated that this refers to ROI, this metric seems to be the most logical one to use, given that the 12% desired return seems to refer to return on investments.

Quantitative Analysis *(based on looking at **new** and/or comparing financial statements to Capstone 1)*

While the candidate is not expected to recap KSFs, perform ratio analysis or do a SWOT analysis in the detail illustrated below, they may have done so and may draw upon these various elements in their Day 1 case analysis.

The candidate was provided with calculations of certain performance measures and ratios for DHC, and the boutique industry benchmarks for both 2019 and 2022. They could analyze these performance measures and ratios and discuss DHC's performance relative to the boutique hotel industry, to gain a better understanding of DHC's financial position.

Summary of Ratio Analysis

Boutique hotel industry (information provided in case):

	DHC		Industry Benchmarks	
	2022	**2019**	**2022**	**2019**
Rev/PAR	$302	$280	$328	$262
Occupancy rate	72%	70%	80%	78%
ADR	$420	$400	$410	$335
Current ratio	0.2	0.2	0.8	0.8
Debt to equity	1.2	2.1	1.9	2.6
Total debt to assets	0.5	0.7	0.6	0.7
Return on equity	6%	8%	12%	11%
Operating margin	8%	9%	17%	16%
Profit margin	3%	3%	9%	8%

There are three important industry standards:

- Average occupancy rate (Occ):
  - % of rooms available that are sold
    = Total rooms sold/Total rooms available for sale
    = RevPAR ÷ ADR

- Average daily rate (ADR):
  - Used to measure financial performance and compare to competitors
  - Average price paid per room (based on the rooms sold/occupied)
    = Total room revenue ÷ Total rooms sold
    = RevPAR ÷ Occ

- Revenue per available room (Rev/PAR):
  - Average daily room revenue generated per available room
    = Total room revenue ÷ Total rooms available for sale
    = ADR × Occ

    Increasing Rev/PAR means either/or:
    - Rates are increasing
    - Occupancy rate is rising

Total room revenue = ADR × # rooms × Occ rate × 365 (for annual)

Total room revenue = Rev/PAR × 365 (for annual)

Operationally, success is viewed as:

- a high occupancy rate (the percentage of total rooms available that are occupied).
- a high average daily rate (ADR).
- an operating margin, net profit margin and return-on-equity ratio that are at least in line with, or superior to, industry averages for boutique hotels.

Analysis:

- Although DHC's 2022 ADR of $420 is higher than the industry average of $410, the occupancy rate is lower (72% versus 80%) and Rev/PAR is lower ($302 versus $328). In 2019, DHC's ADR of $400 exceeded that of the boutique segment industry benchmark of $335, as did its Rev/PAR ($280 versus $262), but its occupancy rate of 70% was lower than the industry rate of 78%.

  Overall, DHC appears to have not kept up with industry growth. The biggest difference appears to be in the ADR; the industry increased by 22% and DHC increased by only 5%. This could partly be due to the penalties enforced by First Canadian Hotel Reviews due to Doug Mallette's unethical behaviour *(link to Capstone 1)*.
- DHC's current ratio is improved slightly from 2019 to 2022, but is well below the industry average of 0.8, suggesting that it will have difficulties servicing its current obligations as they come due. Due to the current portions of DHC's long-term loans and line of credit having increased to the maximum amount of $4 million, DHC's current liabilities as at December 31, 2022, are very high.
- Both the debt-to-equity and total debt-to-assets ratios have decreased from 2019 to 2022 and are favourable relative to the industry averages. This is mostly due to the convertible bond being recognized primarily as equity *(link to Capstone 1).* There is a clear financial constraint on cash. However, DHC's debt-to-equity ratio is much lower than industry benchmarks, which could mean that the company could borrow more in order to fund the opportunities it is currently presented with.
- DHC's return on equity has declined significantly from 2019 to 2022. This is due to the substantial increase in shareholders' equity, given the recognition of the convertible bond, with limited growth in earnings since 2020. That is, earnings have increased by 5.3% [($4,449 - $4,225)/$4,225] since 2019 whereas shareholders' equity has increased by 60.0% [($80,804 - $50,521)/$50,521]. The industry average return on equity is 12%, so DHC has fallen significantly behind. DHC wanted to increase this to 11% by 2020, which has not been achieved and, in fact, the return on equity has worsened since 2019 *(link to Capstone 1).*
- The investment in TMSR is part of the reason for the decline in financial performance. Currently, the company has invested a total of $14,076 ($5,459 plus an interest-free loan of $8,617), with only a return of $365 in 2022. This results in a return on investment of only 2.6% ($365/$14,076). The investment requirements for TMSR have been substantially higher than originally projected *(link to Capstone 1).*
- The HHH management contract is contributing a net profit of $528 ($1,426 - $898). This is lower than the initial expectation of $671 *(link to Capstone 1).*

- DHC's profit margin has not changed significantly from 2019 to 2022 (3.4% to 3.2%). The operating margin declined from 9.2% to 7.9%. Over that same period, the industry averages increased by 1%, from 16% to 17%, and 8% to 9% respectively. This may be due in part to DHC paying higher wages for full-time employees *(link to Capstone 1),* and to DHC's Rev/PAR and occupancy rates falling below the industry average.

Conclusion

DHC's performance measures and ratios for the core boutique hotel business have deteriorated and fallen behind the industry. While the industry has been able to increase room rates and realized benefits from the growth of the industry, DHC has not. Therefore, DHC is at risk of losing its competitive advantage in its core business.

Key Success Factors (KSFs)

Note: The KSFs outlined are not listed in the Capstone 1 case. In the Capstone 1 case, there is discussion of competition based on price, service, location and amenities within a given star rating, and, where the emerging trends are itemized, there is reference to the importance of a recognizable brand. It is also mentioned that franchise agreements are common in the industry. The candidate will have used this information, along with their research, to identify the key elements of success.

Key success factors in the overall hotel industry or boutique hotel segment include:
- being part of a franchised chain, to enhance brand recognition, marketing and quality.
- location, including either offering or being near facilities and services desired by customers.
- processes to ensure that prices are in line with those of competitors.
- professional, skilled, polite and competent staff.
- access to seasonal labour.
- maintaining the hotel and amenities, to ensure good condition.
- keeping up to date with technological changes.
- anticipating the needs of customers through the use of market research, given that customer retention and attraction of new customers is vital.
- brand recognition, as word-of-mouth advertising is often the basis on which travellers determine where to stay; there is usually at least one unique feature that drives the hotel's brand and reputation, allowing the operator to charge higher prices.

Revenues in the hotel industry are seasonal, and influenced by:
- economic conditions impacting the number of trips, length of stay and quality of hotel used by business and leisure travellers, including:
  - per capita disposable income allocated to travel. This is impacted by interest rates, personal income tax rates and employment rates. In addition, fuel prices impact disposable income, as well as the type of transportation used to travel.
  - the level of consumer confidence. The higher the level of consumer confidence, the more dollars are spent on travel.

- corporate profits and the amount of corporate spending available for business travel.
- the number of international visitors travelling to Canada.
- political factors, such as the risk of war and terrorism, which can affect foreign exchange rates, amount of border security and cost of holiday packages and air flights.

The candidate could also perform a SWOT analysis as part of their situational analysis, as a way of identifying key changes.

Strengths *(from Capstone 1 that are still relevant for this case and **new** information in Day 1 case):*

- The DHC brand is recognized for luxury accommodation and its "above and beyond" level of service.
- DHC's hotels are located in attractive tourism destinations, allowing DHC to charge premium prices.
- DHC's hotels are in unique and historically significant buildings, which is a draw for customers.
- DHC's managers/shareholders have considerable experience in the hotel business and have a vested interest in DHC's success.
- DHC's debt ratios are lower than its competitors, potentially providing more borrowing capacity.
- Management is involved in the day-to-day operations and is committed to meeting guests (Alyson, Jessica and the managers of each hotel).
- DHC's mix of business and leisure travellers has remained constant, with only 10% of revenue generated by business travellers versus 30% for the industry *(link to Capstone 1)*. This has now become a strength because the number of business travellers is only expected to increase by 2% versus a 5% increase for leisure travellers.

Weaknesses *(from Capstone 1 that are still relevant for this case and **new** information in Day 1 case):*

- In 2019, DHC had higher ADR and Rev/PAR metrics than its competitors, with an ADR of $400 versus the boutique industry average of $335, and a Rev/PAR of $280 versus $262 for the industry *(link to Capstone 1).* By 2022, these metrics are no longer strengths; DHC's ADR of $420 is almost in line with the boutique industry average of $410 and its occupancy rate is only 72%, compared to 80% for the industry.
- Since the ADR is now on par with the industry, the premium price that DHC was able to charge in the past has been lost *(link to Capstone 1).*
- There was limited growth in DHC's revenues between 2017 and 2019. Although there was some growth in revenue between 2019 and 2022, that growth is not significant, and suggests that DHC was not able to capitalize on industry growth rates.
- DHC is owned by two couples, each owning 50% of its common shares. This could result in sides being taken, such that no decisions can be made, given the equal ownership interests. Patrick will become a 20% owner in 2027 when debt conversion occurs, or sooner if he chooses to convert earlier. This could give him some control in situations where there is a tie between the other owners (20% each).

- Patrick has joined the board as the fifth director. As he has sided with Derek on all decisions, this appears to have raised concerns.
- DHC has four boutique hotels and manages an additional hotel (HHH). As these hotels are all located in Canada, DHC lacks a global presence.
- DHC does not use the franchise model, which is commonly used by large competitors to help finance growth.
- Although customer-loyalty programs are important to many customers, DHC does not offer such a program.
- DHC has a low current ratio, and minimal cash and cash equivalents.
- DHC currently has significantly lower occupancy rates than the boutique hotel industry (72% versus 80%).
- DHC has little diversification of revenue, as 96% of all revenue in 2022, and 97% in 2019 *(link to Capstone 1)* comes from accommodation and food and beverage sales.
- The management contract with HHH appears to have created some conflicts with Martha.

Opportunities *(from Capstone 1 that are still relevant for this case and* ***new*** *information in Day 1 case*):

- The Canadian dollar has declined relative to many other currencies, making it less expensive for international travellers to visit Canada.
- Canada is seen as a safe tourist destination and was recently ranked as the fifth best location for a vacation. This is likely to result in an increased number of international travellers.
- The boutique hotel segment is still in a growth stage, and growth is expected to remain at 4% annually for the next four years.
- Travellers between the ages of 35 and 45 are looking for experiences both inside and outside the hotel, and are willing to pay a premium to acquire new skills while travelling, such as in photography, cooking and painting, which hotels are starting to offer.
- The growth rate for leisure travellers is expected to be 5%. DHC has a higher percentage of leisure travellers than the industry, so should be in a position to benefit from this increase.
- The boutique hotel segment continues to appeal to young and affluent travellers.
- Sales of high-end ski and golf packages have seen growth, which is expected to continue for at least five more years.
- Hotel operators are vertically integrating up and down the supply chain to diversify revenues and profits, and improve margins.
- Although Airbnb and VRBO are attracting many travellers, there are still those who want to be pampered. As long as the price is seen to be appropriate for the service, customers are willing to pay the premium.

Threats *(from Capstone 1 that are still relevant for this case and* ***new*** *information in Day 1 case):*

- Interest rates are rising, causing debt costs to increase. As it has a balance of $4 million outstanding on its line of credit, this impacts DHC.
- The number of business travellers is forecast to increase at only 2% annually, which could impact revenues.

- Should DHC continue to manage HHH and the conference centre, the ADR is likely to be negatively impacted, given that conference attendees tend to pay lower room rates.
- Sites such as Airbnb and VRBO are attracting many travellers, reducing the number of hotel reservations.
- Given the favourable outlook, global chains are expanding into the Canadian boutique hotel market. The increased competition will make it more difficult for DHC to be successful in the future.
- Global chains are acquiring independently owned hotels in order to expand, reducing the number of independent hotel operators and making it increasingly difficult to compete.
- Global chains are expanding by using the franchise business model, which requires less initial capital investment *(link to Capstone 1).*

Summative Assessment #2 – Analyzes the Major Issues

For Summative Assessment #2, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate sufficiently completed a reasonable assessment of the major issues facing DHC.

Unsure – The candidate attempted to complete a reasonable assessment of the major issues facing DHC.

No – The candidate clearly did not complete a reasonable assessment of the major issues facing DHC.

Technical Competencies
2.1.1 Evaluates entity's governance structure (policies, processes, codes).
2.3.3 Evaluates strategic alternatives.

Enabling Competencies
2.1.1 Defines the scope of the problem.
2.1.2 Collects and verifies relevant information.
2.1.3 Performs appropriate analyses.
2.1.4 Integrates information to investigate each potentially viable solution or conclusion.
2.1.6 Uses creativity and innovation to enhance problem-solving and decision-making.

This summative assessment is based on Assessment Opportunities #2 to #6.

Assessment Opportunity #2 (Strategic Issue #1 – Investment in Holiday)

A competent candidate will complete both a quantitative and qualitative assessment of:
- *the proposal to purchase Holiday (with KGI or alone); and*
- *remaining with Holiday with new owners, at potentially reduced rates.*

Quantitative: The candidate should estimate the value of the shares of Holiday and calculate the amount of cash required by DHC to make the investment (at both 40% and 100%). They should calculate an estimated return on the project. They could also prepare an estimate of the change in revenue, given the expected decrease in rate and increase in occupancy for 2024, to help DHC better understand the potential situation/implications of a new owner that is not DHC.

Qualitative: The candidate should discuss the proposed investment in Holiday (both 100% and jointly with Patrick), including: the fit with DHC's vision, mission, core values (which remain unchanged from Capstone 1) and industry trends; the implications of joint ownership/investment; and the implications of having a new owner of Holiday that is not DHC.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Proposed Investment in Holiday – Quantitative Analysis

Based on a multiple of six times EBITDA, the cost of purchasing Holiday's shares and the expected return (using EBITDA) would be calculated as follows:

	Alone (100%)	**With KGI (40%)**
EBITDA	$2,250,000	$2,250,000
Industry valuation	6	6
Estimated value of Holiday	$13,500,000	$13,500,000
Percentage owned	100%	40%
Cost to purchase	**$13,500,000**	**$5,400,000**
Estimated annual earnings	$2,250,000	$900,000
Expected return	17%	17%

If DHC decides to acquire Holiday:

- EBITDA would increase by $2.25 million per year if DHC purchases 100%, and by $900,000 per year if it invests jointly with KGI (40% to DHC, 60% to KGI, as proposed), positively impacting DHC's cash and cash equivalents.
- Historically, Holiday has achieved an operating margin of 20%, which would help to increase DHC's operating and profit margins.
- DHC could set the ADR and may be able to maintain a higher rate than that proposed by another owner.

- The expected return on investment is 17%, which is greater than the 12% rate that DHC requires on projects under its new objectives. This is based on EBITDA, which is the only information available.
- Obtaining the funding required may be an issue, given the current financial position. As it has a favorable debt-to-equity ratio, DHC could seek financing. Alternatively, it could raise capital from its current shareholders in exchange for additional shares in the company.
- The amount required to invest jointly would be lower; however, the rate of return will be the same.

Proposed Investment in Holiday – Qualitative Analysis

Trends:

- There is an increasing trend for hotel companies to expand their offerings. By offering vacation packages through Holiday, this would help DHC align with that trend (*link to Capstone 1*).
- The sale of high-end ski and golf packages is predicted to continue its growth for at least five more years. It would benefit DHC to capitalize on this growth. Many of these packages are sold to international travellers and the trend is for international travellers to increase; the number of leisure travellers is expected to increase by 5% and ski and golf packages will be sold to leisure customers. It would benefit DHC to share in the growth.
- The investment in Holiday will allow DHC to vertically integrate, similar to what the larger hotel operators are doing. This will allow for better cost control and improved margins, as well as for some diversification in revenues and profits.

Core values:

- A core value is to embrace new ideas and change; offering packages would accomplish this.
- A core value is to become part of the community. Providing packages that use multiple services within the community, such as transportation, helps meet this.

Mission/vision:

- The new vision and mission add the words “experiences” and “experiences beyond their expectations”; selling ski and golf packages will help do this.
- Holiday provides services to travellers; this is in line with DHC’s goals.

KSFs:

- Operational success includes having a high occupancy rate; offering vacation packages might help attract more customers to DHC’s hotels, thereby increasing the company’s overall occupancy rate.
- Operational success is also achieved with high profits and margins; the investment in Holiday appears to have higher operating and profit margins than the hotel business.

Other considerations:

- Kelvin is concerned that investing in Holiday would use resources that would be better used in the core business and moves DHC away from that core business (which is a primary objective in 2023).
- Vertical integration in the industry continues to be common among DHC's competitors. Acquiring Holiday would allow DHC to continue to adapt and keep up with its competition.
- Holiday sells to both international and domestic travellers. DHC has yet to develop a presence in the market for international travellers; this may help DHC enter that market.
- Holiday has been in the business for more than 15 years, has substantial experience and a good reputation in this market.
- If DHC invests in Holiday, there may be an opportunity to influence the type of packages sold, to make sure they benefit DHC. It might also be possible to sell packages at DHC's other hotels.
- DHC has successfully worked with Patrick on golf and travel packages in the past; this supports investing with KGI rather than going alone.
- Holiday has expertise that DHC could benefit from.
- If DHC decides to pursue cooking retreat packages at the Northern Ontario hotel, Holiday can be used to market and promote these packages; if DHC goes alone, this could be marketed by DHC *(integration).*
- Whether as part or 100% owner of Holiday, DHC could design and offer more luxury packages that can be sold for higher amounts, and higher room rates if bundled with more luxury amenities and services.
- As a director on DHC's board, Patrick will have a conflict making a decision on the purchase of Holiday (see conflict discussion below).
- As competitors of DHC, if DHC purchases Holiday, other hotels may stop using Holiday.
- One of the reasons for the investment in TMSR was the joint marketing of ski and hotel packages. Buying Holiday could potentially create a conflict.
- Given that DHC has no prior experience in offering vacation packages on the scale that Holiday provides, this could be detrimental to DHC.

Conclusion

The investment in Holiday meets many of DHC's objectives, including those related to cash flows and investment returns. The major drawbacks are that:

- this acquisition requires a significant amount of upfront cash.
- it may not be consistent with concentrating on the core business of unique luxury hotels and resorts.

Kelvin has questioned the 40% ownership, which Derek deferred for discussion at another time. Perhaps another percentage should be considered, such as 50% each, for joint control. There are other considerations that should be discussed (see conflict discussion below).

Not Investing in Holiday – Quantitative Analysis

If DHC continues to use Holiday, it is expected that the number of room nights will increase by 25% and that the room rate will likely decrease to $310 per night for 2024. Patrick states in the case, “I did a rough calculation, factoring in the reduced rates and increase in occupancy, and estimate that our room revenue, net of operating costs, will decrease by about $40,000 for the year.”

The candidate can question the assumption used but does not need to recalculate.

- Presumably, there would be an increase in food and beverage services with the increased number of rooms and guests, which may offset some of this decrease.
- It should be noted that these results are based on estimates from Holiday and may not be reflected in actual results.

Not Investing in Holiday – Qualitative Analysis

- DHC will need to prepare for an increase in volume of 25% on these packages. We will have to consider how this will impact operational requirements, such as staff numbers.
- An increase in rooms occupied will improve the occupancy rate metric but at the same time reduce the ADR as the expected rates decline.
- There is no information provided on who the expected purchaser is. This may impact the relationship in many ways; for example, if it is a competing hotel chain, it may limit DHC’s reservations.

Assessment Opportunity #3 (Strategic Issue #2 – Convert Northern Ontario to a Global franchisee under the FitzGeralds name)

A competent candidate will complete both a quantitative and qualitative assessment of whether the Northern Ontario hotel should become a franchisee of Global.

Quantitative: The candidate should calculate the potential profit from the Northern Ontario hotel if it is converted to a franchise, and compare it to the hotel’s current results.

Qualitative: The candidate should discuss the advantages and disadvantages of being a franchisee, including the fit with DHC’s vision, mission, and core values. The candidate should also address whether DHC’s new objectives can be achieved through this option. The candidate could also comment on the proposed terms of the franchise agreement, and how they can be revised to be fairer for DHC.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Relevant Background Information from Capstone 1 (Researched by candidate):

- The franchise model is used by many chain hotels. With this model, the hotel is owned and operated by the franchisee, who pays a franchise fee for use of the brand name and other support systems, such as the initial setup, training and ongoing advertising. The level of capital investment is high for the franchisee because it must contribute the upfront capital for the business, and therefore, the franchisee incurs much of the risk. The franchisee is under stringent controls to ensure adherence to standards set by the franchisor.
- The main difference from the owned model is that the franchisee is provided support by the franchisor and obtains brand recognition, which will lower the risk related to success of the venture.

Issue Raised by the Board

- Currently, Northern Ontario's ADR and occupancy rates are well below those of the other locations, which is lowering the corporate-wide metrics. In fact, occupancy rates have not changed since 2020 (at 60%), although the ADR has increased to $350. The hotel had the lowest occupancy rate and an ADR lower than the company's average *(link to Capstone 1)*, and the location metrics have not changed since then (as per Jessica). The Northern Ontario hotel is the largest of DHC's current holdings, with 235 rooms *(link to Capstone 1).*
- The Awani Spa is not performing well, given that a large, well-known spa operator opened in the local area in 2018. As a result, the licence was tested for impairment in 2020 *(link to Capstone 1).* Since then, revenues have declined from $1.87 million to $1.5 million in 2022, and the costs have remained the same.

Quantitative Analysis

- Derek states, "If we continue to operate as is, we can expect room revenue net of room operating costs and marketing costs to be $6.7 million. If we operate as a franchisee, room revenue net of room operating costs, franchisee fees and marketing, reservation and technology fees should be around $9.2 million."
- By becoming a Global franchisee rather than continuing to operate as it is, the Northern Ontario hotel is expected to generate $2.5 million in additional operating income on an annual basis. It should also be noted that, with the higher occupancy rate, food and beverage and spa service revenues would likely increase, adding to the operating income.
- It is also necessary to consider the upfront franchise fee of $200,000. This relatively small investment would be recovered in less than one year.
- An additional investment will be required to renovate the hotel so that it complies with Global's standards. An interest-free loan of up to $8 million will be available (the actual amount required is unknown).
- DHC historically spends $1 million per year on marketing, website costs and promotions. If Global takes on these costs, DHC could potentially save up to $1 million per year.
- If there are problems with the contract, the $8 million loan will have to repaid/refinanced.
- The annual increase in operating income of $2.5 million would increase cash flows and could allow DHC to start paying dividends again.

- The occupancy rate should increase from 60% to 70% with franchise support.
- The ADR is expected to increase to $420, which will help increase the overall average ADR for DHC.
- Based on the estimated additional income, the return on this investment will easily be over the required 12%, given that the initial investment is only $200,000. However, the depreciation on the capital investment for renovations of $8 million must be factored into this.

Qualitative Analysis

Advantages:

- Becoming part of a large and successful franchise will provide DHC with access to the best practices in the industry and may help improve all of its hotel operations.
- Operational success includes having a high occupancy rate, and the franchise option suggests that the occupancy rate will increase *(link to KSF).*
- Operational success is achieved with increased operating and net profit margins. Should the franchise model be pursued, the operating margin is slightly lower than it is currently *(link to KSF).*
- Technology risk is a general risk for the hotel industry. It is important to stay at the forefront of technological advancements for internal systems, and to maintain a strong Internet presence. As a franchisee, DHC would pay a monthly fee and, in return, Global would provide all technology requirements, upgrades and website maintenance *(link to industry risks).*
- Brand recognition is important and the FitzGeralds brand is well known and respected for its boutique hotels *(link to emerging trends).*
- Global will spend 50% of the 3.5% fee that it collects from DHC on the Northern Ontario hotel; this shows a commitment on the part of Global and could result in an increase in occupancy.
- Becoming a franchisee will allow DHC to access Global's customer-loyalty program, which is becoming more important to offer in the industry *(link to emerging industry trends).*
- FitzGeralds is in the five-star category of boutique hotels that target leisure travellers, which appears to fit with DHC's new vision and "making guests feel special by providing exceptional services." Similarly, it would appear to fit with the new mission: "We operate unique luxury hotels … providing each guest with attentive service … beyond expectations" *(link to mission/vision).*
- Global has a good reputation as a franchisor; therefore, this lowers the risk that becoming a franchisee would harm DHC's other locations or brand (Alyson is worried that, while Global has a good reputation, that can quickly change and DHC's other hotels might suffer.).
- The FitzGeralds brand targets leisure travellers, who are expected to increase by 5% *(link to industry trends).*
- Since Global is international, this will give DHC access to a larger customer base. Presumably, Global will market to international visitors, who are forecast to increase *(link to industry).*
- Becoming a franchisee might help with the retention of management as managers often leave after about eight months (Jessica's comment).
- Global will provide an interest-free loan to finance the hotel renovations that DHC was planning to do in 2024; the interest-free loan would be a good way to access cash when DHC's other options may be limited.

- The agreement is for 20 years; however, as there is a penalty-free termination by either party allowed every five years, DHC can terminate the contract if the arrangement is not working. However, the 20-year term provides some comfort that this is a long-term commitment by Global.
- The spa has continued to struggle. It is not clear if the spa will continue to operate if the hotel becomes a franchise. If the change results in increased occupancy as expected, the spa results may improve.

Disadvantages:

- As a franchisee, there are a significant number of standards that need to be met, which are all defined by the franchisor (Global); DHC may dislike losing its autonomy on business decisions.
- A general risk for the hotel industry is reputational risk. Should DHC become a franchisee, DHC's reputation will be tied to Global's. Customers may start to think that DHC's other hotels are franchised. Currently, Global has a good reputation in the boutique luxury segment but that could change, and DHC would suffer (Alyson's comment) *(link to industry risks).*
- Global can terminate the agreement at any time if its requirements are not met; this gives a lot of power to Global. DHC should ensure that the "standards" listed in Bullet 1 of DHC's responsibilities are clearly defined. Since DHC operates to a high standard already, there should be no issues with meeting Global's requirements.
- Maintenance of the property, upgrades to furniture and fixtures and renovations may be more extensive, as DHC must comply with Global requirements. This could potentially cost more than the $8 million that Global is willing to help finance.
- DHC must be available for property inspections without notice, which may not be an issue if DHC is meeting the standards; however, preference would be to have advance notice so that DHC is prepared.
- DHC must purchase all room supplies and amenities from Global, who could demand higher prices compared to the general marketplace. Global has set a target to control costs, which may be more difficult if Global increases the cost of the supplies.
- Room rates must be approved by Global, who will have control over much of what impacts the margin.
- Global set targets for ADR and occupancy rates to be reached by 2024, which franchisees say are achievable. These will increase each year thereafter. It is unknown whether DHC will be able to meet these targets, which are quite aggressive. Also uncertain is how much being part of the franchise will increase these rates.
- Being part of the franchise could help with staff retention, per Jessica, but as employees may transfer to other Global hotels, could also hinder this.

Other considerations:

- This gives DHC an alternative method to compete.
- It is uncertain what "provide the lead in hiring of managers for the hotel" means. DHC has had issues with Martha's hotel, where it "assists" (integration). DHC is having a hard time finding managers already. DHC's role needs to be clarified in terms of finding and hiring managers.

- Global will require that DHC attend certain conferences. This will be an opportunity to learn from other operators and keep up to date on trends. DHC may be able to gain some additional knowledge from Global that will increase revenues at its other hotels. As the number of conferences to be attended, and approximate cost, is not specified, DHC should clarify this with Global.
- DHC must deliver financial statements for the Northern Ontario Hotel within 30 days of quarter end. Given the current accounting system, it is uncertain whether this is possible.
- The issue of the spa's continuing poor performance, and whether it will continue to operate, needs to be addressed. The increase in hotel occupancy could potentially help its performance.

Key Insight

The franchise model could potentially help alleviate many of the problems at the Northern Ontario hotel, including the capital needed for upgrades; however, since it must comply with Global's standards and policies, DHC will lose significant control over the hotel. The increase in income is driven by the ADR and the occupancy rate; as the current rate is only 60%, the target of 70% occupancy may not be achievable. To determine whether becoming a franchise is likely to help achieve the extra 10%, perhaps DHC can get an indication from other franchisees what percentage increase they experienced when converting. Also, an ADR of $420, which is a significant increase from $350, might not be a good fit for a Northern Ontario hotel.

Integration

We will need to determine how, and if, franchising will fit with the cooking-retreat option discussed below. It is possible that Global would not permit cooking retreats as it is not consistent with the rest of its hotels. This could impact key employees, such as Chef Norman, who may want more autonomy in their ideas and work.

Conclusion

DHC has struggled for years to make the Northern Ontario hotel successful. DHC may have to accept Global's lead and give up operational control of the hotel. Franchising might be the right answer for Northern Ontario. Global seems to think there is value here, which could increase the occupancy rates and ADR. With the global reach of Global and marketing to international travellers, the franchise of Northern Ontario has a chance to be more successful relative to its current status. Before proceeding, DHC should try to renegotiate some of the agreement terms and requirements and talk to more franchisees—that DHC selects—to ensure that the financial targets are achievable and that franchisees have a good working relationship with Global.

Assessment Opportunity #4 (Strategic Issue #3 – Cooking retreats at Northern Ontario hotel)

A competent candidate will complete both a quantitative and qualitative assessment of whether to offer cooking retreats at the Northern Ontario hotel.

Quantitative: The candidate should assess whether the proposal is likely to help DHC meet its objectives. They should use a relevant tool (such as payback period, breakeven analysis, NPV, etc.) to assess the potential impact of the cooking retreats on DHC's profitability. The candidate should question the assumptions used in the forecast.

Qualitative: The candidate should consider the pros and cons of the alternative, linking back to the mission, vision, objectives, etc. It is important for them to understand the "history" of Northern Ontario from Capstone 1.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Quantitative Analysis

The quantitative analysis is provided to the candidate in the case, and it states that it was prepared by the accounting department. The calculations should therefore be credible. The candidate is to discuss the assumptions and consider a sensitivity analysis (e.g., number of participants, incremental cost of food and cleaning and other operating costs).

	June to Dec. 2023	Jan. to Dec. 2024
Revenues	$3,600 × 20 × 7 classes = $504,000	$3,600 × 20 × 12 = $864,000
Incremental costs for food and room cleaning	400 × 20 × 7 = (56,000)	400 × 20 × 12 = (96,000)
Additional costs for kitchen staff	(120,000) × 7/12 = (70,000)	(120,000)
Marketing costs	(40,000)	(40,000)
Depreciation	1,000,000/10 × 7/12 = (58,000)	(100,000)
Additional operating profit	280,000	508,000
Less taxes at 27%	(75,600)	(137,160)
Additional net (after-tax) profit	204,400	370,840
Add back depreciation	58,000	100,000
Net cash flow	$262,400	$470,840
Operating margin	*56%*	*59%*
Profit margin	*41%*	*43%*

Assuming that the 2025 results are the same as in 2024, the payback period based on net cash flow is as follows:

		Balance to Pay Back
		$1,000,000
2023 cash flows	($262,400)	$737,600
2024 cash flows	($470,840)	$266,760
2025 cash flows	($470,840)	0

Payback = $1 million (upfront cost)/$470,840 (annual net cash flow) = 2.13 years.

<u>Impact on objectives:</u>

- DHC would require $1 million in upfront cash for the renovations, thereby delaying the possibility of paying dividends. As DHC does not currently have this amount of cash, it would have to be financed somehow.
- The increase in cash flows from this venture would increase DHC's operating cash flows fairly quickly, thereby making it more likely that DHC will be able to start paying dividends again.
- Return on this investment in 2024 is $370,840/$1 million = 37%. This meets the requirement that any long-term investment have a 12% return.
- Attendees at the cooking retreats will likely increase the occupancy rate of the Northern Ontario hotel, and the ADR might also increase.

<u>Sensitivity analysis:</u>

It is possible that Chef Norman's assumptions will fluctuate. Therefore, it will be important for DHC to assess how accurate the following measures are likely to be:

- Number of participants (occupancy)
- Rate charged
- Number of retreats, which may be seasonal
- Incremental cost of food and room cleaning
- Renovation cost, which is an estimate, and therefore might be higher

<u>Other considerations:</u>

- Depending on the level of disruption, occupancy rates at the hotel may decrease during the period of renovations to the kitchen.

Qualitative Analysis

- The cooking retreats would be consistent with the core value of embracing new ideas and change *(link to core values).*

- The cooking retreats would be consistent with the vision of providing exceptional services and with the mission of providing each guest with attentive service beyond expectations *(link to mission/vision).*
  - This aspect will be further accomplished, given that customers will get to personally interact with Chef Norman, a renowned chef.
- Operational success includes having a high occupancy rate, and this option may help to increase occupancy *(link to objectives).*
- Operational success also includes increases to the operating and net profit margins and return on equity. As the margins and returns are significantly higher than those for DHC, this should be possible *(link to objectives).*
- Reputational risk is identified as a general risk for the hotel industry. Chef Norman is a renowned chef with a good reputation *(link to risks).*
- DHC has no experience running cooking retreats, but Chef Norman has visited culinary schools around the world; DHC is therefore dependent on him for expertise. At the same time, there is a significant risk, given that this activity is tied specifically to Chef Norman. If Chef Norman decides to leave DHC, it may be unlikely that an equivalent chef would be able to take his place.
- As there is a trend toward health retreats, cooking retreats may also be attractive to travellers *(link to trends).*
- There is a trend for hotels to provide more experiences beyond just the hotel itself, and offering the cooking retreat does this *(link to trends).*
- The cooking retreats will attract new customers, those being the younger, more affluent customers ranging in age from 35 to 45, who want to be pampered and have a unique experience *(link to industry trends).*
- This will also provide travellers willing to pay a premium to acquire new skills with experiences both inside and outside the hotel *(link to industry trends).*
- The cooking retreats will allow DHC to compete in the industry where hotel operators are increasingly also offering all-inclusive vacation packages and retreats that include instruction on cooking *(link to industry trends).*
- A KSF is keeping up with customer needs in order to attract new customers, and offering cooking retreats meets this need *(link to KSF).*

Conclusion

Assuming that the underlying assumptions are valid—particularly the number of participants—the cooking retreats will add profits and cash flows to DHC. More work should be done to try and substantiate the assumptions used in the projection. The main drawback is that $1 million is required upfront and DHC does not have the funds or credit capacity. Perhaps DHC can simplify its plans and reduce the cost. If DHC can obtain the necessary funding, the payback period of only 2.13 years is short. If successful, the cooking retreats will help achieve DHC's objectives. The option appears worth pursuing.

Integration: If the decision is to proceed with the franchise arrangement, DHC will need to discuss with Global whether this can be done as well.

Assessment Opportunity #5 (Strategic Issue #4 – Potential HHH conference centre and a revised management contract)

A competent candidate will complete both a quantitative and qualitative assessment of signing a revised HHH management contract, with responsibility for the conference centre, and the alternative of terminating the contract.

Quantitative: The candidate should critique the assumptions underlying the forecast prepared by Martha and compare it to the forecast from Capstone 1. They should determine that the forecast is very optimistic and there is high risk that it will not be achieved.

Qualitative: The candidate should discuss the qualitative aspects of agreeing to the modified contract, which includes management of the proposed conference centre, versus terminating the contract. They could also consider the implications of not agreeing to the revised contract, discuss the impact of the revised contract on earnings compared to the existing contract, proposed revisions to the terms given by Martha, and the penalties that may be paid/received if the contract is terminated.

Conclusion: The candidate should consider both the quantitative and qualitative aspects of their analyses when drawing conclusions and making recommendations.

Excerpts from Capstone 1

The HHH contract is an example of the managed model. HHH uses DHC to operate the hotel on its behalf. In return, management fees based on gross revenues and gross operating profits are paid to DHC. HHH approves the annual budgets prepared and the hiring of employees but DHC has autonomy with respect to hotel operations. Per Capstone 1, HHH wanted a license for the use of the DHC brand name.

The management contract included the following significant provisions:

- *DHC receives 5% of gross revenues and 8% of the gross operating profits, as defined in the contract.*
- *DHC receives a licensing fee of 3% of gross revenues to use the DHC brand name.*
- *HHH agrees to deposit 4% of gross annual revenues into a reserve fund to finance future capital asset replacements and upgrades. DHC decides when the upgrades are required.*
- *Employees work for HHH except for senior and executive management, who work for DHC. HHH is involved in, and gives approvals on, all new hires.*
- *HHH sets gross operating profit and Rev/PAR targets that must be achieved (based on what competitors in the area do). If the targets are not met for two consecutive years, the contract can be terminated.*
- *The initial management agreement signed with HHH will last for 20 years.*
- *HHH can sell the property.*
- *DHC agrees to not operate another hotel within a 100-kilometre radius of HHH while it is party to this agreement, and for a three-year period after termination of this agreement.*

New Information in Day 1 Case

DHC signed a management contract with HHH. The contract corresponds exactly with the original proposal except for: a penalty of $50,000 per year remaining on the contract, for cancellation with cause, to be paid by the party in breach was added; and the clause requiring DHC to share any losses was removed.

Problems are developing in the relationship with HHH:

- HHH has not contributed the 4% into the reserve fund, as required by the contract.
- HHH has not completed the renovations to the rooms and lobby that DHC requested. This is a breach of the contract, which DHC could potentially use to terminate the current contract without penalties.
- It has been suggested that Martha's not contributing to the fund and delaying renovations has resulted in DHC not meeting the metrics for one year.
- As HHH has not given its final approval on the selected candidates, DHC has had problems hiring managers.

Quantitative Analysis

Assumptions may be optimistic:

- The forecast prepared by Martha suggests that DHC's 2024 net operating income will equal $926,392, which is $398,392 (75%) higher than the actual net profit in 2022 of $528,000.
- The room rates are significantly lower in the revised management contract. In Capstone 1, the ADR was $320 by 2023 with occupancy of 80%, but in the forecast, the ADR for 2024 is $270. This is likely due to the lower group rates provided for conference attendees *(link to industry analysis).*
- The forecast anticipates that gross conference revenues will be 30% of room revenue, but the industry standard is only 10% *(link to industry trends).* This suggests that effort would need to be directed toward filling the 20% with leisure travellers (which supports the need for the overall renovations), or that this assumption may not be valid.
- Martha may be biased in her projections as she is in favour of the proposal and wants to get DHC to accept the changes she is proposing.
- The occupancy rates are holding at the 80% previously forecast and then increase by 5% in 2026, even though business travellers are only expected to grow at the rate of 2% *(link to industry trends).*
- Fee changes:
  - DHC will receive 7% of gross room revenue, compared to 5% in the previous agreement, which is presumably intended to compensate for the extra work of managing the conference centre *(link to Capstone 1).*
  - DHC will no longer receive any percentage of the gross operating profit but will now receive 10% of gross conference revenue *(link to Capstone 1).*
  - DHC will receive 4% of gross room revenue for the licensing fee, compared to 3% previously *(link to Capstone 1).*
- In the forecast that Martha provided, management salaries and benefits have only been increased by $52,000 relative to the actual amount that DHC spent

in 2022 ($950,000 - $898,000). This figure does not seem to be high enough, given that a conference manager will likely need to be hired. We should clarify whether this position is at the expense of HHH or DHC, given that "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" *(link to Capstone 1).*

Impact on objectives:

- There is no upfront cash required, thereby making it more likely that DHC could pay dividends again in the future.
- The operating margins for the revised management contract are 49% to 51%, which appears more optimistic than the 32% of the initial proposal.
- Since this is a management contract, there will be no impact on DHC's occupancy rate or ADR.
- Since no capital outlay is required for the management contract, increased earnings would help the ROE but are not applicable to the ROI.

Terminating the contact:

It is also important to note that, if the existing management agreement was terminated, it may cost DHC $50,000 per year for the remaining 17 years, given the cancellation clause that was added to the agreement. Further, and more importantly, DHC would lose out on incremental net revenue if the contract were terminated. Another consideration is which party is at fault. DHC could be seen as the "at-fault" party as a result of terminating the agreement. However, Martha could also be seen as the "at-fault" party as a result of not making renovations to HHH as previously agreed, discontinuing her contributions to the renovation fund and her lack of cooperation relative to hiring a manager.

Qualitative Analysis

Revised management contract:

- Since it cannot compete for leisure travellers due to increased competition from new chain hotels, HHH wants to attract business travellers. (Alyson thinks that targeting the business traveller will improve the Rev/PAR.) However, the number of business travellers is forecast to increase at 2% annually, which is a slower rate than the 5% for leisure travellers *(link to industry trends).* Perhaps HHH is not targeting the right market.
- HHH has now committed to do the room and lobby renovations and build the conference centre; the renovations alone should help increase occupancy rates.
- Kelvin thinks he could design a unique conference space; this could help draw more customers to the conference space and therefore increase revenue.
- Managing an upscale hotel is consistent with DHC's core business *(link to mission/vision).*

Reasons to consider termination of the contract:

- Although it is a management contract, it is under DHC's brand and therefore any changes will reflect on DHC. Martha has already neglected to renovate the hotel as she had originally agreed; if the building is allowed to deteriorate, this would reflect negatively on DHC's brand.
- It is questionable whether a new contract will support the vision; DHC appears to have lost control of hiring the right managers and renovations, which may negatively impact DHC's reputation *(link to mission/vision).* Perhaps DHC could revise the new management agreement, to ensure that it is allowed to hire the managers of its choice.
- It is questionable whether the new contract satisfies the mission; DHC cannot guarantee that the hotel is luxurious and that each guest will receive attentive service beyond expectations *(link to mission/vision).*
- DHC has no experience with managing conference centres and would have to hire this expertise.
- Once Martha gets what she wants, she may revert to her previous pattern of behavior. However, HHH's poor results appear to have legitimate reasons, some of which would be addressed by these changes, such as completing the agreed-upon renovations.

Consequences of Not Agreeing to the Revised Contract Proposal

In considering the best option, DHC should consider the potential of not agreeing to the proposed revisions.

Qualitative analysis:

- Due to Martha's breaches, DHC may be able to terminate the existing contract and receive penalties.
- If Martha does not proceed with the conference centre and instead continues with the status quo, the potential for conflict increases. If Rev/PAR does not meet its target in the next year, DHC may be in breach of the original agreement and HHH might terminate with penalties.
- In either case, there will be loss of profits on the existing contract.

Quantitative analysis:

- Penalties to be received:
  - 20 years (less 2020 to 2023), so 17 years remaining × $50,000 = $850,000.
- Potential lost profit:
  - Existing contract – from 2022 financial statements: $1,426 - $898 = $528, less other costs (such as the time cost of DHC's management team). DHC will also lose the incremental profit for the remaining 17 years of the contact.

Conclusion

The revised HHH management contract may not be the best option for DHC. As noted, it is not in line with industry trends and does not contribute to many of DHC's stated objectives. In addition, there is significant doubt as to whether Martha's projected results are achievable because the forecast, prepared by Martha, appears to be overly optimistic. Additionally, the forecast results from Capstone 1 were not achieved, which raises questions about the likelihood of Martha's latest forecast results being achievable.

Based on the poor working relationship with HHH, the best approach may be to not accept the revised contract. In addition, DHC should acquire legal advice as to whether HHH is in breach of the current contract; if so, DHC may want to consider terminating the contract (which will help ensure that DHC's brand is not put at further risk, given Martha's actions).

Assessment Opportunity #6 (Strategic Issue #5 – Governance Issues)

A competent candidate will recognize that both Patrick and Derek have a conflict of interest with respect to the investment in Holiday.

The candidate should also question why Patrick and Derek seem to share the same viewpoint and support each other so much.

Governance and Conflict of Interest

As a result of the convertible bond issued to him, Patrick Kuzoff has joined the board as a director.

- It was noted that Jessica and Derek had worked with Patrick in the past and were impressed with his business acumen and found him to be extremely cooperative and easy to work with *(link to Capstone 1).*
- In the board meeting dialogue, it appears that Patrick is always agreeing with Derek. On only one occasion did Patrick add anything to the discussion to support his viewpoint, and this was related to the Holiday option. In this case, Derek supported Patrick and did not add anything other than to support the 60/40 ownership split that Patrick proposed. Derek did not address Kelvin's concerns with respect to how the 60/40 split was arrived at, other than to say that he thought they should take Patrick's support and that he agreed with the split.
- The fact that Patrick's company, KGI, would have a controlling interest in Holiday could cause conflict when decisions are to be made pertaining to Holiday. There could be differences of opinion between what DHC and Patrick would want, but Patrick, having majority, may not consider DHC's opinion. These conflicts may then impact DHC's governance and decision making. Therefore, if DHC decides to split the cost of Holiday with KGI, DHC may want to consider a 50/50 split, to ensure that the company retains some control over the direction of Holiday.

- Derek's investment in KGI creates a further potential for conflict. He may become influenced by how any decision with Holiday would affect KGI, and therefore lose sight of what is best for DHC. At the very least, Derek should be made to disclose his ownership interest in KGI.
- The apparently non-independent opinion by Patrick should concern Alyson and Kelvin. They own 50% of DHC's shares now, but when/if Patrick converts (which he can do at his option), they will only have 40% of the votes. If Patrick always sides with Derek, this indirectly gives Patrick, Derek and his wife Jessica 60% of the votes.

Alyson and Kelvin should bring these concerns up for discussion at the next board meeting. It is important that they understand why Patrick and Derek are always in agreement.

Possible reasons could be as follows:

- It may somehow be linked to the Holiday proposed purchase, which Patrick is very interested in pursuing.
- The extent of Derek's investment is not known; this could be having an influence. Derek should be required to provide details on the size of his investment.
- It may be that Patrick respects Derek and therefore thinks he is always right.
- It is also possible that Patrick is not prepared for the meetings, so is not in a position to provide an independent opinion or, because he is the newest member, is hesitant to disagree with the chair.

Depending on the reason, a course of action can then be taken. At the very least, Patrick should be required to state his reasons for his opinion and his votes on each proposal. Given that Patrick and Derek (given his ownership in KGI) have a conflict when it comes to the Holiday proposal, they should not vote on this proposal or on future proposals with respect to this issue.

The candidate may add that the investment by Derek in KGI may potentially be an indication of a larger issue that needs to be addressed, and that a policy should be created for independence and conflict of interest.

Summative Assessment #3 – Conclude and Advise

For Summative Assessment #3, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate provided reasonable conclusions for each major issue.

Unsure – The candidate attempted to provide reasonable conclusions for each major issue.

No – The candidate clearly did not provide reasonable conclusions for each major issue.

Enabling Competencies
2.1.4 Integrates information to investigate each potentially viable solution or conclusion.
2.1.5 Recommends and justifies a solution or conclusion based on an integrative view of information for the situation.

The candidate should provide a logical conclusion that integrates the analysis for all five major issues (the investment in Holiday, the franchise opportunity with Global, the cooking retreats with Chef Norman in Northern Ontario, the proposed revision to the management contract with HHH, and the potential conflict of interest that exists between Derek/Patrick and KGI).

The recommendations should be consistent with the analyses performed. As well, an overall conclusion should be presented to provide a sense of completion to the report (a "wrapping up" or prioritization of the recommendations).

The candidate was asked for the alternatives that best meet the objectives, mission and vision for DHC. They should consider:

- the alternative's ability to help meet DHC's objectives of achieving a minimum occupancy rate at each hotel of 75%, an overall average daily rate of $430, and a minimum return of 12% on any new investments.
- the level of risk, the upfront investment required, the fit with DHC's mission and vision and core values, and how it fits with industry trends.

The candidate should consider the following:

DHC is trying to concentrate on its core business, that of operating unique luxury hotels. DHC has fallen behind in comparison with the boutique industry standards and is underachieving with respect to occupancy rates, Rev/PAR, and ADR. The candidate should also consider and comment on DHC's significant cash concerns, as the company appears to have no remaining borrowing capacity on its line of credit and the account manager at H&A Bank has been directed to monitor its account more closely. However, DHC may also be able to access additional debt financing, given that its debt-to-equity ratio is less than the bank's covenant, and the boutique hotel industry's average.

The recommendations should address the many concerns of the shareholders and display good professional judgment. Suggesting that further information is required is acceptable as long as it is justified and consistent with the analysis.

Recommendations on Specific Issues

Investment in Holiday

This requires an investment of $13.5 million (100%) or $5.4 million (40%), which DHC will have difficulty financing. If DHC invests in Holiday, there is an opportunity to influence the type of packages sold, to ensure that they are in line with DHC's core values. It also might be possible for Holiday to sell packages for DHC's other hotels. The potential return of 17% on this investment is quite high. However, this acquisition may not be consistent with the company's wish to concentrate on its core business, as it would now be also selling vacation packages. If acquired with KGI, there is potential conflict with Patrick, who would own 60% of Holiday through KGI.

If DHC does not acquire Holiday, it must consider the potential impact of a new owner of the company.

<u>Franchise with Global</u>

This alternative will require only $200,000 upfront cash for the franchise fee. It will also enable DHC to access $8 million in an interest-free loan for renovations. The franchise model may help alleviate many of the problems at the Northern Ontario hotel and improve cash flows, occupancy rates, and ADR, in addition to providing capital for renovations. However, DHC would lose much of its control over the hotel because the company would have to comply with Global's standards. However, it does allow DHC to continue as a unique luxury boutique hotel/resort and will help the company compete with other global chains. With Global's reach and its marketing to international travellers, the franchise model for Northern Ontario looks like it might be the more successful option relative to DHC's continued operation of the hotel. This model, which is being used quite extensively by larger companies, could be the right answer for Northern Ontario.

<u>Cooking retreats</u>

An upfront investment of $1 million is required if DHC pursues the cooking retreats, which DHC may have difficult financing. If successful, the cooking retreats will help DHC achieve its objectives and attracts new customers. The major risk associated with this alternative is that it is tied to Chef Norman. If the franchise option is pursued, there will need to be discussions on whether the cooking retreats fit in. Therefore, DHC should decide on whether to franchise the Northern Ontario hotel first before introducing the cooking classes. In addition, DHC should ensure that the information used to produce the cooking retreat's forecasts is realistic and reliable.

<u>HHH management contract</u>

The HHH management contract does not seem to be working well. Although Martha's forecast indicates that things will improve, it is very optimistic and not in line with industry trends. HHH will be appealing to business rather than leisure travellers, but the growth rate of business travellers is expected to be only 2%. It is likely best if DHC terminates the arrangement and seeks retribution under the existing contract penalty clause.

Overall Conclusions and Recommendations

1. Something must be done for Northern Ontario, which is struggling. The status quo is not an option. Would it be possible to offer the cooking retreats without the $1 million upfront? If this initial investment amount could be reduced, it could be a viable alternative, although the revenue numbers also need to be supportable. Accepting the proposal to be franchisee for the Northern Ontario hotel appears reasonable. It may be possible to do this and also invest in the cooking retreats. If Global is in agreement and perhaps helps finance the $1 million required upfront, DHC could potentially do both.

2. We recommend that DHC terminate the contract with HHH. It does not fit with trends, does not help with many of the objectives, and there is a great risk that Martha's uncooperative behavior will continue.

3. Since financing 100% of the acquisition on its own would be a challenge, DHC should invest in Holiday with Patrick (KGI) to benefit from his experience. DHC should discuss the proposed ownership percentage and decide how much control it wants to have. There are cash implications if the percentage is increased. Additional financing from Patrick could be discussed. His willingness to invest 60% in Holiday may indicate that he has funds available. Given Derek's and Patrick's ownerships in KGI, they should both recuse themselves from a vote on ownership split of a joint purchase of Holiday.

Other recommendations are acceptable if they are supported and take into consideration the financing required.

Summative Assessment #4 – Communication

For Summative Assessment #4, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate adequately communicated their response.

No – The candidate clearly did not communicate their response adequately.

Insufficient communication in a candidate's response would generally include some of the following:

- The response is difficult to understand.; the reader needs to re-read sections several times in order to gain an understanding.
- It is not clear what point the candidate is trying to make.
- The quantitative analysis does not make sense because of illogical ordering or a lack of labelling.
- There is an excessive amount of spelling and grammatical errors.
- The language used is unprofessional.

Summative Assessment #5 – Overall Assessment

For Summative Assessment #5, the candidate must be assessed in one of the following, based on their overall performance:

Clear Pass – Overall, the candidate provided an adequate response, clearly meeting the minimum standards for each of the summative assessments.

Marginal Pass – Overall, the candidate provided an adequate response, with some errors or areas of omission, but the underlying key concepts were presented.

Marginal Fail – Overall, the candidate provided an attempt at a response, with several errors or an incomplete analysis.

Clear Fail – Overall, the candidate did not provide an adequate response because the response was deficient in multiple areas.

To be assessed a Pass, the candidate is expected to perform adequately in all the summative assessments and demonstrate that they addressed issues of importance in a cohesive, professional manner.

In making their overall assessment, markers were asked to consider the following:

1. Did the candidate step back and see the bigger picture, and then address the broader issues identified?
2. Did the candidate prioritize the issues by discussing the major and minor issues in appropriate depth?
3. Did the candidate use both quantitative (when available) and qualitative information to support their discussions and conclusions?
4. Did the candidate use the appropriate tools to perform quantitative analysis?
5. Did the candidate use sufficient case facts (current case and Capstone 1 case) about the external and internal environment to support their discussions?
6. Did the candidate communicate their ideas clearly, integrating and synthesizing the information?

SAMPLE RESPONSE – DHC VERSION 1

Below is an actual passing candidate response.

Role: CPA, Wilson Consulting Group, reporting to Irene Mallik (boss)

Timeline: April 23rd 2023 (pg 5)

Users/Objectives

Board of Directors, founders, shareholders:
- Achieve a minimum occupancy rate at each hotel of 75% and overall ADR of $430
- Invest in projects that will earn a minimum of 12%
- Have enough cash to eventually resume paying dividends
- Strong financial performance
- Long-term financial health

Strategic Analysis Framework

Mission: We are operators of unique boutique hotels with luxurious and welcoming atmosphere providing attentive and caring service that goes beyond expectations

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

New Vision: We make our guests feel special by providing exceptional services and experiences at our hotels and resorts

New Mission: We operate unique luxury hotels and resorts, providing each guest with attentive service and experiences beyond expectations

Values:

- Personally interact with guests and employees and take a hands on approach
- Meet and anticipate customers' expectations by being friendly and attentive
- Embrace new ideas and changes to ensure we continuously strive toward perfection
- Foster teamwork and respect among all employees – includes listening to concerns
- Be an important part of the local community

KSF:

- Retain highly experienced/skilled workforce
- Maintain property (hotel and amenities) in good condition
- Keep up to date with technology changes
- Meet and anticipate customer needs through market research as retention and attraction of new customers is important

SWOT

Strengths:

- Highly experienced management team within the hotel industry – helps ensure success
- Patrick Kuzoff has joined as director, offering more expertise that can help ensure success

Weaknesses:

- DHC lost its gold rating in March 2020 leading to a reduction in revenue – this could also impact reputation and future earnings
- DHC is close to borrowing capacity – appearing highly leveraged will increase the risk to potential investors or lenders, making it difficult to acquire more financing
- Northern Ontario Hotel has low occupancy rates and ADR which impact the overall objective of DHC.
- Potential conflicts of interest (Derek owns part of KGI and Patrick manages KGI) – This could impact their ability to make objective decisions for the good of the company
- Patrick and Derek appear to be communicating poorly with the management team (i.e. not discussing proposals with the whole team) – this can negatively impact decision making by not including all view points and perspectives

Opportunities:

- Domestic travel within Canada is increasing which could bolster hotel occupancy for DHC
- International visitors to Canada have increased due to relative decline in Canadian dollar – potential for more business and earn more revenue

Threats:

- Interest rates have been increasing, which raises the cost of capital should DHC need to seek financing.
- Increased price competition from chain hotels may continue to erode Rev/PAR at HHH

Requireds:

1. Holiday Tours Inc. (Holiday)
    a. Help management team understand the impact of investing in Holiday compared to continuing the relationship with the new owner
    b. Estimate what the shares will cost and calculate the expected rate of return
2. Global Stay N Play Corp. (Global)
    a. Global is interested in making Northern Ontario Hotel a franchise under their 5-star brand called "FitzGeralds" which targets leisure travelers
    b. Determine viability of this proposal
3. Chef Norman wants to offer cooking retreats at Northern Ontario Hotel
4. Martha, owner of HHH, wants to add a conference centre at HHH
    a. Critically review Martha's proposal and forecast and advise whether DHC should accept the proposed modifications

Report to: Board of Directors and Management of Distinct Hotels Corporation (DHC)
From: CPA, Consultant

This report addresses the concerns or issues that management of DHC asked us (Wilson Consulting Group) to analyze.

Holiday Tours Inc. (Holiday) Proposal

DHC has been working with Holiday to secure more business at the Canmore Hotel and the Kelowna Hotel. Holiday is being sold and there's concern that the new buyer will likely decrease the average room rates next year. Patrick and Derek are proposing that DHC choose to invest in Holiday along with Patricks' company, KGI, with a 60/40 split. The issue is whether DHC should allow Holiday to be bought by the new buyer, or consider investing in Holiday.

Quantitative Analysis (see Exhibit I for calculations):

Patrick estimates that if the new buyer lowers room rates from $395 to $310, DHC's room revenue will decrease by about $40,000 in 2024. This is despite the increase in occupancy by 25%.
Alternatively, DHC can enter a 60/40 split with KGI and invest 40% into Holiday. Per our calculations, by multiplying Holiday's EBIDTA by 6, we estimate the share price to be around $6.75. Purchasing 40% of the shares would cost roughly $5,400,000 for 800,000 shares. DHC would need to seek financing for $5,400,000 and with interest rates on the rise, it could become costly down the road.

Holiday's typical operating margin is 20%. Assuming this continues in future, we determined the expected return on investment would be 8.33%.

Qualitative Analysis:

The following are pros and cons of allowing Holiday to be bought by the new buyers.

Pros:

- It is not guaranteed that the new owners will lower the average ADR. Holiday sold approximately 10,000 room nights for DHC last year and it's expected to be either the same or better this year. If the ADR is not lowered, DHC can benefit from this business without having to spend millions in acquisition cost
- Domestic Travel and international travel has been increasing within the industry. The increase in occupancy rates may exceed expectation.

Cons:

- Risk that the new owner of Holiday will make drastic changes beyond lowering the ADR. If new owner does not work well with DHC or their business, DHC could see a decline in revenue or reputation.
- If owner does lower average ADR, it will impact management objectives of averaging $430 ADR overall

The following are pros and cons of investing in Holiday.
Pros:

- DHC will work with Patrick's firm, KGI, to ensure the ADR and occupancy rates at the Canmore and Kelowna hotels meet their annual objectives. Without lowering the ADR, DHC could expect higher revenues and profits which provide more cash for other ventures or issuing dividends
- DHC and KGI could use Holiday to develop and sell packages that promote other DHC hotels, further increasing potential revenue and cash flow.

Cons:

- Initial capital outlay will require financing and DHC is already near capacity. The manager at H&A bank is monitoring DHC's account closely for covenant compliance and to ensure maximum borrowing capacity is not exceeded.
- Derek and Patrick appear to be influenced by their respective ownership in KGI. This may impair their ability to make an objective decision about this investment or future decisions once this investment is made.
- The investment has an estimate return less than 12%. This does not meet the current objective set by the board.

Allowing new buyers to take over for Holiday opens up DHC to risk in losing revenue in the long term. The new owners may work well with DHC, but that is not guaranteed. An investment in Holiday could help boost DHC's business by increasing room revenue for all DHC properties. The current proposal of 60/40, however, does not favour DHC in regards to the required return of 12%. Furthermore, it would require financing. It's recommended that the management team discuss this proposal further with Patrick to consider KGI fully investing in Holiday. This will free up cash for DHC.

Global Stay N Play Corp. (Global) Proposal

The Northern Ontario Hotel (NOH) has been experiencing lower than average occupancy rates and ADR below target. It's lowering DHC's overall corporate metrics. DHC received an offer from Global to make NOH a five-star franchisee under their "FitzGeralds" brand. The issue is whether or not the agreement is beneficial to DHC.

Quantitative Analysis:

Derek has already estimated that if DHC continues to operate the NOH as is, expected room revenue net of operating costs will be $6.7 million. With Global's agreement, the expected room revenue rises to $9.2 million provided NOH can meet Global's targets. Financially speaking, earning more revenue will assist DHC with eventually being in a cash position to issue dividends again or seek other capital projects.

Qualitative Analysis:

The following are some pros and cons of the Global agreement and how it will impact DHC.

Pros:

- Global's brand meets DHC's standard of a 5-star boutique hotel. This aligns with DHC's mission of operating luxury hotels and vision to provide exceptional service
- Global is offering an interest free loan for necessary upgrades which helps DHC save cash lower their cost of capital.
- DHC was planning to make major renovations to the NOH. The interest free loan will help serve to maintain the property in good condition as per the KSF.
- DHC has spent millions in marketing without noticeable improvements. Being a franchisee can boost reputation which can lead to the attraction of new customers. Attracting new customers is a KSF
- DHC has struggled to keep managers at NOH. This proposal could assist with attracting managers since they could potentially work for other Global hotels. Retaining highly skilled employees is a KSF
- Global's targets for NOH of $420 ADR and 70% occupancy rate will encourage DHC to achieve their overall targets.

Cons:

- If the agreement proves unsuccessful for DHC, there is a 5 year wait to terminate which is a long time
- Global's targets of $420 ADR and 70% occupancy rate exceed NOH's performance for the past 3 years. They may be unattainable by the end of 2024. If the targets are not achievable, Derek's estimates on expected revenue will decline and Global can terminate the contract
- Global expects the ADR and Occupancy rate to increase each year after the end of 2024. This may not be achievable as well considering NOH's historical performance
- The interest-free loan is subject to Global's approval. If Global does not approve, the renovations may not proceed as scheduled. Keeping the hotel in good condition is a KSF.

Global's reputation and brand appear to align with DHC's mission and vision statement. The FitzGerald brand has the potential to attract new customers which is key to success as well. If DHC can meet Global's targets, it will improve DHC's financial position. However, the target must be met by the end of 2024 and continue to improve each year thereafter. It's recommended that DHC renegotiate the following elements of the contract to help reduce the risk of contract termination or loss of business:

1. Targets must be met by end of 2024 – discuss with Global a more realistic timeframe that works for NOH based on market research and historical data
2. Targets must improve yearly – remove ability for Global to terminate contract without notice if this criteria is not met.

Cooking Retreat Proposal

Chef Norman at the NOH has proposed starting a cooking retreat to boost business. The issue is whether or not this is too big a risk for DHC and whether or not this will align with DHC's mission, visions and values.

Quantitative Analysis:

Per the information provided by Norman, DHC could expect an incremental increase in cash flow of $262,400 by the end of 2023 and $470,840 in 2024. The initial cost to implement the cooking retreats is a $1,000,000 kitchen renovation. Per the calculation in Exhibit II, the return on investment would be 26%. This exceeds management's target of 12%. Further incremental costs are covered by the increase in revenue so this retreat would be self-sufficient and profitable (assuming his assumptions are met).

Qualitative Analysis:
The following are pros and cons of the cooking retreat.

Pros:

- Taking Chef Norman's proposal seriously aligns with DHC's core value of fostering respect among all employees by listening to their concerns and suggestions.
- Having Chef Norman run a cooking retreat will encourage him to remain at NOH. Retaining highly skilled/experienced employees such as him is a KSF for DHC.
- Offering cooking classes in a luxurious setting and maintaining an exceptional atmosphere aligns with DHC's mission and vision to provide service that makes guests feel special.
- Domestic travel has increased in Canada, which supports the idea that people will travel to NOH for cooking classes.
- Chef Norman is very personable. DHC values personally interacting with guests and being friendly/attentive. His cooking class would align with these values.
- The cooking retreat is a new idea for DHC, and accepting the proposal aligns with the core value of embracing change or new ideas.
- The increased reputation and business could improve DHC's overall metrics. This will help DHC achieve a minimum occupancy rate at each hotel of 75% and overall ADR of $430. Specifically, NOH has had low occupancy rates. This should improve that.
- The additional cash flow can be used for eventual dividend payments

Cons:

- The expected return depends heavily on Norman's assumptions and calculations. A decline in expected revenue could potentially reduce the return below DHC's objective of 12%.
- $1 million in kitchen renovations is expected to be completed by May 2023. That only gives Kelvin 1 month to ensure everything is renovated to his standards. If there are delays, the expected revenue will decline and negatively impact the expected return on investment in 2023.

Overall, the cooking retreat aligns with DHC's core values of fostering teamwork, personally interacting with guests, anticipating customer expectations and embracing new ideas. It further highlights a key success factor of retaining highly skilled employees like Chef Norman and updating the property to ensure it is in good condition. The renovation timeline is a bit narrow, however. It does not leave much time for proper planning or delays. I suggest moving forward with the cooking retreat classes after evaluating a reasonable timeframe for the renovations and determining the minimum required revenue needed to meet the 12% return objective.

Huron Heights Hotel (HHH) Conference Centre Proposal

Martha has proposed adding a conference center to HHH in response to the increased competition from hotel chains. She would like DHC to manage the conference centre in addition to the current management contract already in place.

Quantitative Analysis

Based on Martha's forecast, DHC can expect incremental net operating income of $926,392 in 2024, $932,640 in 2025 and $1,059,651 in 2026. This increase in operating income will assist DHC will funding future capital projects or issue dividends. The new conference room agreement will increase DHC's management fee on gross room revenue from 5% to 7% which is beneficial from a compensation perspective.

Martha has made several assumptions however. The room revenue estimates are based on ADR of $270, $275 and $280 in the years 2024, 2025 and 2026 respectively. Occupancy rates are also estimated be 80% in 2024 and 2025 and 85% in 2026. Historically, HHH has had an ADR of $250 and an occupancy rate of 70%. They've also experience a decline in business due to the increase competition of hotel chains. The rise in occupancy rate and ADR within 1 year of the conference centre being operational may not occur. Furthermore, although conference attendees increase occupancy rates, the group room rates generally lower the ADR not increase it. If these assumptions are not met in reality, DHC's expected revenue will decrease.

Martha assumed that gross conference revenue would be 43% of gross room revenue when historically it would be only 10%. Based on my calculations, the operating income would still be positive, but the expected earnings are not realistic based on Martha's assumptions. Martha should instead base her calculations on the historical 10%

Martha also assumed that food and beverage will be an estimated 30% of room revenue. For DHC as a whole, food and beverage revenue has been 58% of Room Revenue in 2022. This means it's possible for the estimated revenue from this new agreement to be greater than forecasted. It's important, however, to remain conservative.

Qualitative Analysis

Pros:

- Renovations for the conference centre are not expected to reduce the number of rooms. Increasing occupancy while maintaining the same number of rooms is expected to increase the Rev/PAR
- Renovation costs will come out of HHH's funds, leaving capital free for DHC to pursue other ventures or save cash for future dividend payments.
- If Kelvin is able to renovate the conference room per his standards, it will align with DHC's current brand.
- Providing a conference centre aligns with the KSF of anticipating customer needs given business travel is forecasted to increase by 2% annually.

Cons:

- HHH has not given final approval on managers DHC selected. Having highly skilled/experience employees is a KSF. If HHH continues to deny final approval on managers, it can impact future business if service quality declines
- Martha did not renovate rooms and lobbies in the past when asked and has stopped contributing 4% to the reserve fund for renovations. While Martha had her reasons, the fact remains that maintaining the property in good condition is a KSF. There's a risk that Martha will continue to lapse on renovations or maintenance going forward which could negatively impact business since customers expect a clean up-to-date hotel. There's also a risk that there will not be enough funds for future renovations if the contributions to the reserve fund are not made.

Overall, the management fee contract with HHH for the new conference centre is estimated to be profitable and earn more cash flow for DHC. From a financial standpoint, the increased cash flow will assist with potential capital ventures or dividends. There are concerns, however, regarding Martha's managing the reserve fund for renovations and HHH not approving DHC's pick for managers. Unless these issues are addressed, the agreement with HHH may not be beneficial in the long run. Eventually, DHC's brand may be hurt further.

Other Issues Identified

- Patrick and Derek have been discussing strategic proposals without consulting the entire board of directors. During the meeting, Derek moves to a new topic without letting the others discuss their concerns.
  - Open communication and respecting other people's opinions within the board meeting is critical not only because DHC can benefit from multiple perspectives, but it is also one of DHC's core values to foster respect among all employees.
- Patrick and Derek may have conflicts of interest affecting their ability to make an objective decision regarding the Holiday proposal. It is recommended that they allow the rest of the board to discuss the proposal to ensure what is best for DHC as a whole.

Exhibit I - Holiday Tours Inc.
Purpose: Determine value of share price and expected return
(All inputs are from Appendix V unless otherwise stated)

EBITDA	$ 2,250,000
EBITDA multiplier	6
Valuation	$ 13,500,000
# of shares outstanding	2,000,000.00
Estimated Share Price	$ 6.75
40% of Valuation	$ 5,400,000
# of shares	800,000
Operating Margin	20%
Operating Profit	$ 450,000
Expected Return	8.33%

Exhibit II - Chef Norman Proposal
Purpose: Determine return on investment for cooking retreat in 2023
(all inputs are from Appendix VI or Capstone 1 case unless otherwise stated)

Net cash flow	$262,400
Kitchen Renovation	$ 1,000,000
Expected Return	26%

Conclusion: Return on investment is 26% which exceeds DHC target of 12%.

Exhibit III - HHH Proposal

(all inputs are from Appendix II and Appendix VII unless otherwise stated)

DHC's Revenue (2022)	$ 83,886		
Food and Beverage Revenue	$ 48,654		
Food and Beverage as a % of Room revenue	58.00%		
	2024	2025	2026
Gross Room Revenue	$ 938,196.00	$ 955,570.00	$ 1,033,753.00
Proposed Conference revevnue	$ 402,084.00	$ 409,530.00	$ 443,037.00
% of gross room revenue	43%	43%	43%
Historical % of gross room revenue	10%	10%	10%
Revised Gross conference Revenue	$ 93,819.60	$ 95,557.00	$ 103,375.30
Difference	$ 308,264.40	$ 313,973.00	$ 339,661.70
Proposed operating income	$ 926,392.00	$ 932,640.00	$ 1,059,651.00
Revised Operating Income	$ 618,127.60	$ 618,667.00	$ 719,989.30

APPENDIX E

THE COMMON FINAL EXAMINATION
DAY 1 DHC VERSION 2 BOOKLET – MAY 26, 2021

COMMON FINAL EXAMINATION
MAY 26, 2021 – DAY 1

Case (DHC-Version 2) **(Suggested time: 240 minutes)**

It is April 2023, and Irene Mallik, your boss at Wilson Consulting Group, assigns you to another engagement with Distinct Hotels Corporation (DHC).

Since 2020, Canadians' per capita disposable income has increased slightly, and consumer confidence is moderate. A strengthening Canadian dollar has increased travel costs and reduced the number of international visitors to Canada. Interest rates are expected to continue to increase for at least another two years.

The number of leisure travellers is expected to increase by only 2% annually, even for boutique hotels. Leisure travellers, both domestic and international, are increasingly price sensitive. The number of travellers booking with companies such as Airbnb and VRBO continues to increase, at the expense of traditional hotel accommodations. This increase is attributed to families looking for accommodations that include kitchen facilities and more living space at reasonable prices.

The number of business travellers is expected to increase by 6% annually. Recent studies show that face-to-face meetings are still preferred over teleconferencing. Also, a growing number of businesses are willing to pay a premium for hotels that are small, unique, and cater to the needs of business travellers.

On June 20, 2020, after receiving a substantial inheritance, Kelvin and Alyson's son, Jonathan Chung, purchased $3 million of newly issued DHC common shares. Jonathan now owns 8% of DHC and each of the other shareholders own 23%.

Although the Board of Directors (the board) remains committed to branding itself as an operator of boutique hotels that are upscale or luxurious, in 2021, the vision was revised:

"*We make guests feel welcome and special by providing attentive, personalized, and exceptional service in a unique and luxurious setting.*"

The mission was also revised:

"We are operators of unique boutique hotels built with a welcoming and luxurious atmosphere, providing each guest with attentive and caring service beyond expectations."

DHC's core values remain unchanged.

Irene asks you to draft a report for DHC's board, highlighting the significant changes in DHC's situation and evaluating the major decisions facing DHC, with a strategic focus. For each proposal, you are to advise the board of any significant factors the board may not have considered and identify any additional information it must obtain before making decisions. The report should also include any other significant issues you identify.

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APPENDIX I
TRANSCRIPT OF PREVIOUS BOARD MEETING

Derek: Thank you, Irene and CPA, for attending our board meeting. Since your firm's last engagement with DHC, the only change to management is that, following Doug Mallette's termination, Jonathan became the director of marketing and brand development. First Canadian Hotel Reviews accepted that Doug acted alone, and DHC's rating was not impacted.

The major events since the last engagement are summarized below:

April 1, 2020	Purchased Artists Warehouse Hotel (AWH) for $32 million, in cash and non-voting preferred shares issued to Isabelle, as originally proposed.
April 1, 2020	Signed a 20-year management contract with Huron Heights Hotel (HHH), with all terms and conditions as originally proposed.
May 1, 2020	Converted the Kelowna golf course to semi-private status.
May 21, 2020	Updated DHC's website, at a cost of $980,000.
October 19, 2020	Completed renovations of $11 million to the Nova Scotia hotel, and of $4 million in total to DHC's other properties.
November 2, 2020	Finalized a new loan agreement with Northern Land Loans. The loan of $39 million is repayable in annual payments of $2 million on June 30, bears interest at 7.2%, and matures in 13 years.
February 2, 2021	Sold the Awani Spa licensing rights for $750,000.
May 1, 2021	Declared and paid the dividends on DHC's preferred shares and a $500,000 dividend on common shares.
July 2, 2021	Renewed DHC's line of credit, with the same terms and conditions.
April 3, 2022	Completed renovations of $3 million to the Northern Ontario hotel, aimed at attracting people for health and wellness retreats.
May 1, 2022	Declared and paid the dividends on DHC's preferred shares and a $500,000 dividend on common shares.
August 15, 2022	Established an advisory board, which meets quarterly.
March 2, 2023	Isabelle announced her intent to redeem her preferred shares on May 1, 2023. As agreed, the dividends for 2023 will be declared and paid on that date. Commenced refinancing discussions with the bank.

Derek: Although DHC's results have improved, we are delaying going public until 2025 to allow us to improve certain metrics. We have set targets to do so, including maintaining DHC's average daily rate (ADR) of $440. These targets also include increasing our occupancy rate to 85% and achieving an operating margin of 15%, both by 2024. Our advisory board has also provided suggestions that we should keep in mind. We have several investment proposals to discuss. Kelvin, why don't you start?

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Kelvin: I found a great historic property in the Old Montreal district. As one of the city's first banks, it features a unique fa ade. These kinds of properties are seldom available. The lessor would allow us to convert it to a 50-room boutique hotel. The hotel would appeal to leisure travellers wanting personalized and pampered service. I am excited by this opportunity There will be no restaurant, but this should not be an issue as there are a variety of excellent restaurants in the area.

Jessica: I like that the property is in a large metropolitan centre.

Alyson: However, it is much smaller than DHC's other hotels.

Jonathan: Since that is the size more commonly found in Europe, it may appeal to international travellers. I already have some ideas for how to market the hotel.

Kelvin: For now, the building owner, RH Holdings (RH), is only willing to lease the property, but might be convinced to sell in the future. I have summarized the lease terms and prepared some rough numbers.

Derek: What if RH gets a great offer for the building from someone else and decides to sell? How will the advisory board react, given their suggestions for how to achieve DHC's objectives?

Kelvin: We need to remember that the advisory board is just that. Its members have no money invested in the company. We do not have to follow their suggestions. DHC did well without it in the past.

Derek: In terms of risk, how does this type of arrangement compare to our management agreement with HHH? CPA, please provide your thoughts. Jessica, do you want to discuss the situation at AWH?

Jessica: Although Isabelle is still involved with AWH, she wants to retire. The hotel has been struggling, with net earnings after tax of $1,315,000 in 2022. Despite our efforts to improve its standards, and getting a five-star rating, both the ADR of $300 and the occupancy rate of 75% were lower than expected. The occupancy rate is in line with other Toronto hotels and the decline is attributable to fewer leisure travellers in that area of Toronto. Isabelle and I suggest remodelling the hotel to appeal to the business traveller. Isabelle compiled some estimates for our consideration.

Derek: I like the idea. I expect the advisory board would support it because of the increase in the percentage of business travellers.

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Kelvin: The advisory board does not know everything about our business. I am skeptical.

Alyson: Renovations will be costly. We will need to outfit each room with work areas featuring the latest technology and build a business centre, fitness facility, restaurant, and bar. To compete in Toronto's especially competitive market, DHC will also have to provide personalized services, a loyalty program, and a mobile app.

Kelvin: Some of those changes would dramatically change the uniqueness of this hotel.

Jessica: We need to do something. The ADR and occupancy rate have fallen each year since we acquired AWH. If we can renovate while retaining the hotel's charm, it makes sense.

Derek: Sean LeBois said his company would do the renovations for $6 million. I gave Jessica his quote.

Kelvin: The quote is too high. Those renovations should not cost more than $5.7 million. I wish you had asked me about this beforehand. You have put us in an awkward position.

Derek: Who cares if DHC pays him a little extra for this contract? He has spent countless hours helping us out by sitting on our advisory board.

Kelvin: We used LeBois' company for a small job at our Northern Ontario hotel. The work was completed late and some of it was not up to my specifications and needed to be redone.

Derek: Sean knows his company did poorly on that job but that was because of new staff he had hired. He deserves a second chance.

Jonathan: Knowing this proposal was on the agenda, I asked a few large corporations how DHC could obtain their business. They generally set maximum room rates by city, and for Toronto, the rates average $250. The impact on our ADR will depend on the resulting mix of business and leisure travellers. We would also have to provide 30- to 60-day payment terms and guarantee them room availability.

Derek: Let's have CPA review Isabelle's estimates and determine whether the project makes sense for DHC. After the renovations, I would expect operating results at AWH to be comparable with that of our existing properties. We will choose the contractor afterwards. Next on the agenda is Northern Ontario.

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Kelvin: I am proposing additional renovations of $13 million to the Northern Ontario hotel.

Jessica: Nothing we have tried has worked so far, including adding a games room and swimming pool. Since 2019, the ADR has only increased by $40 to $300, and the occupancy rate has only increased to 70%.

Kelvin: Our rooms are too small for families and we do not provide enough extra services. Existing rooms would be converted to one-bedroom suites with kitchens and sitting areas. The renovations will reduce the room count to 150. We could provide childcare, children's clubs, and lifeguards at the pool. These changes should improve the ADR and occupancy rate substantially since they better target families, but will also likely appeal to international travellers.

Alyson: Families are not looking for the pampered service that DHC typically offers. I do not support this proposal.

Derek: Given its northern location, we have never been able to overcome the seasonality factor. I am opposed to investing more money in this hotel when the funds could be better spent elsewhere.

Alyson: Are you suggesting that we sell the Northern Ontario hotel?

Derek: Yes, and the advisory board shares that opinion.

Kelvin: How do you know that? The advisory board has never discussed a possible sale of this property.

Derek: I called a few members of the advisory board and asked for their thoughts. We should be able to sell the hotel for $40 million. If we ask that price, Thomas Wong may have even found a buyer.

Kelvin: You have spent a lot of time working on this without our knowledge. Why did I waste time finding ways to renovate the property?

Alyson: I have also been thinking it might be time to sell. In addition to the room size issue, the location is not ideal for a boutique hotel.

Jessica: Selling might negatively impact DHC's eventual initial public offering plans.

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Derek: I am not sure I agree. CPA can assess the risks and benefits of each alternative. Next is an investment proposal from Jonathan.

Jonathan: In 2020, DHC hired Cindy Woodman, a website designer who previously worked with Airbnb. Cindy suggested that DHC develop a new online booking business specializing in luxury, short-term stays. The proposed name for the business is "Luxury Stays" (Luxury). DHC's and Luxury's websites would be linked, and we would promote the luxury services, to be provided by DHC. Cindy and I have put together additional information.

Derek: The advisory board suggested that DHC target the short-term rental market. Luxury's hosts will be primarily boutique hotels and private homeowners. This is a way for us to penetrate this market segment.

Kelvin: I worry about Luxury negatively impacting DHC's image. How will Luxury find the hosts that will list their accommodations? Would we need to inspect every one of them to ensure that they meet DHC's high standards?

Jonathan: Luxury would use its new website to recruit hosts. The accommodations could also be inspected, but I doubt that Luxury could charge extra fees to recover inspection costs; they would have to be absorbed. Instead, we could do like other similar businesses, and rely on guest reviews to assess how well the accommodations meet DHC's standards.

Alyson: If customers stay in private homes or non-DHC hotels, could it take away revenue from our DHC hotels?

Jonathan: We do not plan to list DHC's hotels, and as the site will appeal to guests who would not otherwise stay at DHC hotels, that should not be an issue.

Jessica: If we choose to create Luxury, DHC would provide extra services for all bookings, thereby offering "exceptional" service to Luxury's clients. Offering these extra services allows all guests to enjoy a unique experience.

Derek: The initial investment is small and targets a new market segment. I think we should consider it. CPA, please provide your assessment.

CPA: Of course. Our report will be ready for your next meeting.

Derek: Thank you. Meeting adjourned.

APPENDIX II
ADVISORY BOARD

The advisory board membership consists of:
- George Karpenter (chairperson, and friend of Derek) has spent twenty years working in upscale hotels.
- Warren Gaspari (friend of Derek) has spent fifteen years as a conference manager with a global hotel chain.
- Samina Kalas (friend of Alyson) stays in short-term rentals whenever she travels.
- Shirley Lata (friend of Jessica) has spent eight years making travel arrangements for staff of the large company that she works for.
- Sean LeBois (friend of Derek) owns a business that specializes in hotel furniture and equipment sales, and hotel renovations.
- Laura Smythe (friend of Jessica) is an equity analyst specializing in the hotel industry.
- Thomas Wong (friend of Derek) has ten years of experience promoting tourism publications.
- Dominique Girard (friend of Jonathan) is a hotel and travel writer for Thomas Wong.

The advisory board's mandate is to provide:
- suggestions regarding DHC's strategic direction.
- information regarding trends in the hotel industry.
- advice on preparing to go public.
- advice on operational issues.
- advice on how to improve community relations.

To help DHC achieve its specific objectives and achieve a successful public offering, the advisory board recently made the following suggestions:
- Ensure that all key metrics align with industry averages, with the exception of the operating margin, which should exceed industry averages.
- Increase the number of rooms to 1,000 by 2025.
- Increase the percentage of business travellers to 40%.
- Diversify in order to reduce reliance on hotel revenue.

APPENDIX III
INTERNAL FINANCIAL STATEMENTS

Distinct Hotels Corporation
Consolidated Statement of Comprehensive Income
For the year ended December 31, 2022
(in thousands of Canadian dollars)

Revenues	
Room revenue	$ 95,204
AWH – room revenue	12,264
Food and beverage	51,410
Golf revenue – annual membership fees	390
Golf revenue – green fees	1,560
Management fees from HHH	1,980
	162,808
Expenses	
Room operating costs	50,458
AWH – room operating costs	6,745
Food and beverage costs	34,959
Golf services costs	1,523
Management salaries and benefits related to HHH contract	1,050
Depreciation and amortization	11,380
Marketing and sales	4,936
Property tax, utilities, and insurance	12,462
Administrative and general	21,668
	145,181
Operating income	17,627
Interest on line of credit	(36)
Interest on long-term debt	(4,835)
Dividends on preferred shares	(1,500)
Income before taxes	11,256
Income taxes	(3,393)
Net income and comprehensive income	$ 7,863

APPENDIX III (continued)
INTERNAL FINANCIAL STATEMENTS

Distinct Hotels Corporation
Consolidated Statement of Financial Position
As at December 31, 2022
(in thousands of Canadian dollars)

Assets	
Cash and cash equivalents	$ 3,980
Trade receivables	1,370
Inventories	2,370
Prepaid expenses	1,700
	9,420
Property, plant, and equipment, net	146,820
AWH – property, plant, and equipment	41,575
Goodwill – AWH	3,500
Total assets	$ 201,315
Liabilities	
Line of credit	$ 1,200
Trade payables and accrued liabilities	14,985
Income taxes payable	2,120
Contract liability – revenue	6,690
Current portion – Nova Scotia loan	3,000
Current portion – Ontario loan	2,000
	29,995
Long-term debt – Nova Scotia	30,000
Long-term debt – Ontario	33,000
Retractable preferred shares	25,000
Deferred tax liability	6,810
Total liabilities	124,805
Shareholders' equity	
Share capital	13,175
Retained earnings	63,335
	76,510
Total liabilities and shareholders' equity	$ 201,315

APPENDIX IV
COMPARISON TO INDUSTRY BENCHMARKS

	DHC		Boutique Hotel Segment	
	2022	**2019**	**2022**	**2019**
Rev/PAR (Occupancy rate × ADR)	$343	$280	$328	$262
Occupancy rate	78%	70%	80%	78%
Average daily rate (ADR)	$440	$400	$410	$335
Percentage of business travellers	15%	10%	35%	30%
Current ratio	0.3	0.2	0.7	0.8
Debt to equity	1.6	2.2	2.1	2.6
Total debt to assets	0.6	0.7	0.7	0.7
Return on equity	10%	8%	12%	11%
Operating margin	11%	9%	14%	16%
Profit margin	5%	3%	6%	8%

APPENDIX V
INFORMATION REGARDING MONTREAL HOTEL

Summary of the proposed lease agreement:

- Lease payments are $50,000 per year plus 16% of room revenues, paid monthly.
- Term is for 15 years with an option to renew for five additional years, with the rent to be determined at that time.
- RH will pay for building insurance, utilities, and property taxes.
- RH will pay 50% of the cost of initial renovations, to a maximum of $5 million. DHC expects renovations to cost a total of $15 million. All renovations must first be approved by RH.
- RH has the right to sell the building at any time, provided that DHC is given 90 days' notice of lease termination. DHC will have the right of first refusal.

Financial estimates are:

- an ADR of $750 and occupancy rate of 80%.
- room operating costs equal to 55% of room revenue.
- administrative and general expenses (including marketing and sales) equal to 13% of room revenue.

APPENDIX VI
ARTISTS WAREHOUSE HOTEL PROPOSAL

Isabelle prepared the following post-renovation earnings forecast for Jessica.

	Note	
ADR	1, 3	$290
Estimated occupancy	2	85%
Number of rooms	4	120
Room revenue		$ 10,796,700
Food and beverage sales – 65% of room revenue	5	7,017,855
Room operating costs – 55% of room revenue	5	(5,938,185)
Food and beverage costs – 50% of food and beverage revenue	5	(3,508,928)
Marketing, property, and administration costs – fixed		(5,000,000)
Operating margin		3,367,442
Less taxes (27%)		(909,209)
		$ 2,458,233

Notes:

1. The ADR used reflects a reduction from the current $300 to $290, to reflect the expected rate reduction required to attract more business travellers.
2. Estimated occupancy assumes a 10% increase.
3. Assumes that 45% of guests are business travellers.
4. Renovations will include the addition of a restaurant and bar. To do so, the number of rooms will decrease from 150 to 120 but we will gain new revenue from the bar and restaurant.
5. These are my best estimates.

APPENDIX VII
NORTHERN ONTARIO HOTEL PROPOSAL

The following information has been gathered regarding the Northern Ontario hotel:

- For the year ended December 31, 2022, total revenue was $16,726,125 and pre-tax profit was $1,338,090.
- As at December 31, 2022, the carrying amount of the hotel's net assets was $40 million.
- After renovations:
  - revenue is expected to be $21.9 million (150 rooms × 365 days × $500 ADR × 80% occupancy).
  - a pre-tax profit of $2,628,000 is expected. Included in this calculation is a depreciation expense of $4.9 million.

APPENDIX VIII
LUXURY STAYS PROPOSAL

Highlights of the business model are as follows:

- Hosts will pay Luxury a commission of 10% of booking revenue, and guests will pay Luxury a separate commission of 3% of booking revenue.
- Luxury will offer additional, personalized services as requested by guests, which will make it unique in this segment of the rental market. The services will include amenities that are normally provided in DHC hotels, such as maid and laundry services, grocery shopping, dog walking and childcare, but will go even further to include things such as chefs preparing meals onsite, personal trainer sessions, massages and physiotherapy. All services will be booked through the Luxury website. These services will be priced at cost plus 25% and will be provided by DHC.
- On the website, guests can search accommodation listings by location, date, property type, amenities, and price.
- Luxury will need to offer at least 1,200 accommodations across five major cities to provide the kind of selection that will attract guests.
- Although the focus will initially be on the Canadian market, once the model proves successful, expansion to accommodations outside Canada will be possible.

Luxury will require an initial investment of $7 million, and annual operating costs of $4 million are expected.

After conducting market research, the following financial forecast was developed.

	2023	2024	2025	2026
Number of nights booked	20,000	80,000	120,000	170,000
Average revenue per night	$300	$350	$370	$380
Commission revenue	$780,000	$3,640,000	$5,772,000	$8,398,000

APPENDIX F

DAY 1 (DHC VERSION 2) – MAY 26, 2021
MARKING GUIDE AND SAMPLE CANDIDATE RESPONSE

MARKING GUIDE
DISTINCT HOTELS CORPORATION (DHC)
VERSION 2

Summative Assessment #1 – Situational Analysis

For Summative Assessment #1, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate used a reasonable situational analysis when analyzing the major issues facing DHC.

Unsure – The candidate attempted to use a reasonable situational analysis when analyzing the major issues facing DHC.

No – The candidate clearly did not use a reasonable situational analysis when analyzing the major issues facing DHC.

Based on 2019 CPA Competency Map:

Technical Competency
2.3.2 Evaluates the entity's internal and external environment and its impact on strategy development.

Enabling Competencies
1.2.2 Performs work competently and with due care.
2.1.1 Defines the scope of the problem.
2.1.2 Collects and verifies relevant information.
2.1.3 Performs appropriate analyses.
2.1.4 Integrates information to investigate each potentially viable solution or conclusion.

A competent candidate will complete a sufficient situational analysis. The focus should be on the factors that have changed since Capstone 1.

Candidates will draw upon their situational analysis when analyzing the major issues facing DHC (Montreal lease, AWH renovations, Northern Ontario renovation or sale, and investment in Luxury). A competent candidate will also identify the potential new cash constraint facing DHC due to the redemption of the preferred shares.

Stakeholder Analysis (Changes)

Jonathan Chung, Alyson and Kelvin's son, joined DHC as a shareholder and director of marketing and brand development in June 2020. He is taking an active role and supports options for which he thinks he can add some value, either by using his contacts or designing marketing materials.

Mission/Vision

The board has changed the vision and mission statements to reflect the fact that DHC is now involved in boutique hotels that are not historical but still upscale and unique. The revised vision is as follows:

We make guests feel welcome and special by providing attentive, personalized, and exceptional service in a unique and luxurious setting.

The mission statement was also revised:

We are operators of unique boutique hotels built with a welcoming and luxurious atmosphere, providing each guest with attentive and caring service beyond expectations.

The major change in the vision and mission is the removal of the reference to historical settings/sites. However, the main objective has not changed and is still to concentrate on operating boutique hotels that are both unique and luxurious.

DHC's five main core values remain unchanged:

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, which includes listening to employees' concerns and viewpoints and bringing the best of each employee's abilities to work each day.

4. Embrace new ideas and change to ensure a continuously strive toward perfection.

5. Become an important part of the local community (added in 2018).

Quantitative Analysis

While candidates are not expected to recap KSFs, perform ratio analysis, or do a SWOT analysis in the detail illustrated below, they may have done so and drawn upon these various elements in their Day 1 case analysis.

<u>Changes in operating income since Capstone 1:</u>

The following table illustrates the impact of the new initiatives that have been undertaken since 2019, considering direct costs only. It appears that each new initiative was successful and contributed to the improvement in results.

	Increase due to new activities since 2019
AWH – room revenue	$ 12,264
Golf revenue – annual membership fees	390
Golf revenue – green fees	554
Management fees from HHH	1,980
Incremental revenue	15,188
Expenses	
AWH – room operating costs	6,745
Cost of golf services	356
Management salaries and benefits re. HHH contract	1,050
Incremental expenses	8,151
Change in operating income (loss)	$ 7,037

<u>Financing:</u>

- The balance outstanding on the line of credit is $1.2 million, with a maximum limit of $4 million (*link to Capstone 1*). It has the following covenants:
  - No dividends in excess of $2 million (DHC paid $2 million in 2021 and 2022: $1.5 million on the preferred shares and $0.5 million on the common shares) (*link to Capstone 1*).
  - Maximum debt to equity of 2.5 (*link to Capstone 1*). Based on the consolidated statements, the current debt to equity is 1.63 ($124,805 ÷ $76,510), so DHC remains in compliance with this requirement. In addition, DHC's debt-to-equity ratio is significantly below the boutique hotel segment industry standard of 2.1. As a result, DHC may be in a good position to leverage more of its assets through refinancing in order to proceed with the proposed projects as well as redeem preferred shares held by Isabelle.
- New preferred shares were issued on April 1, 2020, to Isabelle Logan as part of the consideration for purchase of AWH:
  - DHC issued $25 million of non-voting preferred shares (*link to Capstone 1*). The shares are retractable at Isabelle's option and pay a cumulative annual dividend of $1.5 million.
  - Annual dividends of $1.5 million were paid in 2021 and 2022; dividends for 2023 are to be declared and paid on May 1, when the shares are to be redeemed.

New constraint on cash:

Isabelle notified DHC on March 2, 2023, that she intends to redeem the preferred shares on May 1, 2023, at which time the $25 million is due, as well as $1.5 million for the dividends. Currently, DHC does not have the $25 million required to settle these obligations. This near-term liability will need to be considered when making any investment decisions.

Options to fund the redemption will need to be considered. These may include the following, among other ideas:

- The sale of some assets.
- An additional loan; per the simulation, refinancing discussions have begun with the bank. Given their retractable feature, the preferred shares are presented as debt on the statement of financial position. Therefore, taking out additional financing, in place of the share debt, will not impact DHC's debt-to-equity ratio. However, interest rates are expected to continue to increase for two years, which will increase the cost of debt financing.

New Objectives

DHC intends to go public in 2025. The IPO date was delayed in order to give the company time to improve certain metrics and, therefore, make DHC more attractive to potential investors. These specific objectives are

- to maintain its ADR at $440;
- to increase occupancy rates to 85% by 2024; and
- to increase its operating margin to 15% by 2024.

To help DHC achieve its objectives and, as a result, a successful public offering, the following suggestions were made during the advisory board's most recent meeting:

- Maintain industry average metrics, except the operating margin, which must exceed industry averages.
- Increase the number of rooms to 1,000 by 2025.
- Increase the percentage of business travellers to 40%.
- Diversify in order to reduce reliance on hotel revenue.

Summary of ratio analysis:

Candidates were provided with calculations of certain performance metrics and ratios for DHC and with the boutique industry benchmarks for both 2019 and 2022. They could analyze these performance metrics and ratios and discuss DHC's performance relative to the boutique hotel industry, to assess whether DHC's performance has improved over time (as stated by Derek).

	DHC		Boutique Hotel Benchmarks	
	2022	**2019**	**2022**	**2019**
Rev/PAR (Occupancy rate × ADR)	$343	$280	$328	$262
Occupancy rate	78%	70%	80%	78%
ADR	$440	$400	$410	$335
Percentage of business travellers	15%	10%	35%	30%
Current ratio	0.3	0.2	0.7	0.8
Debt to equity	1.6	2.2	2.1	2.6
Total debt to assets	0.6	0.7	0.7	0.7
Return on equity	10%	8%	12%	11%
Operating margin	11%	9%	14%	16%
Profit margin	5%	3%	6%	8%

There are three important industry standards:

- *Average occupancy rate (Occ)*
  - *% of rooms available that are sold*
    = Total rooms sold ÷ Total rooms available for sale
    = Rev/PAR ÷ ADR

- *Average daily rate (ADR)*
  - *Used to measure financial performance and compare to competitors*
  - *Average price paid per room (based on the rooms sold/occupied)*
    = Total room revenue ÷ Total rooms sold
    = Rev/PAR ÷ Occ

- *Revenue per available room (Rev/PAR)*
  - *Average daily room revenue generated per available room*
    = Total room revenue ÷ Total rooms available for sale
    = ADR × Occ

  - *Increasing Rev/PAR means either/or:*
    - *Rates are increasing*
    - *Occupancy rate is rising*

Total annual room revenue = ADR × number of rooms × Occ rate × 365
Total annual room revenue = Rev/PAR × 365

Operationally, success is viewed as:

- a high occupancy rate (the percentage of total rooms available that are occupied).
- a high average daily rate (ADR).
- an operating margin, net profit margin, and return on equity that are at least in line with, or superior to, industry averages for boutique hotels.

Analysis:

- Although DHC's Rev/PAR (excluding AWH) is higher than the industry average in both 2019 ($280 versus $262) and 2022 ($343 versus $328), the occupancy rates in 2019 (78% versus 80%) and 2022 (70% versus 78%) are lower.
- It should be noted that the increase in DHC's occupancy rate (excluding AWH) is greater than that of the industry, so DHC is getting closer to the industry average. Note that DHC wanted to increase ADR to $420, which it did, and to increase occupancy rates to 80% by 2021, which it did not achieve (*link to Capstone 1*).
- The percentage of business travellers is significantly below the industry average, consistent with 2019 (*link to Capstone 1*). However, due to HHH attracting more business travellers, it has increased by 5%.
- DHC's current ratio has improved since 2019. Although DHC is moving closer to the industry average, it remains below the average of 0.7. DHC's current liabilities as at December 31, 2022, are very high due to the large increase in trade payables and accrued liabilities (*link to Capstone 1*).
- Debt to equity and total debt to asset remain below the industry averages, consistent with 2019 (*link to Capstone 1*).
- The return on equity has increased to 10% but remains below the industry average of 12%. This is driven in part by the 86% [($7,863 – $4,225) ÷ $4,225] increase in the net profit from 2019. DHC wanted to increase the return on equity to 11% by 2020 (*link to Capstone 1*). Although this target was not achieved, there is improvement.
- The operating and profit margins have both improved from 2019. At the same time, the industry averages decreased by 2% (from 16% to 14%, and 8% to 6%, respectively). Therefore, DHC is moving closer to the industry averages. This may still be due to DHC paying higher wages for full-time employees (*from Capstone 1*) and its Rev/PAR being above the industry average.

Conclusion

DHC's performance metrics and ratios for the core boutique hotel business have improved, with only the occupancy rates, operating margin, and profit margin lagging behind the industry. DHC's objectives include staying ahead of industry averages where it is currently outperforming the industry and improving those that are lagging behind.

Key Success Factors (KSFs)

Note: The KSFs outlined are not listed in the Capstone 1 case. In the Capstone 1 case, there is discussion of competition based on price, service, location, and amenities within a given star rating, and, where the emerging trends are itemized, there is reference to the importance of a recognizable brand. It is also mentioned that franchise agreements are common in the industry. The candidate will have used this information, along with their research in Capstone 1, to identify the key elements of success.

Key success factors in the overall hotel industry or boutique hotel segment include

- being part of a franchised chain, to enhance brand recognition, marketing, and quality.
- location, including either offering or being near facilities and services desired by customers.
- processes to ensure that prices are in line with those of competitors.
- professional, skilled, polite, and competent staff.
- access to seasonal labour.
- maintaining the hotel and amenities, to ensure good condition.
- keeping up to date with technological changes.
- anticipating the needs of customers through the use of market research, given that customer retention and attraction of new customers is vital.
- brand recognition, as word-of-mouth advertising is often the basis on which travellers determine where to stay; there is usually at least one unique feature that drives the hotel's brand and reputation, allowing the operator to charge higher prices.

Revenues in the hotel industry are seasonal and influenced by:

- economic conditions impacting the number of trips, length of stay, and quality of hotel used by business and leisure travellers, including:
  - per capita disposable income allocated to travel. This is impacted by interest rates, personal income tax rates, and employment rates. In addition, fuel prices, and the type of transportation used to travel, impact disposable income.
  - the level of consumer confidence. The higher the level of consumer confidence, the more dollars are spent on travel.
- corporate profits and the amount of corporate spending available for business travel.
- the number of international visitors travelling to Canada.
- political factors, such as the risk of war and terrorism, which can affect foreign exchange rates, amount of border security, and the cost of holiday packages and air flights.

Candidates could also perform a SWOT analysis as part of their situational analysis, as a way of identifying key changes.

Strengths (*from Capstone 1 that are still relevant for this case and **new** information in Day 1 case*):

- The DHC brand is recognized for luxury accommodation and its "above-and-beyond" level of service."
- DHC's hotels are located in attractive tourism destinations, allowing DHC to charge premium prices.
- DHC's hotels are in unique and historically significant buildings, which is a draw for customers.
- DHC's shareholders/managers have considerable experience in the hotel business and have a vested interest in DHC's success.
- DHC's debt ratios are lower than its competitors, potentially providing more borrowing capacity.
- Management is involved in the day-to-day operations and is committed to meeting guests (Alyson, Jessica, and the managers of each hotel).
- DHC had higher ADR and Rev/PAR metrics than its competitors in 2019, when DHC had an ADR of $400 versus the boutique industry average of $335, and a Rev/PAR of $280 versus $262 for the industry (*link to Capstone 1*). By 2022, DHC had an ADR of $440 compared to the industry average of $410, and a Rev/PAR of $343 compared to the industry average of $328, suggesting that it is still able to charge premium prices (*link to Capstone 1*). Its occupancy rate remains slightly below the industry average of 80%, at 78%, although the gap is narrowing.
- In 2019, the growth rate for revenues was low; however, by 2022, the growth rate had increased significantly, suggesting that DHC has been able to capitalize on industry growth rates.

Weaknesses (*from Capstone 1 that are still relevant for this case and **new** information in Day 1 case*):

- Previously, DHC was owned by four shareholders (two couples), each owning 25% of the common shares, which could have resulted in sides being taken, such that no decisions could be made given the equal ownership interests. Jonathan Chung now owns 8% of DHC. When combined with the 23% owned by each of his parents, the Chung family now owns 54% of all shares, such that the family has majority voting rights. This could frustrate the Sterne family should the Chung family decide to vote together on a proposal.
- The advisory board appears to be creating disagreement/conflict between the shareholders and may be biased towards advising DHC in a certain direction.
- DHC owns five boutique hotels and now also manages an additional hotel (HHH). As these hotels are all located in Canada, DHC lacks a global presence.
- DHC does not offer a customer loyalty program, although such programs are important to many customers, particularly business travellers.
- DHC has a low current ratio, although the balance of cash and cash equivalents has increased significantly from 2019.
- DHC will need cash to pay out Isabelle on May 1, 2023 (redeeming her preferred shares). If DHC's current refinancing discussions with the bank are unsuccessful, the company could experience a significant cash shortage.

- DHC has little diversification of revenue, as 99% of all revenue in 2022 (97% in 2019) (*link to Capstone 1*) comes from accommodation, food and beverage sales, and management fees from HHH.
- DHC's percentage of business travellers is below the industry average of 35%, at only 15% (*link to Capstone 1*). The low percentage was a weakness in 2019 and remains a concern in 2022, especially given that business travellers are expected to increase by 6% for each of the next five years, while leisure travellers are expected to increase by only 2%.

Opportunities (*from Capstone 1 that are still relevant for this case and* ***new*** *information in Day 1 case*):

- There have been increases in leisure travellers using online travel agencies (OTAs) and peer-to-peer property rental sites to find lower rates. This suggests that investing in Luxury may be beneficial to DHC.
- The number of business travellers is expected to increase by 6% annually. Since increasing its marketing to business travellers, HHH has already experienced a 10% increase in revenue.
- Business travellers are interested in staying in unique, small hotels that cater directly to their needs by providing special services. Some business travellers are willing to pay a premium for this.

Threats (*from Capstone 1 that are still relevant for this case and* ***new*** *information in Day 1 case)*:

- The number of leisure travellers staying in boutique hotels is expected to grow by only 2%, which is problematic for DHC, given that 85% of its customers are leisure travellers.
- Due to the strengthening Canadian dollar, there has been a decline in international leisure travellers.
- Domestic and international leisure travellers are becoming more price sensitive, as they find that the added cost for hotel accommodations outweighs the benefits received. This has resulted in increased use of OTAs and peer-to-peer property rental businesses, thereby increasing the percentage of accommodations provided by short-term rental companies at the expense of hotel accommodations, such as those provided by DHC.
- Interest rates are expected to continue to increase in the next two years. Given DHC's substantial debt, this will increase its interest expense.

Summative Assessment #2 – Analyzes the Major Issues

For Summative Assessment #2, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate sufficiently completed a reasonable assessment of the major issues facing DHC.

Unsure – The candidate attempted to complete a reasonable assessment of the major issues facing DHC.

No – The candidate clearly did not complete a reasonable assessment of the major issues facing DHC.

Technical Competencies
2.1.1 Evaluates the entity's governance structure (policies, processes, codes).
2.3.3 Evaluates strategic alternatives.

Enabling Competencies
2.1.1 Defines the scope of the problem.
2.1.2 Collects and verifies relevant information.
2.1.3 Performs appropriate analyses.
2.1.4 Integrates information to investigate each potentially viable solution or conclusion.
2.1.6 Uses creativity and innovation to enhance problem-solving and decision-making.

This summative assessment is based on Assessment Opportunities #2 to #6.

Assessment Opportunity #2 (Strategic Issue #1 – Lease the Montreal property from RH)

A competent candidate will complete both a qualitative and quantitative assessment of the Montreal lease opportunity.

Quantitative: The candidate should calculate and discuss the potential impacts of this project on DHC's specific objectives.

Qualitative: The candidate should discuss the advantages and disadvantages of the Montreal building lease, including the fit with DHC's new vision and mission and its core values. The candidate should also address DHC's objectives, the advisory board's suggestions for achieving those objectives, and how they can best be achieved.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Quantitative Analysis

The impacts of the Montreal property on the specific objectives of DHC's board are as follows:

- The estimated occupancy rate of 80%, while greater than DHC's 78% occupancy rate, is less than the 85% objective. Indirectly, this may decrease the Rev/PAR (*link to Capstone 1 — a high occupancy rate is a KSF*).
- The estimated ADR of $750 is significantly higher than DHC's current, and objective, rate of $440. Therefore, the Montreal property should positively affect the ADR and, indirectly, the Rev/PAR. *(If the candidate addresses the reasonability of the $750, this is valid.)*
- The expected operating margin is calculated as follows:

Revenue ($750 × 365 days × 80% occupancy × 50 rooms)	$ 10,950,000
Rent expense [$50,000 + (16% × $10,950,000)]	1,802,000
Room operating costs (55%) (Note 1)	6,022,500
Administrative and general, including marketing and sales (13%)	1,423,500
Operating income	$ 1,702,000
Operating margin ($1,702,000 ÷ $10,950,000)	15.54%

Note 1. The candidate could compare the percentage to DHC but should also consider the size of the hotel, given that this hotel would be much smaller.

The operating margin expected from the Montreal property is 15.5%, which is higher than the boutique industry average of 14%. It is also slightly higher than DHC's objective of 15%. Therefore, from a quantitative perspective, this proposal would appear to be aligned with DHC's objective to go public in 2025. However, DHC should also ensure that the inputs to the above projection are tested for reasonability.

- Only a small portion of the rent is a fixed cost (at $50,000 annually), with the remainder based on room revenues. Therefore, DHC will only pay the rest if the rooms get rented and just needs to be able to cover the fixed portion (rent plus any other fixed costs) in order to break even. This decreases operating risk.
- The addition of the Montreal property will increase the number of available rooms by 50 (*link to advisory board suggestions*).
- The Montreal property will not result in diversification, as the revenue generated is still hotel related (*link to advisory board suggestions*).
- Given that this project is meant to appeal mostly to leisure travellers, it will likely not result in an increase in the percentage of business travellers (*link to advisory board suggestions*).

Qualitative Analysis

Mission/vision:

- This proposal complies with the revised mission: "We are operators of unique boutique hotels built with a welcoming and luxurious atmosphere, providing each guest with attentive and caring service beyond expectations" (*link with new vision/mission*).
- This proposal fits with DHC's revised vision: "We make guests feel welcome and special by providing attentive, personalized, and exceptional service in a unique and luxurious setting" (*link with new vision/mission*).
- The property is in the unique, historical setting of Old Montreal and an old bank building. Although this is not specifically included in the revised mission, it is likely still a positive for the property (*link with mission/vision, and to KSF/trend to be in metropolitan centres*).
- DHC's original mandate was to only invest in properties that were able to accommodate between 150 and 250 rooms; the property in Montreal is only projected to contain 50 rooms and, therefore, does not meet this mandate.

Trends:

- Leisure versus business:
  - The number of leisure travellers staying in boutique hotels is expected to increase by only 2% annually (*link to trends*).
  - The property is not intended to attract business travellers, yet this segment of the market is expected to increase by 6% annually for the next five years (*link to trend*). However, "a growing number of businesses are willing to pay a premium for hotels that are small, unique, and cater to the needs of business travellers," so this new potential may still attract business travellers.
- International travellers:
  - The property may attract international travellers, given its smaller size. This taps into a large segment of the market (*link to trends*).
  - In Capstone 1, exchange rate risk was identified as a concern (*link to risks/trends*). This hotel is expected to appeal to international travellers, given its smaller size. This is concerning because in Day 1, the Canadian dollar has strengthened, causing a decline in the number of international visitors coming to Canada.
  - Domestic and international leisure travellers do not feel that the benefits of hotels are worth the higher price premiums; therefore, the ADR of at least $750 may not be realized (*link to trends/threats*).
  - More domestic and international leisure travellers are using short-term rentals because of their lower prices; therefore, the forecasted occupancy rate may not be realized (*link to trends/threats*).
  - Domestic and international leisure travellers are becoming more price sensitive; therefore, the forecast ADR and occupancy rates may not be realized (*link to trends/threats*).

Risks:

- Associated with lease terms:
  - RH has the right to sell the property with 90 days' notice given to DHC. This risk is somewhat mitigated by DHC having the first right of refusal on the building purchase. However, as 90 days may not be enough time to arrange a buyout with financing, etc., DHC should consider changing these terms. Moreover, DHC's $10 million renovation of this property could go to waste if RH decides to sell the property and DHC does not purchase it (perhaps because DHC is unable to acquire the financing needed to purchase the building). This aspect of the lease agreement represents a significant risk and should be renegotiated.
  - DHC may put financing in place to enable it to take advantage of a potential purchase if the opportunity arises; this is an appropriate risk management response to the 90-day notice and right of first refusal.
  - A capital investment of $10 million ($15 million less $5 million from RH) is required to renovate the property; it is risky to make this investment in a property that is not owned and where the lease can be terminated with 90 days' notice.
  - The proposed lease requires the owner of RH to approve renovations; this adds the risk of potential delays and increases in cost.
- Comparison to managed model HHH: (*a directed required: "In terms of risk, how does this type of arrangement compare to our management agreement with HHH?") In Capstone 1, the proposed lease of the Montreal property is consistent with the leased model, whereas the HHH contract is consistent with the managed model.*
  - One risk of this proposed lease (leased model) is that DHC's net profits are partially reliant on the capital requirements of the property. In addition, DHC must ensure that sufficient capital is available for capital improvements. This agreement also requires that any renovations be pre-approved by RH, which adds an additional risk factor to the option.
  - In comparison, the managed model used for HHH is less risky for DHC; although its net profits are still tied to hotel operations, DHC is not responsible for any of the operating costs other than management compensation. In addition, under the managed model, DHC requires little capital, as HHH is responsible for all capital investments.

Summary

This is a risky proposal in that RH can terminate the lease or sell the hotel with only 90 days' notice. Should a decision be made to proceed with this proposal, DHC should attempt to renegotiate this term or put in place risk management processes, such as having purchasing financing in place in advance.

This proposal is also risky because the property is attractive to leisure travellers, for which the growth rate is low, and international travellers, which are declining. As a result, it is possible that the ADR and occupancy rate expected will not be achieved, thereby negatively affecting DHC's specific objectives. DHC should not move forward with this project until these risks are addressed and properly mitigated,

Assessment Opportunity #3 (Strategic Issue #2 – Renovation of AWH)

A competent candidate will complete both a qualitative and quantitative assessment of the issues related to whether AWH should be remodelled in order to appeal to business travellers.

Quantitative: The candidate should critique the preliminary analysis and revise it, based on DHC's ratios and/or industry information. The candidate should discuss the impacts that this proposal would have on DHC's specific objectives.

Qualitative: The candidate should discuss the advantages and disadvantages associated with remodelling, including the fit with DHC's vision, mission, and core values. The candidate should also address DHC's objectives and the advisory board's suggestions for achieving those objectives.

Conclusion: The candidate should consider both their quantitative and qualitative analyses when drawing conclusions and making recommendations.

Quantitative Analysis

Critique and revision of forecast:	**Revised**	**Provided**
Room rate (Note 1)	$290	$290
Occupancy estimated (Note 2)	85%	85%
Number of rooms	120	120
Room revenue	$10,796,700	$10,796,700
Food and beverage sales at 54% (not 65%) of room revenue (Note 3)	5,830,218	7,017,855
Cost of room operating at 55% of room revenue (Note 4)	(5,938,185)	(5,938,185)
Cost of food and beverages at 68% (not 50%) of food and beverage revenue (Note 5)	(3,964,548)	(3,508,928)
Fixed costs for marketing, property, and administration	(5,000,000)	(5,000,000)
Operating margin	1,724,185	3,367,442
	10.4%	18.9%
Less taxes at 27%	(465,530)	(909,209)
Net earnings after tax	$1,258,655	$2,458,233

Contribution margin – food and beverages ($5,830,218 − $3,964,548)	$1,865,670
Contribution margin – rooms ($10,796,700 − $5,938,185)	$4,858,515

Notes:

1. Room rate used:
   - Currently, the ADR is $300 as per dialogue.
   - The forecast rate is $290 due to an increase in business travellers who will likely only be attracted to the hotel if it maintains a lower room rate.
   - However, rates may be lower still as per information gathered by Jonathan (business travellers' rate may be as low as $250).

2. Occupancy rate used:
   - 75% is the current occupancy rate.
   - An 85% occupancy rate is based on an increase in the occupancy rate after targeting business travellers (10% increase in HHH is a good comparative).
     A 90% rate would be achieved if the same number of rooms is rented and the total number of rooms decreases from 150 to 120 as planned (due to renovations, to add restaurant and bar).

3. Food and beverage sales:
   The 65% of room revenue used to determine food and beverage revenue appears high. As per DHC's financial statements, this amount is only 54% ($51,410 ÷ $95,204) (*integration with financial statements*).

4. Variable operating costs:
   The 55% of room revenue appears reasonable. In 2019, this was 47% of room revenue (*link to Capstone 1*). DHC's financial statements show a rate of 53% of room revenue ($50,458 ÷ $95,204). Since the percentage used is higher than what DHC currently incurs, it is assumed that the added costs of the personalized services are included in the room costs.

5. As per DHC's financial statements, the cost of food and beverages is 68% ($34,959 ÷ $51,410); therefore, a higher cost than the 50% that has been used is likely more reasonable.

<u>Other considerations:</u>

- No costs for a customer loyalty program were included. Given that this program will be needed in order to be competitive within the Toronto market, these additional expenses should be factored into the project's analysis once the total cost is known.
- Depending on where the company will get the $6 million required for the capital investments, interest expense may be missing.

Based on the above adjustments, the objectives are impacted as follows:

- The occupancy rate will likely increase as there will be fewer rooms (assuming that demand remains the same or improves).
- The ADR will decrease, based on the lower room rate (given the increased percentage of business travellers).

- As the market is competitive, it appears that any increase in rates will be limited, despite providing more services and facilities.
- Net revenue from food and beverages will improve the contribution margin.
- After the revisions, the operating margin will be 10.4% [$1,724,185 ÷ ($10,796,700 + $5,830,218)], not 18.9%, as in the forecast.
- Given the competitive environment, this initiative appears risky.

Overall objectives:

- The renovations should increase DHC's occupancy rate because the forecast of 85% is higher than AWH's current occupancy rate of 75% and higher than the occupancy rate of 78% for all DHC properties in 2022. If the hotel can achieve an occupancy rate of 85%, then the project will align with the board's specific objective of a company-wide occupancy rate of 85%.
- The revised operating income determined above is significantly less than that determined by Jessica, and it is lower than the earnings of $1,315,000 reported in 2022.
- As the ADR for AWH is expected to be $290, which is less than the current $300 for AWH, this proposal will cause DHC's ADR to decrease. It is also lower than DHC's overall ADR of $440 in 2022, and it is not consistent with the specific objective to at least maintain this ADR.

Qualitative Analysis

Core values:

- If DHC chooses to remodel the hotel to appeal to business travellers, this would be consistent with the core value of embracing new ideas and change (*link to core values/Capstone 1*).

Mission/vision:

- Given that this proposal would include upgrading work areas with the latest technology, the investment is consistent with the revised vision to "make guests feel welcome and special by providing attentive, personalized, and exceptional service in a unique and luxurious setting" (*link with new vision/mission*).
- Additionally, given that DHC will provide personalized services and a loyalty program as part of this proposal, the investment is also consistent with the company's revised mission: "We are operators of unique boutique hotels built with a welcoming and luxurious atmosphere, providing each guest with attentive and caring service beyond expectations" (*link with new vision/mission*).
- All these changes may impact the feel and uniqueness of the hotel (Kelvin's comment), which may be inconsistent with the mission/vision: to provide unique boutique hotels (*link with new mission/vision*).

Industry trends:

- DHC has no customer loyalty program (*link to Capstone 1*); since business travellers expect a customer loyalty program, this might be a good reason to implement one (*link to trends*).
- This proposal would result in an increase in the percentage of business travellers, which is the market segment expected to have the highest growth rate for the next five years (*link to trends*).
- Leisure travellers are now using short-term rentals and moving away from hotel stays, so this will make DHC less reliant on leisure travellers (*link to industry trends*).
- Business travellers are interested in staying in unique, small hotels that cater to their needs, and this proposal would help to attract these customers (*link to industry trends*). The renovations being proposed (proper work areas, fitness facility, business centre, restaurant, bar, and personalized services) would address the needs that have been identified for business travellers (*link to trends*).

Advisory board suggestions:

- This proposal should attract a different customer segment. According to Jonathan, it should be possible to obtain corporate accounts, which may provide more stability (*trend to face-to-face meetings*).
- The advisory board supports this proposal, as it would like to see the percentage of business travellers increase to 40% (*link to advisory board suggestions*).
- This proposal will reduce the number of available rooms from 150 to 120; the advisory board wants the number of rooms to increase, not decrease (*link to advisory board suggestions*).
- This proposal does not adhere to the advisory board's suggestion to diversify and reduce reliance on hotel revenue (*link to advisory board suggestions*). Although appealing to business travellers, which could be seen as some diversification, it is still hotel revenue.

Other:

- Renovations will cost between $5.7 million and $6 million to complete. Based on the financial information we have for DHC, at least a portion of this amount will need to be financed.
- To attract corporate accounts, it will be necessary to provide 30 to 60 days in which to pay, which will increase working capital requirements and related financing costs.
- Jonathan mentioned that DHC will need to provide corporate customers with guaranteed availability, which could create logistical issues and complexities. For example, if the hotel was fully booked and a corporate customer wished to book a room(s), would DHC be forced to cancel other guest bookings?

Summary

At an ADR of $290, this proposal does not help DHC achieve the board's stated objectives. The forecast appears overly optimistic in its assumptions, and the financial results are uncertain.

Although the changes are in line with industry trends, DHC is not that familiar with this segment and may lack the experience necessary for a successful transition. Also, Toronto is already a very competitive market. Given DHC's current lack of available funds and the fact that this renovation would not meet a number of DHC's stated objectives, investing in this particular project may not be the best use of the company's resources, especially when considering the company's plan to go public in 2025.

Assessment Opportunity #4 (Strategic Issue #3 – Renovation or sale of Northern Ontario hotel)

Competent candidates will complete both a qualitative and quantitative assessment of the decision to renovate or sell the Northern Ontario hotel.

Quantitative: The candidate should discuss the proposal to renovate the property, considering the impacts on DHC's quantitative goals, and the achievability of the projections. The candidate should discuss the potential sale offer price.

Qualitative: The candidate should discuss the advantages and disadvantages associated with renovating or selling the Northern Ontario hotel, including the fit with DHC's vision, mission, and core values. The candidate should also address DHC's objectives and the advisory board's suggestions for achieving those objectives.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Given that the hotel in Northern Ontario has consistently struggled (*link to Capstone 1*) and continues to do so, it does not appear that the status quo is an option. DHC must, therefore, determine whether to renovate or sell the hotel.

Quantitative Analysis

- With renovations of $13 million, pre-tax profit is estimated at $2,628,000, compared to $1,338,090 in 2022; this is an increase of $1,289,910. The payback period is approximately 10 years.
- The suggested pre-tax sales proceeds are $40 million. The book value of the assets is noted as being $40 million. Additional information is needed to determine if this is a reasonable offer.
- The $40 million sales price represents a multiple of almost 30x earnings.
- If the Northern Ontario property is sold, the $13 million renovation funds could be allocated towards other projects where there is less risk or a potential for higher returns.

- It will need to be determined whether the assumptions used for the post-renovation room rate and occupancy rate are reasonable. Given the history with this property, the estimates appear optimistic.

Impact on DHC's specific objectives:

- The renovation is projected to increase DHC's occupancy rate to 80% from Northern Ontario's current occupancy of 70%. This is higher than DHC's 2022 occupancy rate of 78% but remains below the specific objective of 85%. Therefore, even with the renovation, it is questionable whether the Northern Ontario hotel will be able to help achieve the objectives that DHC has set in order to go public in 2025.
- Post-renovation, the Northern Ontario property will generate an operating margin of 12% ($2,628,000 ÷ $21,900,000), which is higher than DHC's 2022 operating margin of 10.8% but less than the target of 15% and the industry benchmark of 14%.
- The renovation is projected to increase DHC's ADR, since the Northern Ontario property is expected to generate an ADR of $500, which is greater than the existing ADR of $300 for this property and the actual and target ADR of $440 for DHC as a whole.
- The number of rooms is decreased by 85 rooms, from 235 to 150, which goes against the advisory board's suggestion to increase the number of rooms.
- This change does not increase the percentage of business travellers, nor does it reduce the reliance on hotel revenue, two of the other suggestions made by the advisory board.

Qualitative Analysis

Advantages of renovating:

- Families are looking for accommodations that include kitchen facilities and more living space at reasonable prices, and the intent of this renovation is to include kitchens and sitting areas (*link to trends*).
- Although the Northern Ontario hotel is still struggling relative to DHC's other hotels, its performance has improved in recent years. The renovation is projected to further increase this hotel's performance, although it is questionable whether it will ever achieve the metrics that are desired by DHC.
- This hotel targets leisure travellers, a market segment that is projected to grow by 2% annually. With this renovation, DHC's Northern Ontario hotel would be in a better position to capture that market growth.
- The renovation may help to attract more international travellers to this hotel. This could have a positive impact on this hotel's performance metrics and may also help DHC build its brand with overseas customers.

Disadvantages of renovating:

- It is questionable whether the renovations fit with the revised vision to “make guests feel welcome and special by providing attentive, personalized, and exceptional service in a unique and luxurious setting” (*link with new vision/mission*). Further, it may not achieve the revised mission: “We are operators of unique boutique hotels built with a welcoming and luxurious atmosphere, providing each guest with attentive and caring service beyond expectations” (*link with new vision/mission*).
- Targeting the family market is not likely to help build the DHC brand, as the intent is not to provide pampered service (*Alyson’s comment*) (*link to brand, mission/vision*).
- Given the hotel’s northern location, DHC has not been able to overcome the seasonality factor, which may be part of the reason for its continued underperformance (*link to KSFs*). Renovating the hotel will not help to overcome this disadvantage of the project.
- Customer risk is high — there is a lot of competition for the seasonal revenues from families for the summer and winter holidays. This is likely why the company’s occupancy rates are historically low (*link to industry risks*). It is not known what market research has been done to justify pursuing this option.
- Leisure travellers, especially families, are increasingly using peer-to-peer rental businesses, which is something that DHC does not currently offer (*link to trends*). Therefore, the competition for leisure travellers may continue to increase into the future, making it harder for DHC to attract guests to the Northern Ontario hotel.
- Kelvin thinks the renovated property will appeal to international travellers; however, international leisure travellers are declining (*link to trends*).
- Being more price sensitive, leisure travellers may not be willing to pay high rates or believe the added price premiums for hotels are worth the additional benefits (*link to trends*). Therefore, the projected ADR of $500 may be overly optimistic.
- To facilitate the renovations, it will be necessary to reduce the number of rooms available, which is inconsistent with the advisory board’s suggestions (*link to advisory board suggestion*). However, it is consistent with boutique hotel size (this hotel is larger than normal).
- This option does not achieve the advisory board’s suggestion that DHC diversify and reduce its reliance on hotel revenue (*link to advisory board suggestion*).

Advantages of selling:

- The proceeds from the hotel’s sale could be reinvested in other opportunities (such as the proposals that are being considered in Old Montreal and at the AWH location) to generate higher returns and achieve the company’s stated objectives. DHC could also use the proceeds to pay down debt.
- Due to its size and location, this hotel does not fit the boutique hotel model. Therefore, it may make sense to divest this hotel and allocate the funds towards a project that better fits with DHC’s mandate.
- Many attempts to improve this hotel have been made in the past, and they have been unsuccessful. The location appears to be one of the main issues, and this cannot be changed. If the hotel is sold, no future investments of time and money will be required.

- The advisory board supports the sale option, perhaps because this hotel has been underperforming. Given DHC's objective to go public in 2025, it may be wise to sell this property so that DHC's overall metrics appear to be more attractive to prospective investors.

Disadvantages of selling:

- It could look like DHC is giving up, which might reflect poorly on the management of the other hotels and on DHC's reputation.
- If DHC decides to sell the hotel, the number of rooms will be reduced by the full 235, which will negatively impact DHC's ability to meet the room target of 1,000 set by the advisory board.

Potential conflict (see AO6):

- There is a possible conflict, given that a member of the advisory board (Thomas Wong), who is also a friend of Derek's, might have a potential buyer. It is possible that the sale price is less than fair value and that Thomas will somehow personally benefit from this proposed sale. It is important that members of DHC's advisory board remain independent from DHC's transactions and do not personally benefit from the advice they offer.
- The shareholders need to understand the relationship between the potential buyer and Thomas to determine whether Thomas may be benefitting from the sale.

Summary

Although renovating the Northern Ontario property is projected to positively impact some of the board's specific objectives, there are several significant disadvantages and risks associated with the option, as noted above. There are few risks associated with its sale. Prior to selling, it is imperative that DHC obtains more information about the potential buyer and has a proper valuation of the property performed to ensure that the sale price received approximates the property's fair value.

Assessment Opportunity #5 (Strategic Issue #4 – Investment in Luxury Stays)

A competent candidate will complete both a qualitative and quantitative assessment of the opportunity to invest in the Luxury Stays website.

Quantitative: The candidate should calculate and assess the potential impact of investing in Luxury relative to DHC's specific objectives and quantify the operating margins that could be generated throughout the forecasted period.

Qualitative: The candidate should discuss the advantages and disadvantages associated with the investment in Luxury, including the fit with DHC's vision, mission, and core values. The candidate should also address DHC's objectives and the advisory board's suggestions for achieving those objectives.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Quantitative Analysis

An initial investment of $7 million is required. Derek suggests that the investment is small but, in light of DHC's financial position, this does not seem accurate. It is of the same magnitude as most of the proposals being considered ($5.7 million to $6 million for AWH renovation and $10 million for renovation of Montreal property).

A quantification of the earnings expected to be generated during the forecast period is as follows:

	2023	2024	2025	2026
Commission revenue (given – Note 1)	$ 780,000	$ 3,640,000	$ 5,772,000	$ 8,398,000
Annual operating costs (given)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)
Operating income	$(3,220,000)	$ (360,000)	$ 1,772,000	$ 4,398,000
Operating margin % (Note 2)			31%	52%

Notes:

1. Backup to information provided in the case:
   2023 commission revenue: (20,000)($300)(0.10 + 0.03) = $780,000
   2024 commission revenue: (80,000)($350)(0.10 + 0.03) = $3,640,000
   2025 commission revenue: (120,000)($370)(0.10 + 0.03) = $5,772,000
   2026 commission revenue: (170,000)($380)(0.10 + 0.03) = $8,398,000

2. 2025 operating margin: ($1,772,000 ÷ $5,772,000) = 31%
   2026 operating margin: ($4,398,000 ÷ $8,398,000) = 52%

Other:

The above analysis does not include earnings from personalized services provided to guests, at a price of 25% over cost. Therefore, depending upon the usage rate of these personalized services, the project may be more lucrative than the above forecast currently indicates.

It is currently unknown how accurate and reliable the revenue and cost figures provided are. Before DHC uses the above analysis to make any decisions, the data provided should be validated to ensure its accuracy.

The impacts on DHC's specific objectives are as follows:

- As DHC will not be listing its hotel rooms on the website, there will be no impact on DHC's occupancy rate.
- Based on the calculations above, an investment in Luxury will result in a negative operating margin in 2023 and 2024. By 2025, an operating margin of 31% will be generated, which will increase to 52% by 2026. These operating margins are higher than DHC's 2022 operating margin and the specific objective of 15%.

- The investment will not be profitable until 2025, which is when DHC plans to go public. We should consider how this will impact the attractiveness and initial price of a public offering.
- If this project proves to be unsuccessful, it may reflect poorly on DHC's performance, from the perspective of potential investors, when going public.
- Since DHC will be earning commissions on booking revenue from both guests and hosts, there will be no impact on its hotels' ADR.
- The cost structure for this operation is quite different from operating hotels. Costs are largely fixed and, once the revenue is high enough, any increase will flow to the bottom line.

Qualitative Analysis

Advantages:

- Leisure travellers, especially families, are looking for kitchen facilities and more living space at reasonable prices, which Luxury would help to provide (*link to industry trends*). Leisure travellers often use third-party providers such as Luxury to find lower rates *(link to trends).* This investment is consistent with addressing the increasing competition from Airbnb and VRBO.
- The revised vision and mission include a focus on providing exceptional services. The additional personalized services that would be offered by DHC to guests of Luxury would help to achieve this level of service (*link to vision/mission*). Jonathan believes this proposal would allow DHC to use its strength of providing exceptional services such as dog walking, childcare, housekeeping, massage and personal trainer sessions.
- The advisory board has been looking for ways to enter the short-term rental market and has also suggested that DHC aim to diversify its revenue stream in order to achieve a successful IPO. The investment in Luxury would help to achieve both of these suggestions.
- Cindy, the website designer, has industry experience in the short-term property rental market that DHC could leverage when developing and operating Luxury.
- A presence in the short-term property rental business would help DHC achieve the core value of embracing new ideas and change (*link to core values*).
- Because this business may be very different from the hotels that DHC currently operates, it may be less impacted by any downturn in the industry. Revenue may be more resilient, and the cost structure for this business, of largely fixed costs, is quite different (except for the inspection of the listed accommodations).

Disadvantages:

- It will take time to build this new business/brand. Therefore, it may take longer for the revenue projections to materialize relative to what has been forecasted.
- DHC will face competition that is already established (*link to industry risks*). This reduces the odds that the project will be successful and also increases the risk that its performance does not materialize as the forecast has suggested.

- Kelvin is concerned about sourcing hosts to list their accommodations and ensuring that the accommodations are luxurious and meet DHC's high standards. This is a major concern, given how important DHC's reputation is to its brand. This element has even more importance for the upcoming public offering.
- Since at least 1,200 accommodations in five major cities would be needed to justify the investment, there is a risk that Luxury cannot achieve this threshold and, as a result, DHC may not be able to earn back the fixed costs of the project. This means DHC may lose its investment in the project if it is eventually deemed unsuccessful.
- It may be challenging for DHC to coordinate all the service providers who will be expected to deliver the luxury services directly to the accommodations listed on Luxury's website. Given that the accommodations will be spread across the entire country, it is possible that DHC will be unable to provide the full range of luxury services to every accommodation listed on the website, especially if an accommodation is located in a more remote location.
- DHC may need to visit Luxury accommodations to ensure they meet DHC's high standards, but is likely not able to charge the customer to cover this additional expense, thereby adversely affecting its net profit.
- An investment in Luxury may not achieve the aspects of the vision and mission related to unique hotel properties, as the hosts that choose to list may not offer luxury accommodations (*link with new vision/mission*). This could harm DHC's image and reputation as a luxury brand.
- Linking the two websites (DHC and Luxury) could also dilute DHC's brand if the right hosts are not selected and the Luxury website is given poor reviews by its guests.
- Despite Jonathan's assertion that the site would appeal to a segment of the market that would not stay at DHC hotels, establishing Luxury could take revenue away from DHC hotels if customers stay in private homes or other hotels rather than in DHC hotels, which would reduce DHC's net profit.
- DHC has no experience with this type of project. Its strength is in operating boutique hotels, so a move to short-term property rental would result in a significant change for DHC (*link with new mission/vision*).
- As Luxury is an online booking service, investing in it would be inconsistent with DHC's core value of interacting personally with guests (*link to core values*).

Summary

An investment in Luxury would be a significant change from DHC's core business. A $7 million investment is required, which DHC would need to obtain financing for. The financial results would positively impact DHC's operating margin objective in 2025 and 2026, but not before then, and would allow it to target a new and growing customer segment. The success of this investment is dependent on the ability to recruit hosts that meet DHC's exacting standards.

Assessment Opportunity #6 (Issue #5 – Governance Issues)

A competent candidate will recognize that there are independence and conflict-of-interest concerns regarding the advisory board's impact on shareholder decisions. The candidate could make suggestions to address the issues.

Tension between DHC's Board and Advisory Board Members

In August 2022, DHC formed an eight-member advisory board, whose mandate is to provide suggestions regarding DHC's strategic direction, information on trends in the hotel industry, advice on preparations to go public, DHC's operational issues, and input on how to improve community relations. The advisory board has made several suggestions. Kelvin tells the others that the decisions of DHC's board should not be dictated by the advisory board, given that its role is to advise, the members have no money invested, and DHC's board does not have to do what the advisory board suggests. He is correct that the board is under no obligation to take the advice. In addition, although the advisory board has provided suggestions regarding how to achieve objectives, there is no obligation for the board members to follow these suggestions. However, if the advice of an advisory board is continually ignored, members may lose interest and/or become frustrated, potentially resulting in resignations.

Kelvin has also expressed that the advisory board does not know everything. Although Kelvin is correct in that they will not know everything, it appears that most of the members of the advisory board possess expertise relevant to DHC's business. Therefore, their viewpoints should at least be considered. Kelvin must be more open minded and at least prepared to consider the advisory board's suggestions. One area of expertise appears to be lacking: expertise in taking a company public. It may be helpful to add another member with this skillset, which could help with the lack of independence discussed below. It might also be advisable to add a member who has experience in either law or accounting, or both.

Advisory Board Composition/Conflict

Four of the eight members (50%) appear to be friends of Derek, and two of the eight (25%) are friends of Jessica. The remaining two members, while not friends of the Sterne family, are friends of the Chung family. This results in lack of independence.

Advisory Board Suggestions versus Board Objectives

<u>Advisory board suggestions:</u>

To help DHC achieve its specific objectives and a successful public offering, the advisory board recently made the following suggestions:

- Maintain industry average metrics, with the exception of the operating margin, which should exceed industry averages.
- Increase the number of rooms to 1,000 by 2025.
- Increase the percentage of business travellers to 40%.

- Diversify in order to reduce reliance on hotel revenue.

Board objectives:

The board set targets, including maintaining DHC's average daily rate (ADR) of $440, and increasing its occupancy rate to 85% and achieving an operating margin of 15%, both by 2024.

There appear to be some inconsistencies between the board's objectives and the objectives suggested by the advisory board. These inconsistencies should be discussed and resolved. This will allow DHC's board to make decisions that are aligned with a unified vision for the company.

Derek Using Advisory Board to Promote His Agenda

Not only does the advisory board lack independent members, but Derek has discussed business issues with them outside of formal meetings, with the intent of garnering support for his personal objectives and agenda. DHC's other shareholders have not been privy to these discussions. Examples of how Derek used the advisory board to support his position with respect to the proposals being considered are as follows:

- Derek supports remodelling AWH and stated that the advisory board will support doing so, as it wants to see the percentage of business travellers increase to 40%.
- Derek has stated that he wants to sell the Northern Ontario property, given the inability to overcome the seasonality factor, and the advisory board agrees. Derek explains that he has had discussions with some members of the advisory board outside of a regular meeting. This may have been done to garner support for his preferred position.

Should DHC wish to retain the advisory board, it is recommended that its composition be modified to include members who are independent of the shareholders, rather than their friends. Doing so would help alleviate the problem of Derek or other board members discussing business issues outside of meetings. Further, DHC should develop board and advisory board policies that clearly stipulate that all business-related items be discussed at the advisory board meetings only.

There are also concerns regarding conflicts of interest with members of the advisory board, as follows:

- Sean, a member of the advisory board, has suggested that his company could do the renovations required at AWH at a very competitive price. However, it appears that his company would charge $300,000 more ($6 million − $5.7 million) to complete the work. Also, there are questions about the quality of the work performed by his company, based on a small job done at the Northern Ontario hotel. To settle the issue, the board should vote on whether to hire Sean's company to perform the renovations, or it should explain to Sean that a formal request for proposal (RFP) process has to be followed as company policy. (The board may need to set such a policy first.)

  Going forward, DHC should develop a conflict-of-interest policy, such that it would not be possible for an advisory board member to perform such work or that an advisory board member could only do so with a formal RFP process involving multiple contractors.

- There are concerns about a conflict of interest involving Derek's friend Thomas Wong. Thomas has indicated that he may know of a potential buyer for the Northern Ontario property. As the $40 million selling price is approximately equal to the carrying amount of the net assets, there is some question about the estimated selling price. To address this concern, the board should investigate the nature of the relationship between the potential buyer and Thomas to ensure that he will not benefit from the sale. Additionally, DHC should list the Northern Ontario property for sale to solicit competitive bids and ensure that it will receive fair value in the event of a sale.
- There is a final governance concern related to the fact that Jonathan Chung now owns 8% of DHC. As a result, DHC's other four shareholders each own 23%. This means that, if Jonathan were to vote with his parents, the family would have 54% of the votes, allowing them to determine the outcome of any decision. However, it should be noted that this may not be an issue, at least not at the present time, since Jonathan has not consistently sided with his parents.

Summative Assessment #3 – Conclude and Advise

For Summative Assessment #3, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate provided reasonable conclusions for each major issue.

Unsure – The candidate attempted to provide reasonable conclusions for each major issue.

No – The candidate clearly did not provide reasonable conclusions for each major issue.

Enabling Competencies
2.1.4 Integrates information to investigate each potentially viable solution or conclusion.
2.1.5 Recommends and justifies a solution or conclusion based on an integrative view of information for the situation.

The candidate should provide a logical conclusion that integrates the analysis of all four major issues (Montreal lease, renovating AWH, renovating or selling Northern Ontario, and investing in Luxury).

The recommendations should be consistent with the analyses performed. As well, an overall conclusion should be presented to provide a sense of completion to the report (a wrapping up/prioritization of the recommendations).

The candidate should consider the following:

- The alternative's ability to help DHC in its pursuit to go public in 2025.
- The alternative's ability to help meet the specific objectives, which are to increase occupancy rates to 85%, increase operating margin to 15%, and maintain its ADR at $440.
- The level of risk; the upfront investment required (especially given DHC's apparent cash shortage); the fit with DHC's mission, vision, and core values; and how well it fits with current industry trends.
- DHC wants to remain a unique boutique hotel brand.
- Although several of DHC's performance metrics have improved and/or exceed the boutique hotel industry benchmarks, it is preparing to go public in 2025, so further improvements are necessary.

Financing:

The candidate should also note that DHC needs $25 million to redeem the preferred shares owned by Isabelle, as well as any cash required for any other proposal(s) recommended. Discussions are in place to refinance the preferred shares and, as doing this will not impact the debt-equity ratio, refinancing should be a viable option. Nevertheless, DHC needs to be mindful of its current debt obligations when deciding whether to invest in the various proposals. If DHC sells the Northern Ontario property for $40 million, the proceeds could be used to redeem the preferred shares, leaving $15 million (not considering the tax consequences arising from the sale of the property) for other potential investments.

If the Northern Ontario hotel is not sold, DHC will continue to have capacity to borrow, given its below average total debt-to-equity and total debt-to-assets ratios. However, with interest rates expected to continue increasing for the next two years, debt financing will be increasingly expensive. It will be necessary to consider the impact of any additional debt on the total debt-to-equity ratio, given the covenant on the line of credit, which requires that the debt-to-equity ratio remain below 2.5.

Initial public offering/metric objectives:

DHC plans to take the company public in 2025; however, before that happens, DHC wishes to improve certain metrics. Therefore, in deciding which proposals to accept, it is imperative that DHC's board understand how those decisions would affect the company's important metrics and its chances of ultimately having a successful IPO. DHC's business decisions are likely to be scrutinized by the public markets prior to and after taking the company public, so the board of DHC needs to be diligent when deciding on which direction to take the company.

A competent candidate will consider some of the key points they raised in their analyses and relate them to the targets, as follows:

	Investment ($ millions)	ADR	Occupancy	Number of Rooms	% of Business Travellers	Operating Margin
Targets						
DHC board		$440	85%			15%
Advisory board (Note 1)				1,000 by 2025	40%	Exceed industry average (2022, was 14%)
Proposals						
Montreal lease	$10	$750 Overall increase	80%	+50	Unknown but targeted at leisure so unlikely to increase	15.54%
AWH	$5.7 to $6	$290 Decrease from current $300	85% Increase from current 75%	-30 (from 150 to120)	Increase to 45%	10.4%
Northern ON – reno	$13	$500	80%	-85 (from 235 to 150)	Likely decrease – appeal to families	12%
Northern ON – sell	$40 (inflow)	Should increase as this property has had lower metrics		-235	Likely increase – Northern ON not focused on business	NA
Invest in Luxury	$7	No impact	No impact	No impact		Improve 31% in 2025, 52% in 2026, loss in 2023 and 2024

Note 1. The advisory board has also suggested that DHC diversify, to reduce its reliance on hotel revenue.

The recommendations should address as many of the shareholders' concerns as possible and display good professional judgment. Suggesting that further information is required is acceptable as long as it is justified and consistent with the analysis.

Recommendations on Specific Issues

Montreal lease:

The Montreal lease appears to help DHC meet some of its objectives; i.e., an increase in ADR and in number of rooms. However, the occupancy rate projected is less than the target of 85%, but is higher than the current rate of 78%, and in line with the boutique industry benchmark of 80%. In addition, the projected ADR of $750 may be overly optimistic. Therefore, before a decision is made, more market research should be conducted to ensure that the project's forecasted performance is reasonable.

This proposal will require an investment of $10 million for renovations. If DHC does not sell the Northern Ontario hotel, it will require additional financing before this investment can be made.

Two significant concerns are the reliability of forecast information, particularly given the 2% growth rate projected for leisure travellers staying in premium-priced boutique hotels and increased price sensitivity, and the risk that the landlord can sell the hotel with only 90 days' notice, which may not allow DHC sufficient time to act on the right of first refusal and could result in unexpected challenges should the building be sold to a new owner. If DHC can effectively mitigate these risks, then it is recommended that DHC pursue this investment option.

AWH

Remodelling AWH to appeal to business travellers will require up to $6 million. It does not achieve DHC's specific objective of increasing the ADR or of increasing the number of rooms. DHC would need to determine if there are corporate customers willing to pay higher room rates, although the information provided does not suggest this possibility. The renovation is expected to have an occupancy rate of 85%, which is in line with the target. Additionally, the number of business travellers is expected to grow by 6% annually for the next five years. This may mean the occupancy rate could exceed the 85% forecast and result in favourable overall margin and profit. Given that this renovation does not appear to get DHC much closer to its objectives related to taking the company public, it is recommended that DHC pass on this opportunity. The company's limited cash resources can likely be deployed in a more advantageous way.

Northern Ontario — renovation:

Renovation of the Northern Ontario property will cost $13 million and may positively impact DHC's specific objective of an increased ADR and occupancy rates. However, the ADR and occupancy rate appear to be very optimistic, as they are significantly higher than those achieved previously. Qualitatively, there are many disadvantages associated with renovation and many advantages to selling the property. Given that DHC has repeatedly made additional investments in this hotel without achieving the desired result, it is recommended that the company abandon the idea of renovating the hotel.

Northern Ontario — sale:

Sale of the Northern Ontario property for $40 million (or more) would provide funds for repayment of the debt to Isabelle and for investment. It should also result in an improvement in ADR and occupancy rates (which will likely make the company more attractive when going public). Although the hotel's sale would result in fewer hotel rooms, the funds from this sale could be used to make investments in other hotels that suit DHC's brand and have a greater likelihood of achieving its objectives. It is recommended that the property be sold on the open market.

Investment in Luxury:

An investment in Luxury is expected to cost DHC $7 million and would help it to diversify its revenue sources. However, it is expected that Luxury would only begin to positively impact DHC's specific objectives beginning in 2025, which is not in time for DHC's plan to go public. The success of Luxury is dependent on the number of hosts listing accommodations and the quality of those accommodations. To achieve its quality standards, DHC is likely to incur costs that cannot be recovered, and the standards may also limit the number of listed accommodations. The major advantage of this proposal is that it would allow DHC to target a new customer segment, and one that is growing. Before making a final decision, DHC should seek advice from an IPO specialist in order to determine how this project, and its timing, may affect the company's optics related to going public.

Other:

If DHC requires financing for any of the upfront investments, expectations are that interest rates will continue to increase in the next two years, which will result in increased costs to service the debt (*link to economic conditions*).

Overall Conclusions and Recommendations

1. DHC should sell the Northern Ontario property, allowing DHC to move on from a poor investment that has never been successful. Additionally, the sale will generate the funds necessary to pay Isabelle for her shares and would also allow DHC to pursue other projects.

2. DHC may want to consider investing in Luxury, to change its strategy and diversify its revenues, given new and evolving industry trends and guest preferences.

3. DHC should not consider renovating AWH at this time, given the project's inability to meet DHC's stated objectives.

4. DHC could enter into a lease agreement for the Montreal property, as it fits with DHC's other properties and its mission/vision. However, to minimize its risk, it should consider modifications to the lease agreement or negotiate to purchase the building instead (if finances allow).

Summative Assessment #4 – Communication

For Summative Assessment #4, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate adequately communicated their response.

No – The candidate clearly did not communicate their response adequately.

Insufficient communication in a candidate's response would generally include some of the following:

- The response is difficult to understand; the reader needs to re-read sections several times in order to gain an understanding.
- It is not clear what point the candidate is trying to make.
- The quantitative analysis does not make sense because of illogical ordering or a lack of labelling.
- There is an excessive amount of spelling and grammatical errors.
- The language used is unprofessional.

Summative Assessment #5 – Overall Assessment

For Summative Assessment #5, the candidate must be assessed in one of the following, based on their overall performance:

Clear Pass – Overall, the candidate provided an adequate response, clearly meeting the minimum standards for each of the summative assessments above.

Marginal Pass – Overall, the candidate provided an adequate response, with some errors or areas of omission, but the underlying key concepts were presented.

Marginal Fail – Overall, the candidate provided an attempt at a response, with several errors or an incomplete analysis.

Clear Fail – Overall, the candidate did not provide an adequate response because the response was deficient in multiple areas.

To be assessed a Pass, the candidate is expected to perform adequately in all the summative assessments and demonstrate that they addressed issues of importance in a cohesive, professional manner.

In making their overall assessment, markers were asked to consider the following:

1. Did the candidate step back and see the bigger picture, and then address the broader issues identified?
2. Did the candidate prioritize the issues by discussing the major and minor issues in appropriate depth?
3. Did the candidate use both quantitative (when available) and qualitative information to support their discussions and conclusions?
4. Did the candidate use the appropriate tools to perform quantitative analysis?
5. Did the candidate use sufficient case facts (current case and Capstone 1 case) about the external and internal environment to support their discussions?
6. Did the candidate communicate their ideas clearly, integrating and synthesizing the information?

SAMPLE RESPONSE – DHC VERSION 2

Below is an actual passing candidate response.

From: CPA

To: Irene Mallik

Re: DHC – VARIOUS ISSUES

Situational analysis:

Vision:

We make guests feel welcome and special by providing attentive, personalized, and exceptional service in a unique and luxurious setting.

Mission:

We are operators of unique boutique hotels built with a welcoming and luxurious atmosphere, proving each guest with attentive and caring service beyond expectation.

Value:

- Interact personally with guests and employees and take a hand on approach
- Meet and anticipate guests' expectation
- Foster teamwork and respect between all employees
- Embrace new ideas
- Become an important part of local community

Key Successful factors (KSF)

- Retaining highly skilled and experience workforce
- Keep up to date with technology change
- Maintain properties in good condition
- Anticipating customers' needs
- Provide unique services and amenities
- Using market research
- Retaining and attracting guests

Strength:

- Higher ADR than industry average
- Cindy previously worked with Airbnb

Weakness:

- Board member conflict

Threat:

- Interest rate increase

- Leisure travelers are increasingly price sensitive and looking for accommodations that include kitchen and more living space
- Strengthen Canadian dollar has increased travel costs and reduce international travelers

Opportunity:

- Disposable income has increased
- Leisure travelers expected to increase by 2%
- Business traveller is expected to increase by 6%
- Business traveller are willing to pay a premium for hotel that are small, unique and cater to the needs

Objectives:

- Increase number of rooms
- Increase percentage of business traveller to 40%
- Diversify to reduce reliance on hotel revenue
- Increase occupancy rate to 85% and operating margin of 15%

Overall financial analysis:

- ADR is higher than industry average, means that guests recognized that DHC as a luxurious hotel or value its services and willing to pay more. While the occupancy rate is little bit lower than average. Overall, DHC is able to generate more revenue than its competitors which have positively impact on revenue growth and overall profitability.
- Percentage of business traveller is only 15% which is way less than industry average of 35% for 2022, which is also not meet board's objectives.
- The operating margin 11% is lower than average of 14%, given the DHC is able to generate more room revenues, this means that DHC incurred a higher cost than average or competitors.
- Current ratio is only 0.3 which is much lower than average, means DHC may have liquidate issue and not have enough ability to meet its short term obligations, which could cause going concern issue.

Montreal hotel

Quantitative analysis:

As calculated in Exhibit 1, the operating income is $1.7 million which will increase DHC s operating margin by 16% which exceed the board's objective of 15%. Therefore, this project will contribute to overall operating margin and will help DHC to meet board objectives.

Qualitative analysis:

- Hotel have only 50 rooms which may not enough to help DHC to achieve board objective to increase the room to 1000.
- Hotel is the city's first banks that is unique which is align with DHC's vision.
- Hotel would appeal to leisure travelers which allow DHC to take advantage of the trend of increase of leisure travellers which will benefit revenue growth and overall profitability.

- Hotel appeal to international tarvellers, however, consider strengthen Canadian dollar has increased travel costs and reduce international travelers. This may not help DHC to attract international tourists and increase overall profitability.
- RH has right to sell building at any time which increased risk of uncertainty. After DCH renovation and start operating, RHI may sell property which will cause DHC lost the money and time they invested in.
- Operate his hotel will increase room revenue, which will not help DHC to diversify to reduce reliance on hotel revenue which is the objective.
- RH is only willing to lease which will reduce the initial investment required, and would not further decrease DHC's current ratio.

Conclusion: I would suggest to pursue this opportunity since it may help DHC to meet the objectives that to increase operating margin, increase rooms, and take advantage of the trend to attract more leisure travellers.

Artists Warehouse hotel

Quantitative analysis:

The ARD OF $290 is higher than average rate at Toronto of $250, and the occupancy rate is 85% which is higher than DHC and the industry average. Therefore, both ARD and occupancy rate may not achievable. As calculated in Exhibit 2, the revised operating income is only $996K which is lower than Isabelle calculation, but it still help DHC to increase operating margin by 17% which allow DHC to meet objectives.

Qualitative analysis:

- The rooms decreased from 150 to 120 which will have negatively impact on meet objectives of 1000 rooms. And it will also reduce our room revenue and reduce overall profitability.
- Renovation will cost $6 million which will reduce cash flow and we may need to seek more finance for renovation. Given the interest rate is increasing, this will also increase financing costs.
- Renovation to outfit room with work areas featuring the latest technology which may attract more business traveller. This will allow DHC to take advantage of the trend that business traveller is expected to increase by 6%, will result in increasing in revenue and overall profitability. With the latest technology is also align with KSF that to keep up to date with technology.
- Renovation will build a business center, fitness facility, restaurant and bar. This will increase revenue from those amenities which will help to achieve board objective to diversify room revenue.
- More amenities build is consistent with KSF that to provide unique amenities and will able for DHC to provide more personalized services which is also align with vision and mission.
- Given the competition in Toronto, the revenue may not good as expected, which may future reduce operating income and will not achieve our objectives.
- The property is located in a large metropolitan center which may attract more guests, especially business travellers which will help DHC to achieve its goal to increase business traveller to 40% and will increase room revenue and overall profitability.

Conclusion: I would suggest to do the renovation as it is consistent with DHC's vision and industry KSF. It will also attract more business traveller which will help to achieve objectives. The operating margin is 17% which also meet the objective.

Northern Ontario Hotel

Quantitative analysis:

If the hotel sell at $40M which is at its carrying amount. Even DHC can receive a huge proceed, but DHC will not generate any gain from the disposition. Given DHC's reputation, the selling price seems to low since there should be goodwill which is also valuable. This selling price is not favorable to DHC.

The ADR of $500 and 80% of occupancy rate seems reasonable after renovation which is consistent with the industry average. As calculated in Exhibit 3, the renovation will increase room revenue by $5 million and increase pre tax profit by $1.3M which is almost double. It will help DHC to achieve its operation margin objectives.

Qualitative analysis:

- Selling the property would provide DHC a significant amount of proceed that allow us pursue other investment opportunities.
- We will lost the revenue generated from this hotel if property is sold, which will have negative impact on gross margin, and negatively impact IPO.
- Selling the hotel will reduce overall room numbers which will not helping to meet board's objectives.
- Renovation will cost $13M, we may need to seek additional finance for it. Since interest rate increasing, which will increase financing costs and further reduce current ratio which may cause going concern issue.
- Hotel after renovation will attract more families and international travellers. However, families are not looking for the pampered services that DHC offers which will limit our ability to provide services. In addition, consider the strengthen Canadian dollar has reduce international travelers, this will reduce the occupancy rate and ultimately revenue and overall profitability.
- the renovation will reduce room numbers to 150 which will have negatively impact to meet objective of 1000 rooms.
- Renovation is meet industry KSF that maintaining property in good condition which will attract more customers and increase room revenue and overall profitability.

Conclusion: I would suggest to renovation this hotel rather than selling. Since renovation is more consistent with DHC's vision and KSF, it will also help to meet the objective of operating income. Selling hotel will have negatively impact on operating income and IPO, therefore, not recommended.

Luxury Stay

Quantitative analysis: as calculated in Exhibit 4, the first 2 years will be a loss which will have negative impact on operating income and will have income after 2024. Consider the objective need to be achieve by 2024 and IPO will be in 2025. This investment will have negatively impact on objective achievement and IPO. Total operating income over 4 years is only $2.6 M which means it will take more than 4 years to recover the initial investment of $7 million. Therefore, form financial perspective, this investment is not recommended.

Qualitative analysis:

- Cindy previously worked with Airbnb, therefore, she has the experience and knowledge regarding the short term rental market which will help DHC to be successful for this investment.
- Luxury will offer additional, personified services, will attract more guests resulting in increase in revenue and overall profitability. This is align with DHC's vision of providing attentive, personalized, and exceptional service.
- The personalized services will increase revenue from amenities and luxury will earn commission income which will diversified DHC's revenue and provide more revenue stream which will meet board's objectives.
- Luxury need to offer at least 1200 accommodations which will help DHC to meet the objective to increase room number to 1000.
- This is a new market that DHC does not have experience, which may resulting the operating is not successful and have a negative impact on operating margin and overall profitability that may not allow us to achieve objective and negatively impact IPO.
- The room or services provided hosts may not meet DHC's standard which will damage reputation and resulting in guests lost and negatively impact on operating margin and IPO.
- Customer stay in homes or non-DHC hotels may take away revenue from DHC hotels and will have negatively impact on operating margin and result in not meet board's objectives and IPO.

Conclusion: I would not suggest this investment since it will have negative impact on operating margin and IPO which is not an ideal investment before 2025, even though it could diversified room revenue and help DHC to achieve 1000 room goal. This investment maybe be reconsidered after IPO.

Board members conflict and independence of board members

It seems like that most of the board members are Derek's friend, which may result that the decision made is based on Derek's idea or more favorable to Derek rather than DHC and result conflict of interest. In addition, Derek discussed some strategic issues with the board members directly over the phone rather than discussed in the board meeting and consulting Kelvin's opinion. This can be evidence by Derek is hiring Lebois's company to do the renovation at a cost of $6m which is higher than market and want to sell Northern Ontario hotel at $40M.

This could cause conflict between board members and the strategic decision made by the board may not best for DHC which will have negatively impact on DHC's successful.

For the renovation, Kevin mentioned that his company' work was completed late and not meet the expectations. The only reason I can think of is Sean Lebios is one of board members and Derek's friend. For the Northern Ontario hotel, Derek is planning to sell the property without discuss in the board also result conflict and the selling price of $40M is not favorable to DHC.

Derek and his firends might take advantage of DHC and take benefit from the project for themselves rather than DHC. This will increase DHC' costs and reduce the overall profitability. In addition, the renovation project doe by leBois is not meet the expectation which may have negatively impact DHC's reputation and will result in loss of guests which is not align with KSF to retaining and attracting customers.

This conflict between board members, especially Kelvin and Derek as we can see from board meeting, may negatively impact DHC's continue success and decisions regarding company's future direction.

I would suggest the board to include more independent parties in order to give more independent advices. And Kevin and Derek need to communicate to solve this conflict personally and not bring this to board meeting.

Overall conclusion:

Based on my analysis, I recommend the following in order of priority:

- First, renovation the Artists warehouse hotel, since it required least initial investment amount.= and will help DHC to improve operating margin. His project also consistent with DHC's vision and industry KSF. It will also attract more business traveller which will help to achieve objectives. However, we should renovation with Lebois to reduce the renovation cost, otherwise, we should choose other company to do this.
- Secondly, renovate Northern Ontario Hotel since the renovation is aligning with DHC's vision and KSF, it will also increase operating margin and allow DHC to meet the objective and positively impact IPO.
- Thirdly, if we can find additional finance, then we should pursue the proposed lease agreement with RH since it will help DHC to improve the operating margin and increase room numbers.
- Finally, I would not recommend the Luxury stay proposal as it will reduce the operating margin for 2023 and 2024 which will result that DHC will not be able to meet the objectives and will have negatively impact on IPO in 2025. This investment may be reconsidered after IPO.

Exhibit 1.
Calculate operaitng margin

lease payment		50,000.00	
16% of room revenue		1,752,000.00	
Total lease payment		1,802,000.00	PMT
Lease term	15+5	20.00	N
		-	FV
Initla investment	$15M-5M	1,000,000.00	
Room revenue			
# OF ROOMS		50.00	
ADR		750.00	
# OF Days		365.00	
		13,687,500.00	
occupancy rate		80%	
room revenue		10,950,000.00	
Operating cost	55%	(6,022,500.00)	
lease costs		(1,802,000.00)	
General expense	13%	(1,423,500.00)	
operaitng income		1,702,000.00	
operating margin		16%	

Exhibit 2.
Revised operting income

ADR		250.00
Occupancy		75%
# of rooms		120.00
		22,500.00
		365.00
room revenue		8,212,500.00
food & beverage	65%	5,338,125.00
room operting costs	55%	(4,516,875.00)
food costs	50%	(2,669,062.50)
fixed costs		(5,000,000.00)
		1,364,687.50
tax	27%	(368,465.63)
		996,221.88
operating margin		17%

Exhibit 3.

Revenue after renovation		21,900,000.00
Currnet revenue		16,726,125.00
Incremental revenue		5,173,875.00
operating costs	55%	(2,845,631.25)
incremental operating income		2,328,243.75
operating margin		45%
pre tax profit after renovation		2,628,000.00
current pre tax profit		(1,338,090.00)
Increment pre tax profit		1,289,910.00
		96%

Exhibit 4.

	Initial	2023	2024	2025	2026	Total
commission revenue		780,000.00	3,640,000.00	5,772,000.00	8,398,000.00	
annual operating costs		(4,000,000.00)	(4,000,000.00)	(4,000,000.00)	(4,000,000.00)	
Initial investment	(7,000,000.00)					
Operating income		(3,220,000.00)	(360,000.00)	1,772,000.00	4,398,000.00	2,590,000.00
Operating margin		-413%	-10%	31%	52%	

APPENDIX G

THE COMMON FINAL EXAMINATION
DAY 1 DHC VERSION 3 BOOKLET – SEPTEMBER 13, 2021

COMMON FINAL EXAMINATION
SEPTEMBER 13, 2021 – DAY 1

Case (DHC-Version 3) **(Suggested time: 240 minutes)**

It is March 2023, and your boss, Irene Malik, assigns you to another engagement with Distinct Hotels Corporation (DHC).

Over the past three years, the trend of travellers using websites such as Airbnb and VRBO has increased. Many travellers prefer the convenience, ease of booking and unique accommodations that these websites offer. Whereas chain hotels have suffered significantly from this trend, boutique hotels have not been affected as severely because travellers are still attracted to the unique experiences that many boutique hotels offer. As a result, the occupancy rates of chain hotels have decreased in each of the past three years whereas occupancy rates for boutique hotels have been relatively stable.

In recent years, it has been revealed that websites such as First Canadian Hotel Review are prone to posting fake reviews. This has resulted in travellers losing confidence in online review websites. Therefore, building brand loyalty and retaining customers has become even more vital to the success of companies in the hotel industry. In addition, a hotel's presence and reputation on social media is quickly becoming the main factor behind the public's perception. Viral news stories and negative social media attention have become serious risk factors for the hotel industry.

It has also recently been shown that companies in the hotel industry can increase their customer retention and brand loyalty by providing unique vacation packages. Vacation packages that include a mix of accommodation, activities, and transportation offer a convenient and easy way for leisure travellers to book their entire vacation. Vacation packages appear to be particularly attractive to international travellers.

Business travel has decreased in recent years as companies are relying more heavily on video conferencing as a cost cutting measure. Leisure travel, however, has continually surpassed its growth expectations. In addition, Canada is still a sought-after tourist destination. Growth in the Canadian tourism industry has been driven mainly by travellers who value Canada's natural beauty and the abundance of outdoor activities that the country has to offer.

In March 2020, Doug Mallette was let go due to his unethical behavior. Since his departure, Doug has regularly published negative posts related to DHC on social media and travel blogs for both Ontario and Quebec. He has also been featured in a few newspapers in Ontario and Quebec, claiming he was wrongfully dismissed. As a result, the public's opinion of DHC has been negatively impacted in both of those provinces.

On November 15, 2021, DHC accepted an offer to sell its Northern Ontario hotel along with the rights to the Awani Spa name. Upon sale, the loan related to the Northern Ontario property and the company's line of credit were paid off. DHC now intends to only use its line of credit for operational or emergency reasons, and not for making any major capital investments. DHC currently has $18 million available in cash resources.

The shareholders decided against taking DHC public. The company's mission, vision, and core values have not changed. Going forward, DHC's Board of Directors (the board) has decided to give preference to investments that will increase the overall occupancy rate and ADR. The shareholders also prefer to make investments that will help DHC increase its brand visibility and brand loyalty.

Irene asks you to review the information that she has provided and to draft a report to the board that analyzes and makes a recommendation for each strategic option that has been presented. She would also like you to comment on DHC's overall strategic direction and how each option may affect that direction, and whether you have noted any other issues that should be discussed with the board.

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APPENDIX I
TRANSCRIPT OF PREVIOUS BOARD MEETING

Derek: Thank you for attending today, Irene.

Here is a summary of the major events that have occurred since February 2020:

March 15, 2020	Terminated Doug Mallette for unethical behaviour.
April 1, 2020	Converted the golf course in Kelowna to semi-private, according to the original proposal.
April 1, 2020	Patrick Kuzoff loaned DHC $20 million in the form of a convertible bond, as originally proposed.
July 1, 2020	Signed management contract with Huron Heights Hotel (HHH) consistent with the original proposal, except that DHC did not allow the use of DHC's name. The hotel is therefore still branded as HHH.
July 1, 2020	Acquired a 20% investment in Topomo Mountain Ski Resort (TMSR), with the same terms as originally proposed.
November 30, 2020	Completed $8 million of renovations at HHH. The hotel is now rated as a five-star hotel.
November 15, 2021	Sold Northern Ontario hotel for $46.5 million. At the time of the sale, the outstanding loan was $40 million.
March 10, 2022	Completed renovations on TMSR on time and only slightly over budget.
July 15, 2022	Renewed line of credit with H&A bank, with the same terms and conditions.

Derek: Doug Mallette's behaviour continues to harm DHC. Given the bad publicity that Doug has brought to DHC, I think we were lucky to get the generous deal we did on the Northern Ontario hotel.

Kelvin: I agree. Doug's negative posts on social media have not stopped and continue to hurt DHC's reputation, especially in Ontario and Quebec. We really need to do something to defend DHC. This has gone on long enough

Derek: I have a solution—divest completely from Eastern Canada and focus solely on DHC's presence and growth in Western Canada.

Kelvin: That seems drastic, Derek. The eastern provinces represent a significant portion of the overall Canadian market. Why would we divest from them completely?

Derek: I know it sounds extreme, but hear me out. I could not be more excited about this idea.

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Jessica: Okay Derek, tell us.

Derek: Gladly I would like to introduce my proposal for a Western Corridor. With the investment opportunities that DHC currently has, combined with the properties we already own in Western Canada, we have the chance to create a network of luxury hotels. Our guests will be able to travel from one DHC hotel to the next with both convenience and ease.

In addition to enjoying the luxury of DHC's hotels, our guests will be able to participate in unique and sought-after experiences as they move from one to the other

Alyson: Wow, that is interesting But how do you intend to accomplish this?

Derek: I came up with the idea while reviewing a potential strategic alliance that Jessica recently discovered. Jessica, please tell us about Peak Revie.

Jessica: Peak Revie is a 150-room, log-cabin-style hotel near a world-class ski hill in Revelstoke, British Columbia. The owner, Miranda Murdoch, recently approached me to express interest in collaborating with DHC.

From what Miranda has told me, her guests are always satisfied, and her customer retention rate proves it. However, she claims that few people are aware of Peak Revie despite all her efforts to promote the hotel, and it continues to underperform. To alleviate this, she wants to collaborate with DHC. Miranda is confident that the hotel's performance would greatly improve if it were rebranded and marketed as a DHC hotel.

Kelvin: Okay, but I fail to see how this opportunity would lead us to leave Eastern Canada.

Derek: Jessica, tell everyone about the vans that Miranda has purchased.

Jessica: Miranda mentioned that the hotel's remote location is the main reason for its underperformance. The nearest major airport is over two hours away in Kelowna, and many guests have complained about how hard it is to access the hotel. As a solution, Miranda purchased a fleet of transportation vans to transport passengers to and from Kelowna, as well as between the hotel and the ski hill. Since purchasing the vans, the hotel's performance has improved. However, Miranda overbought, and a number of these vans are underutilized.

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Derek: If we team up with Miranda, we will get both an ownership interest in Peak Revie and the use of these vans That would allow DHC to transport its guests from various airports to our hotels, and from one DHC hotel to another. Talk about service On top of that, Peak Revie is located near one of the best ski hills on the continent. It could not be more perfect.

Kelvin: The opportunity does sound interesting, but this hotel lacks any kind of historical appeal.

That said, one thing I like about this proposal is the hotel's proximity to the ski hill. As we have seen, the unique experiences that we offer our guests have quickly become a major competitive advantage for us. After we purchased the stake in TMSR and began to offer skiers a discounted rate at our Canmore hotel, the occupancy rate increased nicely. In fact, an obvious new key success factor is having activities affiliated with our hotels. Our guests love receiving discounts

However, we need to analyze whether this opportunity makes sense on a stand-alone basis. What is it going to cost? And how much of an upfront cash investment is required?

Jessica: I have compiled the details of the opportunity.

Derek: Next, Alyson, please tell us about the recent development at HHH.

Alyson: HHH is about to go up for sale. Martha is overwhelmed and is ready to move on. She is asking $25 million for all the outstanding shares of HHH and is giving us the first opportunity to purchase the hotel.

Kelvin: I do not see HHH fitting with our brand as it is clearly not a boutique hotel. The building does not have any historical or artistic appeal. Besides, competition has only become fiercer in that market and occupancy rates are declining.

Alyson: That is true, but HHH is in a popular area of downtown Vancouver, and we do not yet have a presence in an urban core. This is our chance to increase our brand visibility. It would be fantastic for DHC. It is almost impossible to find a historical building for sale in any city's core.

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Alyson: Also, Martha has offered us an attractive transition plan where she only requires a 20% cash down payment and will provide financing for the remainder.

Derek: Once rebranded, this hotel would fit perfectly into the Western Corridor. Being directly linked to our other hotels will surely increase the financial performance of HHH. Remember, guests will be transported from one hotel to the next.

Kelvin: DHC cannot accept any strategic proposal simply because it fits into your Western Corridor idea, Derek.

Derek: Kelvin, try to see the big picture. The Western Corridor would boost the occupancy rates at each of our hotels because we will offer vacation packages that include multiple hotels with a variety of experiences. The Western Corridor would be a huge competitive advantage for us.

Let's have Irene's team look at the potential HHH purchase.

Alyson: Moving on, Derek, tell us more about the Tofino castle.

Derek: Thanks, Alyson. We have been given a once-in-a-lifetime opportunity to acquire a historical castle in one of the most beautiful parts of Canada. I have put together some information, as well as an income projection. Not only would this property set us apart from the competition, it would also complete the Western Corridor in spectacular fashion.

Alyson: I understand that the property is oceanfront. There would be an abundance of hotel-affiliated activities that we could offer, such as whale watching and sea kayaking. This does seem like an opportunity to be seriously considered.

Jessica: From your report, Derek, it seems that some Tofino residents are unhappy that the castle has gone up for sale.

Derek: Yes, and there is also a fast-growing petition on social media to have the castle designated as a national historic site. The petitioners claim that converting the castle to a for-profit hotel would be against the public interest and that the castle should belong to the community. They have also threatened further action. We need to move fast on this before the petitioners get their wish.

Kelvin: What is the asking price?

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Derek: Unfortunately, the price is high. We could only afford it if we sell another property. Given the bad publicity in Eastern Canada, Cape Breton makes the most sense. The Cape Breton hotel is our only remaining hotel in Eastern Canada, and needs a large renovation. Thankfully, based on a preliminary assessment, the selling price of the Cape Breton hotel would be roughly the same as the purchase price of the Tofino castle.

Kelvin: We need to slow down here. I do not think that selling the Cape Breton hotel makes much sense, especially since the hotel's renovation has already been planned and is set to begin shortly.

Alyson: It is true that this hotel has struggled in the past few years.

Kelvin: Agreed, but with this renovation, which is long overdue, its performance will improve. Once completed, Cape Breton will easily be one of the best hotels in that area.

Speaking of renovations, do we have any idea what it would cost to convert the Tofino castle into a hotel?

Derek: I estimate it will cost $20 million. Also, H&A bank has agreed to transfer the debt secured by the Cape Breton hotel to the castle.

Kelvin: We know that renovating antique structures is always a major challenge, especially the initial conversion. It will be very difficult for me to create a realistic renovation budget before we complete a full structural assessment. It is impossible to know what kind of potential issues we might find without this kind of analysis.

Derek, I looked at your earnings projection for the Tofino hotel and added some notes. I am not sure about the accuracy of some of your assumptions.

Jessica: Also, before we make any decisions, we need to ensure that each project makes sense for DHC on a stand-alone basis.

APPENDIX I (continued)
TRANSCRIPT OF PREVIOUS BOARD MEETING

Kelvin: I have also compiled more information on the Cape Breton property. For now, we will assume that the proceeds from the potential sale of Cape Breton would be sufficient to purchase the castle in Tofino. Irene, with that assumption in mind, please get your team to provide a complete analysis of both the castle in Tofino and the Cape Breton hotel, and recommend which of the two properties fits best with DHC.

Derek: I still think we should sell Cape Breton and pursue the Western Corridor. We would save money by having all our properties close to each other and would also be able to escape the bad press that we have endured in Ontario and Quebec. Although it has not happened yet, the Cape Breton hotel could easily be hurt by Doug's actions.

Jessica: Your Western Corridor idea is great, Derek, but we cannot abandon Eastern Canada on a whim. Sure, we only have one property there now, but more opportunities are bound to arise in the future.

Kelvin: I spoke with a local public relations firm, Camden and Co., and they have offered to represent DHC to combat the negative perception Doug has generated. They are confident that they can quickly repair the damage done. Camden and Co. have a high success rate and have agreed to charge us $120,000 for the engagement.

Derek: That seems like a huge waste of money to me, especially given our opportunities out West. Let us not forget our core value of embracing new ideas and change

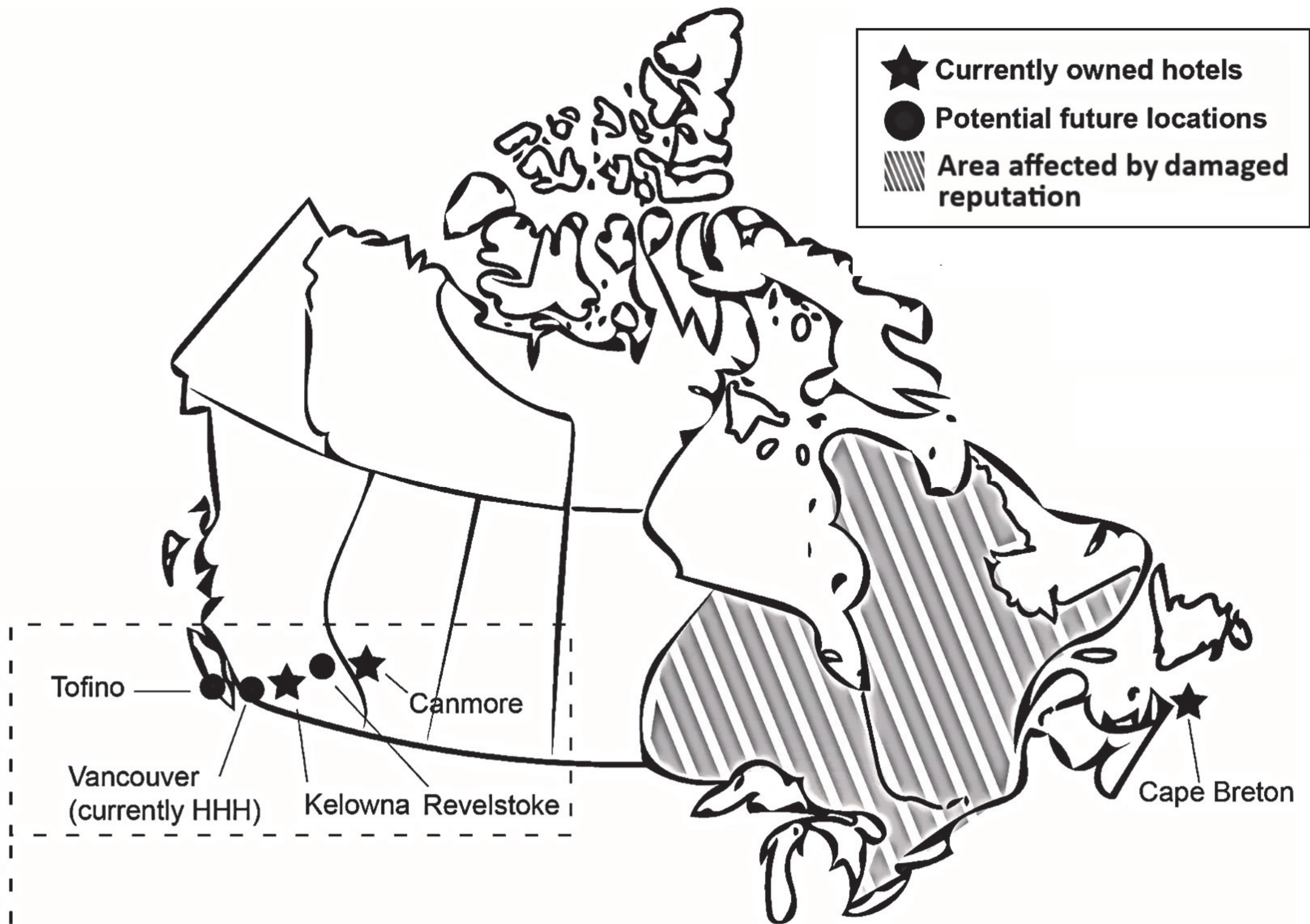
Kelvin: Along with the potential impact on our ADR and occupancy rate, I would also like to know what kind of rate of return DHC could expect on each of these possible investments.

Irene, could your team analyze these proposals for us? We obviously need an impartial assessment.

Irene: Gladly.

Derek: Thank you. Meeting adjourned.

APPENDIX II
MAP OF CURRENT AND POTENTIAL FUTURE OPERATIONS



Driving distance and time between locations in the proposed Western Corridor are as follows:

Locations	Distance	Travel Time
Canmore to Revelstoke	300 kilometres	3.5 hours
Revelstoke to Kelowna	200 kilometres	2.5 hours
Kelowna to Vancouver	390 kilometres	4.5 hours
Vancouver to Tofino	280 kilometres	5.5 hours (including ferry to Vancouver Island)

APPENDIX III
PERFORMANCE METRICS

	DHC (Note 1)		Boutique Hotel Benchmarks	
	2022	**2019**	**2022**	**2019**
Total rooms available	525	760	N/A	N/A
Occupancy rate (Note 2)	75%	70%	77%	78%
Average daily rate (ADR)	$425	$400	$375	$335
Revenue per available room	$319	$280	$289	$261

Notes:

1. Excludes the rooms at HHH, which are currently managed by DHC.
2. The occupancy rates at both the Canmore and Kelowna hotels increased when each hotel was formally marketed with its hotel-affiliated activity (TMSR for Canmore, and the semi-private golf course for Kelowna); Canmore hotel's rate rose by 10% whereas Kelowna's rose by 8%.

APPENDIX IV
PEAK REVIE HOTEL PROPOSAL
(Prepared by Jessica Sterne)

Performance Metric Data

	Projected First Year Metrics if Acquired by DHC	2022 (Actual)
Total rooms available	150	150
Occupancy rate (Note 1)	73%	63%
Average daily rate (ADR)	\$395	\$380
Revenue per available room	\$288	\$239

Note 1 – The 10% projected increase is based solely on converting Peak Revie to a DHC hotel.

Proposal Details

Peak Revie has 150 guest rooms and is rated as a five-star hotel. Amenities include a full-service restaurant, fitness facility, pool, etc. The hotel was built in 1992 and was last renovated in 2016. It is located only five kilometres from the ski hill, which is not directly affiliated with the hotel.

Reviews for Peak Revie have been very positive, both online and in the community. As many guests return year after year to see friends and ski the nearby mountain, customer retention is high. In 2022, the hotel's profit margin was equal to 8% of room revenue.

Important aspects of the proposal are as follows:

- For a \$3.5 million upfront cash investment, DHC will receive 35% of the outstanding common shares of the business. Currently, Miranda is the sole owner, with 100% of the common shares.
- All future renovation and improvement costs will be divided according to ownership percentages.
- DHC can use Peak Revie's fleet of transportation vans for other operations and hotels.
- The hotel will be rebranded as a DHC hotel; however, no licensing fees will be paid.
- DHC will be responsible for managing the hotel. A management fee equal to 10% of the gross profit generated by the hotel operations will be paid quarterly to DHC.
- DHC will be responsible for marketing the hotel.
- Miranda will retain the right to sell her shares to other parties; however, no new shares will be issued.
- All major decisions will require the unanimous support of the shareholders. Any disputes between shareholders will be resolved through an independent arbitration process.

APPENDIX V
PROPOSAL TO PURCHASE HURON HEIGHTS HOTEL

(Prepared by Jessica Sterne)

Performance Metric Data

	2022 (Actual)
Total rooms available	170
Occupancy rate	68%
Average daily rate (ADR)	$325
Revenue per available room	$221

Additional Information

- In 2022, HHH had net earnings of $2.1 million, cash flow from operations of $2.4 million, and a profit margin of 7%.
- The debt component of the proposal would have an interest rate of 5% and a term of 12 years.
- 17 years remain on DHC's existing management agreement with HHH.
- The management contract with HHH has been successful; however, without 100% control over HHH, to date, the management of it has been challenging. Working with Martha has hindered the decision-making process.
- The hotel currently does not have any affiliated activities. However, given HHH's location, there are an abundance of activities near the hotel. Moreover, there are several golf courses within an hour's drive, and a famous ski hill is within a two-hour drive.
- Competition in major metropolitan areas has increased in recent years as new hospitality companies have entered the market. This trend is expected to continue.
- Given that DHC manages the hotel, the quality of service meets the company's high standards.
- Currently, 70% of HHH guests are business travellers.

APPENDIX VI
PROPOSAL TO PURCHASE TOFINO HISTORICAL CASTLE
(Prepared by Derek Sterne)

Projected Performance Metric Data

	Year 1 of Operations (Projected)
Total rooms available	105
Occupancy rate	85%
Average daily rate (ADR)	$600
Revenue per available room	$510

	Annual Earnings (Projected)	Notes
Revenue		
Room revenue	$19,545,750	Hotel to be open 365 days per year
Food and beverage	11,727,450	60% of room revenue
Total revenue	31,273,200	
Expenses		
Room operating costs	10,750,163	55% of room revenue
Food and beverage costs	8,795,588	75% of food and beverage revenue
Other variable costs	5,316,444	17% of total revenue
Fixed costs	2,500,000	
Total operating costs	27,362,195	
Operating income	3,911,005	
Tax (27%)	1,055,971	
Net earnings	$2,855,034	
Profit margin	9%	

Additional Information

- The castle was featured in *Classic Canada* magazine. According to the magazine, the building and surrounding area meet the requirements to be designated as a national historic site.
- Celebrities and British royals have stayed at the castle in the past.
- If acquired by DHC, the property will be closed to the general public as too many visitors will disrupt guests. Only DHC's guests will be allowed on the property.

APPENDIX VII
NOTES ON PROPOSAL TO PURCHASE THE TOFINO CASTLE

(Prepared by Kelvin Chung)

- The structure was never meant to be divided into individual rooms, so 105 rooms may be overly optimistic. As it will be a challenge to effectively divide the space, 95 rooms is likely more realistic, but there is a chance it could be even fewer.
- An 85% occupancy rate seems high—why would this hotel's occupancy rate exceed DHC's average occupancy?
- At an ADR of $600, we would be charging our customers a large premium relative to the industry.

APPENDIX VIII
INFORMATION ON CAPE BRETON HOTEL AND UPCOMING RENOVATION
(Prepared by Kelvin Chung)

Performance Metric Data

	2022 (Actual)
Total rooms available	165
Occupancy rate	66%
Average daily rate (ADR)	$390
Revenue per available room	$257

2022 Annual Earnings

	Pre-renovation Actuals	**Notes**
Revenue		
Room revenue	$15,501,915	Hotel is open 365 days per year
Food and beverage	8,526,053	55% of room revenue
Total revenue	24,027,968	
Expenses		
Room operating costs	7,905,977	51% of room revenue
Food and beverage costs	5,882,977	69% of food and beverage revenue
Other variable costs	4,565,314	19% of total revenue
Fixed costs	2,500,000	
Total operating costs	20,854,268	
Operating income	3,173,700	
Tax (27%)	856,899	
Net earnings	$2,316,801	
Profit margin	10%	

Additional Information

- This hotel was last renovated in 2014. Therefore, the rooms and decor are outdated, causing the hotel to underperform.
- The renovation will cost $12 million, based on a negotiated, fixed-price contract.
- After renovation, the occupancy rate of the hotel is expected to be in line with DHC’s 2022 averages, but it may take a few years before the ADR reaches DHC’s average.
- Although DHC and Patrick have discussed a formal agreement that would provide DHC’s hotel guests with preferred rates at Patrick’s Nova Scotia golf courses, an agreement has yet to be reached.

APPENDIX H

DAY 1 (VERSION 3) – SEPTEMBER 13, 2021
MARKING GUIDE AND SAMPLE CANDIDATE RESPONSE

MARKING GUIDE
DISTINCT HOTELS CORPORATION (DHC)
VERSION 3

Summative Assessment #1 – Situational Analysis

For Summative Assessment #1, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate used a reasonable situational analysis when analyzing the major issues facing DHC.

Unsure – The candidate attempted to use a reasonable situational analysis when analyzing the major issues facing DHC.

No – The candidate clearly did not use a reasonable situational analysis when analyzing the major issues facing DHC.

Technical Competencies (based on the 2020 CPA Competency Map)
2.3.2 Evaluates the entity's internal and external environment and its impact on strategy development

Enabling Competencies
1.4.1 Performs work carefully, thoroughly and competently in accordance with relevant technical and professional standards
2.1.1 Applies knowledge of the organization's competitive environment and strategic direction when performing assigned work
2.1.3 Identifies the strategic impact of internal decisions and external influences on project plans and initiatives
6.1.1 Identifies and articulates issues within areas of work responsibility
6.2.1 Maintains an objective and questioning mindset to avoid biased analyses

A competent candidate will complete a sufficient situational analysis.

The candidate should draw upon their situational analysis when analyzing the major issues facing DHC (the investment in Peak Revie; purchase of HHH; purchase of the castle in Tofino; sale or renovation of the Cape Breton hotel; development of the Western Corridor).

Mission/Vision/Core Values

DHC's mission, vision, and core values have remained the same.

Financing

The line of credit, which has a limit of $4 million, was paid down completely with the proceeds from the sale of the Northern Ontario hotel. DHC only plans to use this credit facility for operational and/or emergency reasons, and not for making any major capital investments.

The line of credit has the following covenants:

- Lender approval is required prior to any payment of dividends; previously, dividends in excess of $2 million required lender approval (link to Capstone 1).
- Maximum debt-to-equity ratio is 2.5 (link to Capstone 1).

Quantitative Analysis (based on Appendix III)

For the years 2019 and 2022, the candidate is provided with certain performance measures and ratios for both DHC and the boutique hotel industry. The candidate should analyze these performance measures and ratios and discuss DHC's performance relative to the boutique hotel industry.

	DHC		**Boutique Hotel Benchmarks**	
	2022	**2019**	**2022**	**2019**
Total rooms available	525	760	N/A	N/A
Occupancy rate	75%	70%	77%	78%
Average daily rate (ADR)	$425	$400	$375	$335
Revenue per available room (Rev/PAR)	$319	$280	$289	$261

Given that DHC sold its Northern Ontario hotel, the total number of available rooms has dropped. DHC's occupancy rate went up due to its success in associating activities that are near its hotels, such as golf and skiing, directly with the hotels. The occupancy rate also likely increased as a result of selling the Northern Ontario hotel, which had been struggling for several years. DHC's ADR is up in 2022 relative to 2019, most likely due to the sale of the Northern Ontario property.

However, relative to the boutique hotel industry, DHC's occupancy rate still lags. This may be because DHC's Cape Breton hotel has been suffering lately, given that the property is long overdue for a renovation. DHC's Rev/PAR is high relative to the industry, most likely because the company can charge higher than average rates due to the quality and locations of its hotels.

Conclusion

As a result of selling the Northern Ontario hotel and formally establishing hotel-affiliated activities, DHC has been able to improve its performance relative to the key performance measures. Overall, DHC's Rev/PAR, which incorporates occupancy rates and ADR, went from $280 in 2019 to $319 in 2022 (compared to $261 and $289, respectively, for the industry). However, DHC's occupancy rate is still lower than the industry average.

Key Success Factors (KSFs)

Key success factors in the overall hotel industry or boutique hotel segment include the following:

- Being part of a franchised chain to enhance brand recognition, marketing, and quality
- Location, including either offering, or being near, facilities and services desired by customers
- Processes to ensure that prices are in line with those of competitors
- Professional, skilled, polite, and competent staff
- Access to seasonal labour
- Maintaining the hotel and amenities in good condition
- Keeping up to date with technological changes
- Anticipating customers' needs by using market research, because customer retention and attraction of new customers is vital
- Brand recognition, because word-of-mouth advertising is often the basis on which travellers determine where to stay; there is usually at least one unique feature that drives the hotel's brand and reputation, allowing the operator to charge higher prices
- Providing unique experiences and vacation packages (**new** in Day 1 case)
- Offering hotel-affiliated activities for which guests receive discounts when they use both DHC's hotel and activities linked to DHC; doing so has helped improve the performance of both the Canmore and Kelowna hotels (**new** in Day 1 case)
- Building brand loyalty and customer retention, which has become increasingly important, given the public's growing skepticism of the authenticity of reviews posted online to websites such as First Canadian Hotel Reviews (**new** in Day 1 case)
- Maintaining a favourable presence and reputation on social media, which has become increasingly important; viral news stories that circulate on social media can greatly impact reputation (**new** in Day 1 case)

Revenues in the hotel industry are seasonal and are influenced by the following:

- Economic conditions affecting the number of trips, length of stay, and quality of hotel used by business and leisure travellers, such as
  - per capita disposable income allocated to travel. This is influenced by interest rates, personal income tax rates, and employment rates. In addition, fuel prices, and the type of transportation used to travel, affect disposable income.
  - the level of consumer confidence. The higher the level of consumer confidence, the more dollars are spent on travel.
- Corporate profits and the amount of corporate spending available for business travel
- The number of international visitors travelling to Canada
- Political factors, such as the risk of war and terrorism, which can affect foreign exchange rates, amount of border security, and the cost of holiday packages and flights

Strengths

- In 2019 and 2022, DHC had higher ADR and Rev/PAR metrics than the industry average. In 2019, DHC had an ADR of $400 versus the boutique industry average of $335, and a Rev/PAR of $280 versus $261 for the industry (link to Capstone 1). In 2022, DHC's metrics continue to outperform the boutique industry; however, the gap for ADR has narrowed.
- DHC's superior ADR supports that it can charge a premium for its hotel rooms relative to the industry standard without a negative impact.
- The DHC brand is recognized for its luxury accommodation and "above-and-beyond" level of service.
- DHC's hotels are in attractive tourism destinations, allowing it to charge premium prices.
- DHC's hotels are in unique and historically significant buildings, which is a draw for customers.
- DHC's shareholders/managers have considerable experience in the hotel business and have a vested interest in the company's success.
- Management is involved in the day-to-day operations and is committed to meeting guests (Alyson, Jessica, and the managers of each hotel).
- DHC completely paid off its line of credit and has reserved that credit facility for emergencies and operational needs only (and not for making any major capital investments).
- It has been shown that travellers are attracted to the unique experiences that many boutique hotels offer; DHC has capitalized on this by providing its hotel-affiliated activities.

Weaknesses

- DHC is owned by two couples, each owning 50% of its common shares. This could result in sides being taken, such that no decisions can be made, given the equal ownership interests. Patrick will become a 20% owner in 2027 when debt conversion occurs, or sooner if he chooses to convert earlier. This could give him some control in situations in which there is a tie between the other owners (20% each).
- DHC has three boutique hotels and manages an additional hotel (HHH). As these hotels are all located in Canada, DHC lacks a global presence.
- DHC does not use the franchise model, which is commonly used by large competitors in order to help finance growth.
- DHC does not currently operate any DHC-branded hotels in a major metropolitan area; this lack of presence in an urban core could make it more challenging to build brand awareness.
- DHC currently has low occupancy rates relative to the boutique hotel industry (75% versus 77%).
- Doug Mallette posted a succession of negative stories relating to his experience with DHC and has been featured in several newspapers in Quebec and Ontario, resulting in a decline in the public's perception of DHC, primarily in those two provinces.

Opportunities

- Canada is seen as a safe and sought-after tourist destination, which is likely to result in an increased number of international travellers.
- Many travellers come to Canada because of the country's natural beauty and the abundance of outdoor activities available.
- Although Airbnb and VRBO are attracting more travellers, there are still those who prefer the unique experiences offered by some boutique hotels; these experiences extend beyond the immediate hotel amenities to include attractions such as hotel-affiliated activities.
- Travellers are attracted to unique experiences, and although DHC has capitalized on this at some of its hotels (golf in Kelowna; TMSR in Canmore), there remains an opportunity to create more unique experiences through hotel-affiliated activities (such as golf near the Cape Breton hotel).
- In an effort to build brand loyalty and retain customers, some hotels have begun to offer vacation packages.
- The strength of DHC's brand is leading to expansion opportunities. For example, Miranda's Peak Revie proposal is a result of DHC's brand.
- DHC can rectify the damage caused by Doug Mallette's actions. Camden and Co. has a reputation for achieving this type of success and is confident in its ability to reverse the damage done.
- DHC can "link" its hotels through the "Western Corridor," which would present it with an opportunity to provide unique vacation packages that include luxurious accommodations and activities.

Threats

- Given the increasing usage of video conferencing as a cost-cutting measure, the number of business travellers has declined in recent years. There is no indication that this trend will slow down, which may further reduce the number of business travellers staying at DHC properties.
- Online booking sites such as Airbnb and VRBO are attracting many travellers, reducing the number of hotel reservations. Although this trend is affecting chain hotels more severely, sites like Airbnb and VRBO still represent a threat to DHC.
- Given the favourable outlook, global chains are likely to continue to expand into the Canadian boutique hotel market. The increased competition will make it more difficult for DHC to be successful in the future.
- Unfavourable social media posts and a negative online perception have become a major risk factor for the hotel industry. Due to Doug Mallette's actions, DHC has recently suffered negative social media attention. In addition, DHC is at risk of creating even more negative attention on social media, given the situation surrounding the castle in Tofino.

New Objectives

DHC's primary objectives are to increase the company's overall occupancy rate and ADR. Also, DHC's Board of Directors wishes to focus the company's investment funds on projects that will increase both brand visibility and brand loyalty. DHC currently has $18 million in cash resources (it also has access to a $4 million line of credit, but the company has stated it will not use these funds for capital investments).

In Capstone 1, DHC's stated objectives were to increase the 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 its net profit margin to 8%; increase the return on equity to 11%; and ensure that any long-term strategic investments made will provide an appropriate return required for the related risk of the investment.

Summative Assessment #2 – Analyzes the Major Issues

For Summative Assessment #2, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate sufficiently completed a reasonable assessment of the major issues facing DHC.

Unsure – The candidate attempted to complete a reasonable assessment of the major issues facing DHC.

No – The candidate clearly did not complete a reasonable assessment of the major issues facing DHC.

Technical Competencies
2.3.3 Evaluates strategic alternatives

Enabling Competencies
2.1.1 Applies knowledge of the organization's competitive environment and strategic direction when performing assigned work
2.2.1 Assists in identifying and monitoring risks within areas of work responsibility
6.1.2 Uses qualitative and quantitative techniques to clarify the nature of problems
6.1.3 Demonstrates skepticism, objectivity, due care and persistence when identifying issues
6.2.3 Questions the relevance and tests the quality of information and assumptions in own analysis
6.2.4 Completes thorough quantitative and qualitative analyses to identify and evaluate potentially viable alternatives

This summative assessment is based on Assessment Opportunities #2 to #6.

Assessment Opportunity #2 (Strategic Issue #1 – Peak Revie proposal)

A competent candidate will complete both a quantitative and qualitative assessment of DHC's opportunity to purchase a 35% ownership stake in Peak Revie.

Quantitative: The candidate is expected to calculate the potential return of the Peak Revie investment. The candidate should calculate Peak Revie's estimated net earnings figure if DHC becomes involved and discuss the assumptions that were used to derive that estimation.

Qualitative: The candidate should discuss the proposed investment in Peak Revie, including the fit with DHC's vision, mission, core values (which remain unchanged from Capstone 1), and industry trends; the implications of joint ownership; and the implications of having access to Peak Revie's fleet of vans.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Quantitative Analysis

For $3.5 million, DHC is being offered a 35% ownership stake in Peak Revie.

	Projected First Year Metrics if Acquired	2022 – Actual
Total rooms available	150	150
Occupancy rate	73%	63%
Average daily rate (ADR)	$395	$380
Revenue per available room (Rev/PAR)	$288	$239
Purchase price	$3,500,000	
Proposed % ownership	35%	
Profit margin (2022)	8%	
Revenue – projected first year, if acquired	$15,768,000	
Net earnings – projected first year, if acquired	$1,261,440	
DHC's portion of net earnings	$441,504	
ROI	13%	

Based on the projected performance metrics that have been provided for the first year of operations, as well as Peak Revie's 2022 profit margin, net earnings of roughly $1.3 million are expected if DHC purchases Peak Revie. DHC's portion of the net earnings (based on a 35% ownership) would be roughly $442,000. Therefore, DHC's projected return on investment would be 13% (which is greater than the 11% return on investment objective that DHC had set in Capstone 1; therefore, this investment appears to be attractive from a quantitative perspective).

Additional quantitative analysis and considerations

- It appears that the purchase of Peak Revie would cause DHC's overall occupancy rate and ADR to fall, even if the projected increase in occupancy rate occurs. Therefore, this investment would violate DHC's stated goal of making investments that would increase the company's occupancy rate and ADR.
- However, Peak Revie's projected Rev/PAR is almost equal to the industry average.
- Based on the projected performance of Peak Revie and the terms of the proposed investment, DHC would earn a 13% return on investment. This level of return is attractive and would help DHC build the company's financial strength.
- The projection provided should be scrutinized to the extent possible, and the assumptions used to build the projection should be questioned and verified.
- DHC currently has $18 million in available cash resources. As this proposal only requires an upfront cash investment of $3.5 million, DHC can finance the project without taking on additional debt.
- As DHC is purchasing shares of Peak Revie, it will become partially liable for any of Peak Revie's outstanding debts. It is, therefore, important to assess Peak Revie's current level of debt and determine whether any of those obligations would be too risky to assume.
- As part of the proposed investment, DHC would earn a management fee equal to 10% of gross profit; based on the projection above, this would equal at least $125,000 in the first year of operations after the investment is made.
- The projection prepared by Jessica does not consider the potential boost to the occupancy rate from the Western Corridor proposal, if DHC goes ahead with it (integration). As Peak Revie would be linked to DHC's other nearby hotels in Canmore and Kelowna, the occupancy rate for Peak Revie could exceed the projection.

Qualitative Analysis

Advantages

- This proposal aligns with the trend of increasing leisure travellers.
- It also aligns with the trend of providing guests with unique experiences, given the hotel's ready access to a world-class ski hill.
- It would help DHC provide unique vacation packages, which is a growing trend in the industry.
- It would help increase DHC's brand visibility by adding a new location.
- Peak Revie appears to have strong customer retention, which would likely help this project align with DHC's stated goal of increasing brand loyalty.
- This option takes advantage of Canada's natural beauty, which is one of the main reasons that travellers visit Canada.
- It would help DHC realize the Western Corridor proposal, as Peak Revie is located between two existing DHC locations, Canmore and Kelowna.
- As Peak Revie is in Western Canada, it would avoid the negative attention that DHC has received in Ontario and Quebec.

- Peak Revie appears to fit with DHC's stated mission and vision; it is located in a unique setting and appears to provide its guests with high-quality service.
- As Kelvin pointed out, having unique experiences tied directly to its hotels has provided DHC with a significant competitive advantage. Although Peak Revie does not have a formal agreement with the nearby ski hill, the proximity to the ski hill is an advantage for this potential investment.
- It might be possible to increase the occupancy rate of the hotel by providing customers of the nearby ski hill with a discount at Peak Revie; this strategy proved effective for the Canmore hotel and TMSR. However, the economics of this would need to be assessed before a decision can be made.
- With the proximity to the Canmore hotel and TMSR, guests could be transported from one ski hill/hotel to the next, which could lead to an increase in occupancy rate and customer loyalty (integration).
- Attributes such as ease and convenience have been shown to be increasingly important to travellers. Given the fleet of transportation vans that DHC would gain access to through this investment, DHC's other nearby hotels could improve their service offerings (integration). The vans could be used across all DHC's Western Canada hotels to provide convenient and accessible transportation to and from airports and other DHC locations.

Disadvantages

- Peak Revie has a remote location that guests have complained is hard to get to. Its remoteness could still prove challenging, even though it would be somewhat mitigated by access to the fleet of transportation vans.
- Despite Miranda's efforts to promote it, public awareness of Peak Revie is low. This issue could potentially be resolved if the hotel is rebranded and marketed as a DHC hotel.
- As Kelvin pointed out, the hotel does not appear to have any historical significance; therefore, that aspect of DHC's mission/vision would not be met (link with mission/vision).
- If it made this investment, DHC would lose total control of its brand; the hotel would be rebranded as a DHC hotel, but the decisions of the hotel would not be completely in DHC's control (given that Miranda would need to agree to any decisions that were made).
- Although HHH has been a good business decision overall for DHC, working with Martha has hindered the decision-making process. By choosing to invest in Peak Revie, DHC would have to work with Miranda, which presents the risk of similar issues arising. DHC's owners appear to prefer having complete control over the company's projects, which would not be the case with Peak Revie (integration).

<u>Other considerations</u>

- Proposed agreement details:
  - Management duties: Under the proposed agreement, DHC would be responsible for managing Peak Revie (and would receive a management fee for doing so). Before agreeing to the proposal, DHC should assess whether the company is currently in a position to take on these duties.
  - No licensing fee: Under the proposed agreement, the hotel would be rebranded as a DHC hotel, but DHC would not be paid a licensing fee. DHC's brand has value. The board must assess whether this stipulation of the agreement is fair, given the return that DHC can expect from the arrangement.
  - Using an independent arbitrator: This aspect of the agreement should help ensure that any disputes that arise between Miranda and DHC's board are resolved in a fair manner.
  - Sale of shares: Under the proposed agreement, Miranda would be allowed to sell her shares to other parties (although no new shares are allowed to be issued). This is potentially problematic. If Miranda decides to sell her shares to a new shareholder, DHC would be forced to work with that new party.

Conclusion

Based on the information provided, the investment in Peak Revie looks positive. DHC will need to conduct an adequate amount of due diligence over the information provided, as well as over the rest of Peak Revie's operations. If those due diligence procedures do not uncover any concerns, this project appears worth pursuing. The quantitative aspects of the proposal appear attractive, the hotel itself is situated near a world class ski hill, and the terms of the investment appear fair. As discussed above, DHC may still want to renegotiate some of the elements of the agreement. Also, because this hotel does not align with the historical element of DHC's mission and vision, the company may need to revise its mission and vision statements if the investment is made. Nevertheless, this investment appears to be good on a stand-alone basis.

Further, if DHC decides to proceed with the Western Corridor, this investment would likely become even more successful. The location of the hotel fits nicely within the Western Corridor, and the results of the hotel are likely to improve if Peak Revie is included as part of a package vacation that features the other DHC hotels and activities within the area.

Assessment Opportunity #3 (Strategic Issue #2 – Potential purchase of HHH)

A competent candidate will complete both a quantitative and qualitative assessment of DHC's opportunity to purchase HHH from Martha.

Quantitative: The candidate is expected to calculate the potential return of the HHH purchase option. The candidate should also compare the cash flow generated from the investment versus the cash flow required to service the loan from Martha.

Qualitative: The candidate should discuss the proposed investment in HHH, including the fit with DHC's vision, mission, core values (which remain unchanged from Capstone 1), and industry trends and the implications of owning a hotel in downtown Vancouver.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Quantitative Analysis

	2022 – Actual
Total rooms available	170
Occupancy rate	68%
Average daily rate (ADR)	$325
Revenue per available room (Rev/PAR)	$221
Purchase price (for all outstanding shares)	$25,000,000
Upfront cash (requires 20% down payment)	$5,000,000
Proposed % ownership	100%
Net earnings (2022)	$2,100,000
Profit margin (2022)	7%
ROI	8%
Loan Repayment	
Initial loan	$20,000,000
Interest rate	5%
Years to repay	12
Annual repayment	$2,256,508
Cash flow from operations	$2,400,000
Extra cash flow (cash shortfall)	$143,492

Additional quantitative analysis and considerations

- It appears that the purchase of HHH would cause DHC's overall occupancy rate and ADR to fall. Therefore, this investment would violate DHC's stated goal of making investments that would increase the company's occupancy rate and ADR.
- Moreover, HHH's current occupancy rate and ADR are well below the boutique hotel industry's averages.
- The ROI (8%) appears to be attractive, although it is lower than the Peak Revie option (13%) and the 11% return rate that is mentioned in Capstone 1 as being a reasonable rate of return.
- The analysis does not consider the potential boost to occupancy that the hotel would get if rebranded as a DHC hotel (Peak Revie expects a 10% boost). Therefore, if rebranded, the performance of the hotel may improve significantly.
- The sale structure ($5 million of upfront cash and a $20 million loan issued by Martha) would fit within DHC's investment budget.
- Cash flow from operations ($2.4 million) would cover the required debt payments to Martha ($2.26 million). Therefore, even with HHH's 2022 results, DHC's cash flow would improve by making this purchase.
- The analysis does not consider the potential boost in occupancy from the Western Corridor, should DHC decide to proceed with that proposal (integration).

Qualitative Analysis

Advantages

- DHC currently does not have a hotel in any major metropolitan area; this option would give DHC increased exposure and brand visibility, which would help achieve the board's objectives and could also help improve the occupancy rate at all DHC hotels.
- HHH has been renovated and is now classified as a five-star hotel, which aligns with DHC's business model.
- Martha appears determined to sell the hotel; therefore, if DHC does not make the purchase, it could be forced to work with whoever buys HHH, which could be problematic. By purchasing HHH, DHC can avoid that issue and take full control.
- Given that DHC manages the hotel, the current quality of service at HHH meets DHC's standards.
- As it already manages the hotel, DHC is very familiar with the property, which lowers the risk of this option.
- This hotel could also be used to provide guests with vacation packages, which is in keeping with the industry trend to offer vacation packages. However, DHC could feasibly include HHH in a vacation package even if it does not purchase the property. (However, not purchasing the hotel would lower the attractiveness of including it in a vacation package, because DHC would not get the increase in brand exposure and would have to continue working with Martha, which could slow the process.)

- If DHC partners with Peak Revie and, therefore, gets access to the transportation vans, DHC would be able to shuttle guests from HHH's location to some of the unique experiences and activities, such as ski hills and golf courses, that are in relatively close proximity to the hotel (integration).
- If DHC proceeds with the Western Corridor opportunity, the rebranded hotel would fit nicely within the chain of hotels, given its geographical location.

Disadvantages

- The building has no historic value and is not currently considered a boutique hotel; by making the purchase and rebranding the hotel as a DHC hotel, the company would be deviating from its current business model.
- As the hotel has no historic component, that aspect of DHC's mission and vision would be violated.
- Given that HHH is dissimilar to DHC's other hotels (no historic value; not technically a boutique hotel; in a metropolitan core rather than a natural setting), there could be some brand confusion among DHC's guests, who expect a similar experience to what DHC has historically been known for.
- As mentioned by Kelvin, competition among hotels within HHH's market is strong; therefore, occupancy rates are declining.
- As the trend is towards fewer business travellers, and as 70% of HHH's guests are business travellers, it is possible that HHH's current occupancy rate will continue to decline.
- HHH does not currently have any hotel-affiliated activities, which was identified by Kelvin as a new KSF for DHC.
- If DHC purchases HHH, it would no longer earn any revenue from the management contract currently in place between DHC and HHH. Those revenue figures have not been provided but should be considered when analyzing the potential investment.

Conclusion

Quantitatively, this investment appears strong. With an ROI of 8% and positive cashflow (even after the applicable debt payment), DHC would benefit financially from making this investment.

Qualitatively, the biggest risk is that, given that HHH deviates significantly from DHC's other hotels in terms of its style (no historic or boutique appeal), there may be some brand confusion as a result of rebranding HHH as a DHC hotel. Nevertheless, there are many positive aspects to the purchase. Foremost, the purchase and rebrand would provide DHC with more exposure, given HHH's location. That would satisfy one of the board's main objectives. On the other hand, the board would also need to accept that this purchase likely lowers the company's ADR and occupancy rate, at least initially.

More due diligence is required. However, if DHC can gain comfort over the sustainability of HHH's current metrics, with the possibility of improving those metrics, this investment appears to be strong on a stand-alone basis.

If the Western Corridor proposal is pursued and the hotel included in vacation packages related to the Western Corridor, the metrics of HHH would likely improve.

Assessment Opportunity #4 (Strategic Issue #3 – Purchase castle in Tofino and convert it to a hotel)

A competent candidate will complete both a quantitative and qualitative assessment of DHC's opportunity to purchase the castle in Tofino and convert it to a hotel.

Quantitative: The candidate should critique the annual net earnings projection provided by recalculating Derek's projection and should discuss the potential profitability of the investment.

Qualitative: The candidate should consider the advantages and disadvantages of this strategic alternative, including the fit with DHC's vision, mission, core values (which remain unchanged from Capstone 1), and industry trends and the project's overall risk profile (especially when compared to the potential renovation of the Cape Breton hotel).

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Quantitative Analysis

A key assumption is that the cost of the castle will be approximately the same as the amount that DHC can get from the sale of the Cape Breton hotel.

	GIVEN	CANDIDATE ANALYSIS	
	Year 1 of Operations (Projected)	**Revised Projection (95 rooms, 75% occ.)**	**Revised Projection (85 rooms, 75% occ.)**
Total rooms available	105	95	85
Occupancy rate	85%	75%	75%
Average daily rate (ADR)	$600	$600	$600
Revenue per available room (Rev/PAR)	$510	$450	$450
Revenue			
Room revenue	$19,545,750	$15,603,750	$13,961,250
Food and beverage	11,727,450	9,362,250	8,376,750
	31,273,200	24,966,000	22,338,000
Expenses			
Room operating costs	10,750,163	8,582,063	7,678,688
Food and beverage costs	8,795,588	7,021,688	6,282,563
Other variable operating costs	5,316,444	4,244,220	3,797,460
Other fixed operating costs	2,500,000	2,500,000	2,500,000
Total operating costs	27,362,195	22,347,971	20,258,711
Operating income	3,911,005	2,618,029	2,079,289
Tax (27%)	1,055,971	706,868	561,408
Net earnings	**$ 2,855,034**	**$ 1,911,161**	**$ 1,517,881**
Profit margin	9%	8%	7%

<u>Sensitivity analysis</u>

Some of the assumptions used in Derek's projection for the Tofino castle may be too optimistic. Kelvin provided some extra information that could be used to generate a sensitivity analysis for the potential profitability of the project. As Derek's projection appears to be the most optimistic, it was used as the best-case scenario, and two other scenarios were projected.

The key findings were as follows:

- Total number of rooms – As per Kelvin's note, it might not be possible to easily divide the castle into rooms, since the structure was never meant to be partitioned in that way. As a result, 105 rooms might be too optimistic. Thus, we used 95 rooms and 85 rooms (since it could be less than 95) as the possible total number of rooms available in the sensitivity analysis.
- Derek also used an initial occupancy rate of 85% rather than DHC's current average occupancy rate or the industry average occupancy rate. We used a 75% occupancy rate instead, which seems more realistic given that it aligns with DHC's current occupancy. However, even that level of occupancy may be overly optimistic, especially in the first few years that the hotel is open.
- Derek has used an ADR of $600 in his projection, whereas DHC's current company-wide ADR is $425 and the industry's is only $375. As Kelvin pointed out, a $600 ADR may be too high for many of this hotel's potential customers. Therefore, although the projection provided uses a $600 ADR, it may be wise to calculate a further projection using a lower ADR, such as $500 and $425.

<u>Additional quantitative analysis and considerations</u>

- Renovation costs may exceed the $20 million estimate put forth by Derek. If this happens, DHC's return on investment from the project will fall.
- The projection and the sensitivity analysis are based on hypothetical situations; DHC cannot project with certainty the actual results of the project.
- DHC currently has $18 million of cash resources to put towards investment; however, the renovation is projected to cost $20 million. If DHC proceeds with this investment, it is unlikely that the company will have any cash left for other projects, such as the potential purchase of Peak Revie and/or HHH.
- The analysis provided does not incorporate any revenue that could be potentially generated through offering hotel-affiliated activities, such as whale watching and sea kayaking.

It is important to note that given the many unknown variables associated with this investment, such as the renovation costs, ADR, and occupancy rate, the project's estimated return is uncertain and may not be accurate. We recommend more research be done so that inputs and assumptions are more accurate.

Qualitative Analysis

Advantages

- The purchase and renovation of the castle in Tofino fits perfectly with the company's mission and vision statements. The castle is uniquely historical, and after the renovation, it is assumed the property will offer superb luxury.
- The castle is located in Tofino, which is far from Quebec and Ontario, where the bad publicity that DHC recently suffered is concentrated.
- The castle would appeal to leisure travellers, an aspect of the hotel market that is projected to increase.
- The castle is in a beautiful part of Canada, which will take advantage of the trend of travellers visiting Canada for its natural beauty.
- The castle itself would provide a unique experience to guests, which is what many customers of the boutique hotel industry want.
- The surrounding area may provide the potential for further unique experiences. Alyson mentioned the potential for whale watching tours and sea kayaking. These potential hotel-affiliated activities could be a key success factor for the project.
- The property could be a part of the Western Corridor, which may help increase the hotel's performance, as well as the performance of the other hotels that are a part of the corridor.
- The castle has attracted famous people in the past (such as celebrities and British royals), suggesting that it is a desirable tourist destination.
- The castle has been featured in magazines, suggesting that many people are probably already aware of it, which could make it easier to attract guests to the hotel.
- DHC currently does not have any hotels on Vancouver Island. Having a hotel here would help increase DHC's brand visibility, which aligns with the board's stated objectives.
- As long as DHC ensures that the level of service offered at this hotel is exceptional, this project matches perfectly with DHC's stated mission and vision.

Disadvantages

- There is a growing petition on social media to have the castle designated a national historic site. It is possible that DHC's reputation will be hurt if it purchases and renovates the hotel. Recently, it has become very important for companies to protect their online reputation.
- This investment may violate DHC's value of being an important and positive part of the community, given that the plan is to prohibit the general public from visiting the castle once it is converted into a hotel.
- Given the petition, DHC will have to move fast to secure the investment, which could make the investment riskier because DHC will have less time to perform an adequate level of due diligence (such as conducting a full structural assessment of the castle, as Kelvin suggested).
- DHC will have to complete the initial conversion to a hotel; as Kelvin pointed out, this is always a challenge, and it is possible that unexpected issues will arise throughout the renovation process.

- The company typically invests in hotels that are capable of offering between 150 and 250 rooms. Given that the castle is projected to have only 105 rooms (a figure that could drop even lower), this investment violates the company's room number preference (link to Capstone 1).

Conclusion

Overall, the proposal to purchase and convert the castle in Tofino into a DHC hotel appears to be both risky and expensive. It is risky for several reasons. First, DHC may experience a significant amount of public backlash if the castle is converted to a hotel and the public is then prohibited from accessing it. There is already a growing petition on social media. Given that DHC has already experienced a tarnished reputation in Ontario and Quebec, it may be unwise to expose the company to further negative news stories and social media posts. Second, the castle was never meant to be converted into a hotel, and although Derek has estimated that the renovation will cost $20 million, there is a chance that the cost will exceed that amount.

Further, although the castle's initial net earnings projection provided by Derek exceeds the current performance of the Cape Breton hotel, it is far from certain whether that will materialize. The revised projections of the castle show net earnings below the Cape Breton hotel's net earnings. Once the Cape Breton hotel has been renovated (at a cost far below that of the castle's renovation), the difference in performance will likely become even greater.

Derek has said that DHC should leave Eastern Canada and focus solely on the company's development within Western Canada. He claims that Doug's actions have led to a ruined reputation in all of Eastern Canada. However, Cape Breton is located in an area that appears to be unaffected by Doug's actions. Moreover, Camden and Co. has offered to represent DHC and is confident they can restore DHC's reputation in Ontario and Quebec. Therefore, it does not appear that DHC should leave Eastern Canada because of this issue. At this time, it does not appear that DHC should sell the Cape Breton hotel in order to invest in the castle.

Assessment Opportunity #5 (Strategic Issue #4 – Sell or renovate the Cape Breton hotel)

A competent candidate will complete both a quantitative and qualitative assessment of the decision to proceed with the renovation of DHC's Cape Breton hotel. The candidate should also discuss whether it makes strategic sense for DHC to sell the Cape Breton hotel so it can purchase the castle in Tofino.

Quantitative: The candidate should calculate the annual net earnings that DHC may expect if the company decides to renovate the Cape Breton hotel. The candidate should also compare the projected profitability of the renovation option with the other strategic options that are currently available to DHC.

Qualitative: The candidate should consider the advantages and disadvantages of this strategic alternative, including the fit with DHC's vision, mission, core values (which remain unchanged from Capstone 1), and industry trends.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Quantitative Analysis

	GIVEN	CANDIDATE ANALYSIS
	2022 (Pre-reno)	**Post-reno Annual Projection**
Total rooms available	165	165
Occupancy rate	66%	75%
Average daily rate (ADR)	$390	$400
Revenue per available room (Rev/PAR)	$257	$300
Revenue		
Room revenue	$15,501,915	$18,067,500
Food and beverage	8,526,053	9,937,125
	24,027,968	28,004,625
Expenses		
Room operating costs	7,905,977	9,214,425
Food and beverage costs	5,882,977	6,856,616
Other variable operating costs	4,565,314	5,320,879
Other fixed operating costs	2,500,000	2,500,000
Total operating costs	20,854,268	23,891,920
Operating income	3,173,700	4,112,705
Tax (27%)	856,899	1,110,430
Net earnings	$ 2,316,801	$ 3,002,275
Profit margin	10%	11%

If the information that has been provided is accurate, the net earnings of the Cape Breton hotel will almost certainly exceed the net earnings of the castle hotel in Tofino. In addition, the cost to renovate the Cape Breton hotel ($12 million) will be far less than the cost to renovate the castle ($20 million). Therefore, from a quantitative perspective, it seems that the Cape Breton hotel renovation is the better option.

Also, the $12 million cost of the hotel's renovation is within DHC's current cash budget of $18 million; therefore, DHC would not require any further debt financing to fund the renovation.

Qualitative Analysis

<u>Advantages</u>

- The renovation will ensure that DHC's Cape Breton hotel adheres to the company's mission of operating hotels that offer a luxurious atmosphere. The hotel's weak performance appears related to the current state of the hotel, since it is overdue for a renovation.
- The renovation has been planned and is already set to begin; therefore, it appears that it would be a simple process to complete the renovation.
- The cost of the renovation is already known, given that the company has negotiated a fixed-price contact. There is, therefore, no risk that DHC will suffer from cost overruns relative to the renovation.
- Cape Breton has been a part of DHC for years and the board knows the property well, making it less likely that unexpected issues will be uncovered during the renovation process.
- There is a possible synergy between DHC and Patrick to provide the guests of the Cape Breton hotel with a preferred rate at Patrick's Nova Scotia golf courses. This may help improve the occupancy rate of the hotel, just as TMSR did for Canmore and the golf course did for Kelowna. Providing guests at the Kelowna and Canmore hotels with discounts has been shown to increase customer satisfaction.
- There is less risk associated with this investment because DHC is already very familiar with the area and market.
- According to Kelvin, if the renovation takes place, the hotel will be one of the best hotels in the area. This should help increase the hotel's occupancy rate so that it is in line with the board's stated objectives.
- With the renovation, guests are more likely to enjoy their stay at the hotel and are therefore more likely to return. The renovation could help maintain and even build DHC's brand loyalty.

<u>Disadvantages:</u>

- DHC's reputation has suffered in Ontario and Quebec as a result of the negative attention associated with Doug Mallette. It is possible that, even if DHC renovates the Cape Breton hotel, the hotel's results will suffer, since there is a risk of it also being affected.
  - However, this risk can be mitigated by engaging the public relations firm to promote DHC and help rebuild its brand.
  - As Cape Breton is somewhat removed from Ontario and Quebec, it is also possible that the negative publicity will not affect the results of this hotel.

- Although DHC and Patrick have discussed the possibility of providing guests with preferred rates at Patrick's golf courses, no formal agreement exists, and this hotel has no other hotel-affiliated activity, which now appears to be a KSF of the industry.
- Cape Breton is geographically isolated from the rest of DHC's hotels. This increases the logistical challenges of the hotel, especially given that some of the board members like to meet and greet guests personally.
- Given the isolated location of the Cape Breton hotel, there is no chance to include the property in a vacation package that includes other DHC destinations.
- This hotel does not fit within DHC's proposed Western Corridor and would, therefore, not be able to benefit from being linked to DHC's other hotels and activities.
- Given that the renovation has already been planned for, if DHC sells this property, it may incur cancellation costs.

Conclusion

The renovation of the Cape Breton hotel will cost DHC less than the renovation of the castle, and the projected performance of the Cape Breton hotel outperforms the castle. By making the investment in Cape Breton, DHC will earn more while risking less. Given that the Cape Breton hotel is already established and the risks with it appear to be lower than the risks associated with the castle in Tofino, DHC should move forward with the property's renovation as originally planned and forgo the purchase of the castle.

Assessment Opportunity #6 (Strategic Issue #5 – Build the Western Corridor)

A competent candidate will provide a discussion of the Western Corridor and whether it makes strategic sense for DHC to create a linked group of hotels/activities in Western Canada.

Building the Western Corridor

Advantages

- The Western Corridor could take advantage of the growth in leisure travellers by giving travellers the option to stay at multiple hotels that offer various unique experiences, such as golf, skiing, and sightseeing.
- Many travellers prefer the convenience, ease of booking, and unique accommodations that websites like Airbnb and VRBO offer. The Western Corridor would offer DHC's guests many of the same benefits, as a guest could book a multi-hotel/experience vacation with DHC.
- Not only will guests get to participate in the unique experiences at DHC's hotels along the Western Corridor, but they will also experience travelling through Western Canada, which could be a sought-after experience in and of itself. This would take advantage of the trend that has seen visitors come to Canada to enjoy the country's natural beauty.
- If customers of the Western Corridor have a good experience, the Western Corridor could help boost DHC's customer retention and brand loyalty.

- Some boutique hotel companies are offering vacation packages; by linking its hotels together and offering multi-hotel stays/experiences, DHC could offer a unique Western Canadian luxury vacation package at one price, taking advantage of the trend.
- If DHC decides to sell the Cape Breton hotel in order to purchase the castle in Tofino and, therefore, extend the Western Corridor to Vancouver Island, it would escape the negative publicity that it has suffered in Ontario and Quebec, which has the potential to negatively affect the Cape Breton hotel in the future (as Derek pointed out).
- The creation of the Western Corridor mostly meets DHC's stated mission and vision by offering guests unique experiences while also offering exceptional services. However, given that Peak Revie and HHH do not have any historical element, that aspect of DHC's mission and vision would be violated.
- The Western Corridor would also allow DHC to take advantage of the Peak Revie vans that are currently sitting idle.
- Based on the boost in occupancy experienced at both the Kelowna and Canmore hotels when those hotels became officially affiliated with nearby activities, the Western Corridor would help boost the occupancy rates of the hotels that form the corridor.
- International travellers appear to be particularly attracted to vacation packages. The Western Corridor might, therefore, help DHC attract more international tourists.

Disadvantages

- Driving guests around would create an extra liability for DHC.
- DHC would need to sell its Cape Breton hotel in order to extend the Western Corridor to Vancouver Island.
- Driving guests from one location to the next is not something that DHC currently offers. DHC has no experience in this area, and it could be more challenging than it appears.
- DHC's guests may not be attracted to the longer drive times between DHC's current and prospective hotels. In addition, depending on the condition of the vans, the trips to and from DHC's hotels/activities may not be viewed as "luxurious" by DHC's guests. This would not align with the company's mission and vision.

Conclusion

Based on the analysis performed, the Western Corridor proposal would help boost the occupancy rate of hotels that form the corridor and might also help build brand loyalty through the offering of multiple unique experiences. DHC should proceed with the Western Corridor proposal, especially between Canmore, Revelstoke, and Kelowna. If DHC decides to purchase HHH, that hotel should also be a part of the Western Corridor, as its inclusion on the Western Corridor route may increase the number of leisure travellers who currently visit the downtown Vancouver location.

Tofino would be the last hotel on the Western Corridor, but given both the qualitative and quantitative assessments performed above, it should not be purchased. Nevertheless, based on the geography of the company's other hotels, DHC can still proceed with the Western Corridor proposal.

Summative Assessment #3 – Conclude and Advise

For Summative Assessment #3, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate provided reasonable conclusions for each major issue.

Unsure – The candidate attempted to provide reasonable conclusions for each major issue.

No – The candidate clearly did not provide reasonable conclusions for each major issue.

Enabling Competencies

6.3.1 Uses evidence and judgment to recommend and justify solutions or conclusions
6.3.2 Articulates limitations to recommendations
6.3.3 Applies decision criteria to choose among viable alternatives
6.3.4 Ensures that decision criteria do not conflict with professional ethics and values

The candidate should provide a logical conclusion that integrates the analysis of all five major issues (the investment in Peak Revie, the purchase of HHH, the purchase of the castle in Tofino, the sale or renovation of the Cape Breton hotel, and the development of the Western Corridor).

The recommendations should be consistent with the analyses performed. As well, an overall conclusion should be presented that acknowledges the company's available investment capital and integrates the analysis of each major issue in a logical manner.

The candidate was asked to review the available information, assess each strategic option on a stand-alone basis, and comment on DHC's overall direction. As part of their assessment, the candidate should consider whether the available investment options will help DHC to

- *increase the company's ADR and occupancy rates;*
- *improve the company's profitability;*
- *build brand visibility and brand loyalty; and*
- *realize the company's mission and vision.*

The candidate should consider the trends within the boutique hotel industry while making their assessments and recommendations.

Recommendations on Specific Issues

Investment in Peak Revie

Both qualitatively and quantitatively, this is a good investment, and it should be pursued. Quantitively, the investment appears to have a strong projected return of 13%, and this is before the potential increase to the occupancy rate that would result from connecting the hotel to the Western Corridor. However, at least initially, this investment is projected to lower DHC's overall ADR and occupancy rate, which would violate the board's stated goals. Given the potential growth of the hotel, however, it is possible that Peak Revie's performance metrics will quickly improve.

Qualitatively, the acquisition of the hotel would provide DHC with another location, which would help satisfy the board's objective to increase brand visibility. Moreover, Peak Revie has a strong guest retention rate; this would help satisfy the board's objective to build DHC's brand loyalty. The investment in Peak Revie would also likely contribute to the performance of all of the company's hotels in Western Canada, as DHC would gain access to the fleet of transportation vans that Peak Revie currently owns.

At a cost of $3.5 million, this is an investment worth making.

Purchase of HHH

Given HHH's current performance, if DHC were to make this investment, the company's ADR and occupancy rate would fall. This would violate the board's stated goals of only making investments that increase these metrics. Nevertheless, the projected return on this investment is quite attractive at 8%, and this is before any potential boosts to the hotel's metrics, given what may result from the acquisition. HHH's performance could improve in a number of ways: 1) rebranding the hotel as a DHC hotel; 2) connecting this hotel to DHC's other hotels in Western Canada via the Western Corridor; and 3) connecting this hotel to sought-after and unique experiences in the area. In addition, given the increase in brand visibility that DHC would enjoy from this investment, the company's other hotels would benefit from the acquisition.

However, this investment is not without risk, given that HHH, in its current form, is not a typical boutique hotel (and, therefore, violates the company's mission/vision) and caters mostly to business travellers. If, through further due diligence procedures, DHC can gain confidence in the sustainability and potential growth of HHH, this investment is recommended.

This option has both significant advantages and disadvantages — depending on how the candidate assessed the option, they may recommend for or against the option. If the candidate recommends that DHC purchase HHH, this hotel can also be a part of the Western Corridor.

Purchase and renovation of castle in Tofino

Given both the risk and cost associated with this investment option, we recommend that DHC forgo the project. The main risks include the inability to accurately estimate the cost of renovation, and the risk associated with attracting negative attention from the local population and on social media. Moreover, there are many uncertainties relative to the potential performance of the castle in Tofino. Although this project adheres to the company's stated mission and vision and appears to satisfy the board's stated objectives, there are too many unknown variables and risks. Therefore, we recommend that DHC forgo this opportunity and, instead, move forward with the renovation of the hotel in Cape Breton.

Sale or renovation of Cape Breton hotel

Not only will the renovation of the Cape Breton hotel cost less than the renovation of the castle in Tofino, but the projected performance of the hotel is greater than that of the castle. In addition, the risks associated with the Cape Breton hotel are fewer relative to the castle in Tofino. This is mainly because DHC is very familiar with the hotel, so there is far less uncertainty associated with the project.

We recommend that DHC proceed with the renovation of the Cape Breton hotel. We also recommend that DHC hire the public relations firm, Camden and Co., to combat the bad press that Doug Mallette has generated. The cost of $120,000 seems a reasonable price to pay to ensure that DHC's strong reputation is maintained in Eastern Canada and potentially beyond.

Building the Western Corridor

DHC should move ahead with Derek's idea to link the company's Western Canada hotels together, using the transportation vans that Peak Revie currently owns. However, the company should not sell the Cape Breton hotel in order to fund the purchase of the castle in Tofino. Nevertheless, the company can still provide a unique experience by linking together the hotels in Canmore, Revelstoke, and Kelowna (which are all located near each other geographically). If the company decides to purchase HHH, that hotel can also be linked with the others.

However, if DHC decides to pursue either Peak Revie or the acquisition of HHH, the company should revisit and revise its mission and vision statements to include boutique hotels that are not limited to historical buildings.

Overall Conclusions and Recommendations

DHC should proceed with the Western Corridor proposal but should retain and renovate the Cape Breton hotel. By building the Western Corridor, DHC will be able to provide its guests with a highly unique travel experience. This will help build DHC's brand and benefit the company financially (by increasing the occupancy rates of the hotels that form the Western Corridor). The company should also hire Camden and Co. to repair the damage caused by Doug Mallette, as this will ensure that DHC can take advantage of any future growth opportunities that present themselves in Ontario and Quebec. This will also ensure that the reputational damage Doug caused does not spread to other parts of Canada.

DHC currently has $18 million to invest. After the Cape Breton renovation ($12 million) and the investment in Peak Revie ($3.5 million), both of which are highly recommended, DHC will be left with $2.5 million. If DHC decides to pursue the purchase of HHH ($5 million), it will need to seek debt financing. Alternatively, to avoid the need for further debt financing, DHC could negotiate with either Martha or Miranda to adjust the upfront cash requirement of the investment.

Other recommendations are acceptable if they are supported and take into consideration the financing required.

Summative Assessment #4 – Communication

For Summative Assessment #4, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate adequately communicated their response.

No – The candidate clearly did not communicate their response adequately.

Insufficient communication in a candidate's response would generally include some of the following:

- The response is difficult to understand.
- The reader needs to re-read sections several times in order to gain an understanding.
- It is not clear what point the candidate is trying to make.
- The quantitative analysis does not make sense because of illogical ordering or a lack of labelling.
- There is an excessive amount of spelling and grammatical errors.
- Unprofessional language is used.

Summative Assessment #5 – Overall Assessment

For Summative Assessment #5, the candidate must be assessed in one of the following, based on their overall performance:

Clear Pass – Overall, the candidate provided an adequate response, clearly meeting the minimum standards for each of the summative assessments.

Marginal Pass – Overall, the candidate provided an adequate response, with some errors or areas of omission, but including the underlying key concepts.

Marginal Fail – Overall, the candidate provided an attempt at a response, with several errors or an incomplete analysis.

Clear Fail – Overall, the candidate did not provide an adequate response because the response was deficient in multiple areas.

To be assessed a Pass, the candidate is expected to perform adequately in all the summative assessments and demonstrate that they addressed issues of importance in a cohesive, professional manner.

In making their overall assessment, markers were asked to consider the following:

1. Did the candidate step back and see the bigger picture, and then address the broader issues identified?
2. Did the candidate prioritize the issues by discussing the major and minor issues in appropriate depth?
3. Did the candidate use both quantitative (when available) and qualitative information to support their discussions and conclusions?
4. Did the candidate use the appropriate tools to perform quantitative analysis?
5. Did the candidate use sufficient case facts (current case and Capstone 1 case) about the external and internal environments to support their discussions?
6. Did the candidate communicate their ideas clearly, integrating and synthesizing the information?

SAMPLE RESPONSE – DHC VERSION 3

Below is an actual passing candidate response.

To: Board of Directors, DHC

From: CPA, WCG

RE: Various Issues & Analysis

March 2023:

Situational Analysis:

Strengths:

- DHC provides unique experiences for their guests. This is a major competitive advantage as customers enjoy having unique activities and amenities affiliated with their hotel and likely leads to DHC improving its occupancy rates.
- Occupancy rates have remained relatively stable (75-78%) regardless of online presence such as Airbnb and VRBO due to DHC's unique experiences they offer. This provides DHC some reasonability with their financial projections and alleviates any going concerns.
- DHC appears to be in a healthy cash position as they have $18 million in excess cash and have successfully paid off any debts relating to the Northern Ontario property upon sale of it. This allows DHC the flexibility to pursue capital investments that allow them to grow, and depending on the required amount, could avoid any interest costs.

Weaknesses:

- DHC currently has a negative brand image and online presence in the East (Ontario & Quebec) due to Doug posting negative reviews and newspaper publishing claiming he was wrongfully dismissed. This impacts a main key success factor for building a hotels brand perception through their reputation and online presence and could hinder DHC's operating results.
- DHC is struggling with the existing management of HHH with Martha as they do not have 100% ownership and struggle to make decisions while working with Martha. There is 17 years remaining on the agreement. DHC has an opportunity to purchase HHH which would address this and will be discussed later.

Opportunities:

- Although chain hotels have suffered, the boutique industry has not due to travellers' still being attracted to the unique experiences the hotels offer. This has decreased the competition of major chain hotels taking customers away from the boutique hotel industry.
- Companies can increase their customer retention and brand loyalty by providing unique vacation packages. It has become increasingly important for hotels to retain customers and build brand loyalty. If DHC were to provide vacation packages, this could benefit their financial performance and increase their occupancy rates.

- In particular, vacation packages are extremely attractive to international travellers. If DHC were to provide vacation packages, this would be an effective way of targeting this consumer segment.
- Canada is a sought-after tourist destination due to its natural beauty and outdoor activities. If DHC were to target properties surrounded by nature and outdoor activities, they would appeal to this market of travellers.

Threats:

- Websites such as Airbnb and VRBO are increasingly being used by travellers due to its convenience, ease of booking and unique accommodations. Although it has not impacted the boutique industry yet, it may in the future which would lead to decreased demand and occupancy rates for DHC.
- Viral news stories and negative social media attention have become serious risk factors for the industry. This impacts a main key success factor to building a strong brand reputation and online presence. DHC currently has some negative online presence due to Doug regularly posting negative reviews as well as being featured in newspapers claiming he was wrongfully dismissed by DHC. This is a current issue that can lead to serious negative impacts for DHC's Ontario and Quebec (eastern) locations and will be addressed later.
- Business travel is greatly reduced due to companies relying more on video conferencing. This directly impacts DHC with their HHH management agreement as 70% of guests are business travellers.

Key Success Factors:

Existing:

1. Retain and attract a highly skilled and experienced workforce.
2. Offer unique and luxurious amenities.
3. Maintain properties in good condition.
4. Keep up-to-date on new technology improvements.
5. Predict customer needs.
6. Use market research.
7. Retain and attract customers.

New:

1. Build brand loyalty and retaining customers has become more important than ever.
2. Building a hotel's presence and reputation on social media is quickly becoming the main factor behind public perception of the brand.
3. Provide activities affiliated with the company's hotels.

Mission: "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."

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

Values:

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 towards perfection.
5. Become an important part of the local community.

Stakeholder Analysis:

DHC is no longer intending to go public. No previous shareholders have sold. Patrick has convertible bonds but has not exercised any options yet. All existing owners' mentality has not changed.

Long Term Goals:

1. DHC only intends to use its line of credit for operational or emergency funds and not for capital investments.
2. DHC is no longer intending to go public.
3. DHC is focused on increasing its occupancy rates and ADR.
4. Investments must increase DHC's brand visibility and brand loyalty.

Financial Analysis:

1. DHC currently has $18 million available in cash resources.
2. DHC appears to be in a healthy position with their cash and outstanding debts as it has been mentioned as loans relating to the Northern Ontario were paid off upon sale of the property.

2022 Targets:

- ADR of $420 – DHC achieved this goal as they had an ADR of $425 in 2022, and well ahead of industry ($375).
- Occupancy rate of 80% - DHC did not achieve this goal as they had occupancy rates of 75% in 2022, behind industry (77%).

Issue #1: Consider whether DHC should purchase a 35% ownership in Peak Revie.

Analysis: DHC is considering whether to purchase a 35% ownership in Peak Revie, a 150-room log-cabin hotel near a world class ski resort in Revelstoke, B.C.

Quantitative Analysis:

As per **Appendix I**, I have calculated that the 35% ownership investment in Peak Revie would net a 45% return on investment for DHC. This is a highly profitable proposal. It is important to consider the assumptions that went into this projection: a 10% increase in occupancy rates due to rebranding of the location to DHC. I consider this fairly reasonable as DHC does have a positive brand image in the West with existing locations in Canmore (3.5 hours) and Kelowna (2 hours). Additionally, if DHC were to pair with the local ski hill (5km), they would likely see comparable results when they offered affiliated activities at the Canmore and Kelowna locations (10% and 8% occupancy rate increases, respectively).

DHC wants to improve its occupancy rates and ADR. Given the current projections, this property is slightly lower on both of these metrics ($395 vs $425, 73% vs 75%) and would slightly decrease DHC's overall metrics. Quantitatively, the investment in Revie is a good opportunity.

Qualitative Analysis (pro – invest, con – don't invest):

- **Pro:** Peak Revie has strong customer retention. This is a key success factor in the industry to attract and retain customers. By investing in the property, they will likely improve their percentage of returning customers and have a more reliable occupancy rate.
- **Con:** Few people are aware of the location. This is a negative due to the fact that high brand awareness is a key success factor and an investment requirement for DHC.
    - That being said, Miranda believes that rebranding the hotel to DHC would improve the brand awareness. I believe this is reasonable as DHC has several existing and successful operations in the near vicinity (Canmore & Kelowna).
- **Pro:** Miranda purchased an excess amount of vans and has told DHC they would be able to use them as part of the terms of the agreement. This would allow DHC to shuttle their customers from hotel to hotel (leading to improved occupancy rates for other DHC hotels) as well as to nearby outdoor activities (golfing, skiing, etc.). This has been identified as an opportunity for DHC to capitalize on as consumers are tending to enjoy the vacation packages. Investing in Revie would allow DHC to prepare this style of accommodations and to improve occupancy rates at other locations.
- **Con:** The location is remote, with the nearest airport being 2 hours away. This will hinder travellers and specifically international travellers. International travellers in particular are a key consumer segment if DHC were to provide vacation packages, as mentioned in the opportunities.
    - That being said, DHC & Revie would have access to the vans to shuttle them to and from the hotel/airport and Miranda has mentioned that the vans have already improved the results.
- **Pro:** The world-renowned ski hill is 5 KM away and DHC could package ski & stay vacation packages – these are becoming very popular with consumers and has become a key success factor to provide affiliated activities with the hotel.
- **Con:** There is very little historical appeal for the location. This goes directly against DHCs mission statement of providing accommodations in historical sites. The investment does not align with DHCs mission objective.
- **Pro:** Investing in Revie provides DHC to rebrand as a "West Coast Corridor". Although this does not entirely align with mission & vision statements, this is an opportunity to further brand themselves, a main key success factor within the industry. This could lead to increased brand awareness as DHC would become very unique boutique hotel operators on the West Coast, a location they are performing well in.

Recommendation: Overall, I recommend pursuing the investment to acquire 35% ownership in Peak Revie. Although the ADR and occupancy rates are currently below the companies overall performance, this investment will likely lead to increased occupancy rates at other existing locations due to the vans and guest convenience. Additionally, this provides DHC ability to further develop a very specific and unique brand of a boutique hotel operator on the East & West Coast who provide unique affiliated activities for guests to enjoy. This completely aligns with current trends of consumers who enjoy Canada's nature and outdoor activities and brand

loyalty. The cost to purchase is $3.5 million and within DHCs ability to pay ($18 million available). They do not need to seek financing and can avoid the cost of interest.

Issue #2: Consider which of the two locations are better for DHC: the West Coast Castle purchase or the existing Cape Breton hotel (East Coast).

Analysis: DHC is currently considering between two locations: the existing Cape Breton location (East Coast) or the investment opportunity to purchase the Castle in Tofino (West Coast). We will be considering and comparing both options here.

Quantitative Analysis:

Tofino Castle: As per **Appendix II**, I have determined that based on Derek's projections, the Tofino investment has a 14% rate of return which is profitable. Additionally, it would exceed current occupancy rates and ADR for DHC overall, which would help improve its numbers. However, Kelvin does not agree with the projections. Adjusted projections in line with company averages and less rooms suggests a far less profitable rate of return of 4%. Quantitatively, this is not a good option for DHC to pursue.

Cape Breton: The Cape Breton location results in a 24% rate of return after the renovation improvements. Occupancy rates of 75% are in line with company average. ADR of $390 is slightly below but it is expected to reach company average in 2 years. Quantitatively, Cape Breton is the more profitable option.

Qualitative Analysis:

Tofino (pro – purchase, con – don't purchase):

- **Pro:** The Castle is very historic and aligns with DHCs mission statement of providing accommodations in historical sites.
- **Con:** The sale of the castle has faced heavy public opposition as it would privatize a location that meets the requirements to be designated as a national historical site and they believe it belongs to the community. If DHC were to purchase it, it would not be open to the public and DHCs brand may be negatively impacted. This is particularly important because it is a key success factor to have a strong brand perception and would not help DHCs other West Coast locations (Kelowna & Canmore) as well if they proceed with our recommendations to invest in Revie and develop the West Coast Corridor branding.
- **Pro:** The purchase of the Tofino castle would fit perfectly with the West Coast Corridor and would fit DHCs future branding (if they proceed with this recommendation).
    - However, it is worth noting that a 5.5 hour commute is required from Vancouver in order to reach the Tofino location. It is quite remote from all existing DHC locations, unless DHC were to purchase HHH (to be addressed).
- **Con:** Kelvin is unable to determine the renovation costs without a complete structural assessment. This may result in a further reduced profit margin and return on investment (already only at 4% with Kelvin's assumptions). It is uncertain that DHC is able to generate a positive return on this investment.
- **Pro:** The Tofino Castle is situated on the ocean and aligns with consumers desire to travel to Canada for its natural beauty. This would lead to increased occupancy rates.

- **Pro:** The location would provide consumers with unique affiliated experiences such as ocean kayaking and whale watching. This aligns with current consumer trends of having unique affiliated outdoor activities and can lead to increased occupancy rates and results, especially with the international travellers who are especially attracted to such vacation packages.

Cape Breton (pro - keep & renovate, con – sell & purchase Tofino):

- **Pro:** As Cape Breton is their only East Coast location, keeping and renovating it allows them to maintain their brand awareness on the East Coast, which keeps doors open to future opportunities.
- **Con:** DHC has a negative brand image in Ontario and Quebec due to Doug. This may spillover into the East Coast and negatively impact the locations results. This would reduce ADR and occupancy rate, a key goal for DHC.
    - That being said, based on the map provided (Appendix II, exam) the East Coast is not expected to be negatively impacted by Doug.
- **Con:** DHC would experience lower operating costs if all of their locations were in closer proximity of each other due to travel, etc. By selling Cape Breton, DHC can lower their operating costs and improve their operating & profit margins.
- **Pro:** The reason that Cape Breton's performances has struggled is that it has not been renovated since 2014 and is due for major renovations. By renovating, DHC would be committing to fulfilling the key success factor of having up-to-date properties in good condition.

Recommendation: I recommend to renovate the Cape Breton location. Not only does it generate a 24% rate of return compared to 4% for Tofino, DHC avoids negative future brand perception due to the residents being opposed to the sale of the Castle. This would severely impact DHCs existing operations in Kelowna and Canmore as well as hinder DHCs success with the recommended investment in Peak Revie.

Issue #3: Consider whether DHC should purchase 100% of HHH from Martha.

Analysis:

Quantitative Analysis:

As per **Appendix III,** I have calculated the return on investment is 4% which is very low considering the large amount required to invest in this option ($25 million) and would take several years to payback. Additionally, ADR of $325 and the occupancy rate of 68% is far below company average (doesn't include HHH results) and would negatively impact DHCs overall metrics, a main priority for them. Quantitatively, this is not a good investment for DHC.

Qualitative Analysis:

- **Pro:** HHH is located in Downtown Vancouver and would provide DHC an opportunity to enter the large metropolitan market.
    - That being said, it has been identified that consumers want to travel to Canada because of its natural beauty, which does not include cities. I believe this is a miss on aligning with consumer demand.
- **Con:** The location is not a boutique hotel. This does not align with DHCs mission of being operators of boutique hotels.

- **Pro:** The location increases DHCs brand awareness. This is a key success factor for the industry and might positively impact DHCs other locations, especially the ones located on/near the West Coast (Canmore, Kelowna, Revie (if pursued)). This could lead to improved occupancy rates at other DHC locations.
- **Con:** There is no historical appeal to HHH. Again, this goes against DHCs mission statement of providing accommodations in historical sites and reduces DHCs brand.
- **Con:** There is a lot of competition in the large metro areas due to Airbnb and VRBO. This may lead to weak performances if DHC struggles to remain competitive.
- **Con:** 70% of guests are business travellers. Due to video conferencing, business travel is expected to decline and will negatively impact future results such as occupancy rates and profit margins.
- **Pro:** Purchasing HHH allows DHC 100% ownership. DHC is struggling with the existing management of HHH with Martha as they do not have 100% ownership and struggle to make decisions while working with Martha. There is 17 years remaining on the agreement. If DHC were to purchase it, results may improve due to better decision making.

Recommendation: Do not pursue HHH. An estimated 4% return on investment is very low for a $25 million investment and would take several years to payback. Additionally, due to business travel trends, HHH results may further weaken and this return on investment may further be reduced. It is questionable if DHC is able to generate a positive return on investment in future years.

Issue #4: Consider whether DHC should seek help from the PR firm Camden and Co.

Analysis:

Quantitative Analysis: The cost for DHC to address the negative publicity is $120,000. Given the annual sales from 2019 of $124 million, I would consider this a low cost to address a major issue.

Qualitative Analysis (pro – purchase, con – don't purchase):

- **Pro:** The representatives are confident they can quickly address and clear up the negative perception. This is important as news can quickly spread and negative brand images can quickly be impacted. The brand perception is a main key success factor within the industry.
- **Con:** DHC could attempt to address it internally.
  - That being said, DHC did not hire a Director of Marketing & Branding to replace Doug. I do not believe they have these resources available.
- **Pro:** If DHC proceeds with our recommendation of renovating the Cape Breton location, it is important that the negative publicity and brand perception does not spill into the East Coast as well as this would directly the impact of DHCs recommended investment and Cape Breton's future operating results.

Recommendation: Due to this being a major success factor within the industry, the low cost relative to total annual sales and the lack of alternatives available to DHC, I would advise DHC to acquire the help of Camden and Co., especially if DHC accepts our recommendation of renovating the Cape Breton location.

Overall Recommendations: Overall, DHC is operating in a healthy economy and industry with several areas for opportunity. However, there are major risks associated with brand perception as well as brand loyalty. To capitalize on these opportunities and to avoid these risks, we are advising DHC to:

1. Invest in a 35% ownership in Peak Revie for $3.5 million. DHC has $18 million available for capital investments (not considering their line of credit). DHC is able to purchase 35% ownership in Peak Revie with a portion of these funds, leaving them with remaining balance of $14.5 million for capital investments. We are also recommending they pursue a partnership with the local ski hill to create a vacation package to align with consumer demand.
2. Renovate the existing Cape Breton location in favour of selling it and pursuing the Tofino Castle. Although the castle is a unique property, there will be too much negative brand perception and will not only impact its results, but other DHC locations, especially in the West Coast. This is an area DHC is recommended to further pursue and it is important to maintain a positive brand perception. Overall, Cape Breton nets a greater return on investment and can lead to future East Coast investments.
3. Do not purchase HHH. Based on business trends, it is very questionable if DHC would be able to earn back its $25 million investment.
4. Seek PR services from Camden and Co. in order to quickly address the negative brand perception Ontario & Quebec have on DHC to ensure a successful renovation and ongoing operations at the Cape Breton hotel.

Please contact us if you have any further questions or concerns.

Appendix I

	Actual (2022)	Proposed
Room Revenue	$ 13,107,150	$ 15,787,163
Profit Margin (8% room rev)	$ 1,048,572	$ 1,262,973
Proposed Purchase Price (35%)	$ 3,500,000	
Implied Value	$ 10,000,000	
DHC Management Fee	$ 1,578,716	(using proposed)
DHC Return on Investment	45%	
Occupancy Rate	73%	
ADR	$ 395	

Conclusion: The proposed investment in Peak Revie nets for an estimated return of 45% in the first year. ADR of $395 would negatively impact their rate and occupancy rate would have a slight negative impact.

Appendix II

Purchase of Tofino Castle:	**Projected (Derek)**	**Adjusted (Kelvin)**	**Renovations of Cape Breton:** Actual (2022)	Projected
Rooms Available	105	95	165	165
Occupancy Rate	85%	75%	66%	75%
ADR	$ 600	$ 425	$ 390	$ 390
Room Revenue	$ 19,545,750	$ 11,052,656	$ 15,501,915	$ 17,615,813
Food & Bev Rev	$ 11,727,450	$ 6,631,594	$ 8,526,053	$ 9,688,697
Total Revenue	$ 31,273,200	$ 17,684,250	$ 24,027,968	$ 27,304,509
Room Operating Costs	$ 10,750,163	$ 6,078,961	$ 7,905,976.65	$ 8,984,064.38
Food & Bev Costs	$ 8,795,588	$ 4,973,695	$ 5,882,976.74	$ 6,685,200.84
Other Variable Costs	$ 5,316,444	$ 3,006,323	$ 4,565,313.97	$ 5,187,856.78
Fixed Costs	$ 2,500,000	$ 2,500,001	$ 2,500,000	$ 2,500,001
Total Operating Costs	$ 27,362,194	$ 16,558,980	$ 20,854,267	$ 23,357,123
Operating Income	$ 3,911,006	$ 1,125,270	$ 3,173,701	$ 3,947,386
Tax (27%)	$ 1,055,972	$ 303,823	$ 856,899	$ 1,065,794
Net Earnings	$ 2,855,034	$ 821,447	$ 2,316,802	$ 2,881,592
Profit Margin	9%	5%	10%	11%
Cost of Renovations	$ 20,000,000		$ 12,000,000	$ 12,000,000
Return on Investment	14%	4%	19%	24%

Note: Cost of investment is only renovations as Cape Breton location would be sold if purchasing Tofino to make the purchase of Tofino netural.

Conclusion: Based on Derek's projections, the Tofino investment has a 14% rate of return which is profitable. Additionally, it would exceed current occupancy rates and ADR for DHC overall, which would help imrpove its numbers. However, Kelvin does not agree with the projections. Adjusted projections in line with company averages suggests a far less profitable rate of return of 4%.

The Cape Breton location results in a 24% rate of return after the renovation improvements. Occupancy rates of 75% are in line with company average. ADR of $390 is slightly below but it is expected to reach company average in 2 years. Cape Breton is the more profitable option.

Appendix III	2022 Results	
Operating Profit (pre-tax)	$	2,876,712
Interest	$	1,000,000
Taxes	$	776,712
Adjusted Net Earnings	$	1,100,000
Required Investment	$	25,000,000
Return on Investment		4%
ADR	$	325
Occupancy Rate	$	1

Conclusion: Based on 2022 results,the return on investment is 4% which is fairly low considering the large amount required to invest in this option. ADR of $325 and the occupancy rate of 68% is far below company average (doesn't include HHH results).

APPENDIX I

RESULTS BY SUMMATIVE ASSESSMENT OPPORTUNITY FOR DAY 1 VERSION 1, VERSION 2 AND VERSION 3

Results by Summative Assessment Opportunity

Marking Results – Distinct Hotels Version 1

Indicator	Papers (normal population)	Did not meet standard[1]	Marginal[1]	Yes, met standard
Situational Analysis	7004	0.17	1.04	98.79
Analysis	7004	2.27	25.46	72.27
Conclude and Advise	7004	0.46	6.57	92.98
Communication	7004	0.00	0.14	99.86

Marking Results – Distinct Hotels Version 2

Indicator	Papers	Did not meet standard[1]	Marginal[1]	Yes, met standard
Situational Analysis	280	0.00	0.71	99.29
Analysis	280	5.36	45.71	48.93
Conclude and Advise	280	5.71	50.00	49.29
Communication	280	0.00	0.00	100.00

Marking Results – Distinct Hotels Version 3

Indicator	Papers	Did not meet standard[1]	Marginal[1]	Yes, met standard
Situational Analysis	994	0.50	3.52	95.98
Analysis	994	5.33	61.77	32.90
Conclude and Advise	994	3.52	31.99	64.49
Communication	994	0.20	0.00	99.80

[1]Clearly failing papers (i.e., did not meet the standard) were marked twice. All marginally failing or marginally passing papers were marked a second time to determine which ones met the passing standard. A selection of papers that were close to the margin were also looked at by third marker. The clear pass papers were marked only once, however, they were audited.

The BOE ensures that Version 2 and Version 3 difficulties are equated with Version 1. Any differences in the above statistics are attributable to the mix of candidates writing, which varies with each version.

APPENDIX J

BOARD OF EXAMINERS' COMMENTS ON DAY 1 SIMULATION VERSION 1, VERSION 2 AND VERSION 3

BOARD OF EXAMINERS' COMMENTS ON DAY 1 (DHC VERSION 1, VERSION 2 AND VERSION 3)

Paper/Simulation: Day 1 – Linked Case, DHC Version 1 (on Sept 2020 CFE)

Estimated time to complete: 240 minutes

Simulation difficulty: Average

Competency Map coverage: N/A; Enabling Skills

Evaluators' comments by Summative Assessment Opportunity (SO)

SO#1 (Situational Analysis)

Candidates were expected to highlight the internal factors, such as the change in mission and vision statements, and the external factors, such as key industry trends, that would influence DHC's business and have an effect on the key decisions to be made. Any significant changes that had taken place since Capstone 1 should have also been noted. Although not explicitly mentioned in the simulation, it was clear from DHC's financial statements (Appendix II) and the industry ratios provided (Appendix III) that DHC had limited resources to invest and that the company's performance had lagged behind the industry in the past three years. In the simulation, DHC's primary objectives were to concentrate on the company's core hotel business, improve the occupancy and average daily rate, earn a minimum of 12% on any strategic investments made, and have an adequate level of cash in order to once again pay dividends. Candidates were expected to acknowledge these objectives and consider how each of the decisions listed below would either help or hinder the company's pursuit of these aims. Candidates were rewarded when they made links back to the company's situational analysis and the potential financial constraint within their analysis of SO#2.

A strong situational analysis acknowledged these issues. Strong candidates analyzed DHC's financial statements and the company's performance metrics relative to the industry and provided an assessment of the company's financial health. Strong candidates often displayed greater depth of understanding and integration. For example, some strong candidates recognized that the company's reduced performance may have been partly caused by Doug Mallette's unethical behaviour and the company's subsequent loss of its gold rating from First Canadian Hotel Reviews; they used this information in their analysis of Holiday and Global, stating that these companies had good reputations, which might help reduce the harm caused by Doug.

Weak candidates simply listed case facts within a SWOT analysis without highlighting the crucial points or explaining the implications of the case facts listed. In addition, weak candidates frequently made links back to the mission and vision but failed to describe how the option would satisfy the mission and vision. For example, they would tie their discussions in SO#2 back to DHC's mission and vision by stating, each time, that the option would help DHC achieve their stated mission and vision, but never went further to explain how or why that was the case.

SO#2 (Analysis of the Issues)

There were five major issues that candidates were expected to analyze from a strategic perspective. Candidates were expected to provide an in-depth qualitative discussion for each of the major issues while also displaying an acceptable level of numeracy skill in their discussion of the issues. (Note that, compared to some prior Day 1 cases, the calculations required for DHC V1 were more basic, as the main skill being tested in this Day 1 case was the ability to critique the calculations provided. Note that AO6 did not have a quantitative element as it was an underlying issue that candidates should have seen on step back.)

Major Issue #1 (AO2): Purchase Holiday Tours, either 100% or 40/60% with KGI?

DHC is faced with a decision to purchase Holiday, a company that sells vacation packages and has provided DHC with a large number of room reservations. DHC is also considering whether to purchase 100% of Holiday or to split the cost 40/60% with KGI. Candidates were provided with some basic financial information pertaining to Holiday (Appendix IV) and were expected to assess whether Holiday should be purchased, either independently (100%) or with KGI (40/60%), or not at all. Candidates could have used the financial information provided to estimate the cost to purchase Holiday. Their qualitative analysis was expected to touch on some of the differences from DHC's core business. Candidates were expected to identify that a 40/60% split with KGI creates a conflict of interest, given that Derek holds an unknown ownership interest in KGI.

Most candidates provided a sufficient analysis of this issue. They assessed both potential ownership structures and acknowledged the potential conflict that existed between Derek and KGI, given Derek's fractional ownership in KGI. Quantitatively, most candidates provided a basic valuation and purchase cost for Holiday and acknowledged that DHC may not have the funds or debt capacity available to make the purchase. Some candidates analyzed the option of purchasing 100% of Holiday without considering the 40/60% split, or vice versa, but still hit on the key discussion points.

Strong candidates discussed how purchasing Holiday would fail to meet the company's objective of focusing on its core hotel business, given that Holiday's business was to sell vacation packages. Strong candidates also had separate discussions for each of the potential options relevant to this decision; whether to purchase 100% of Holiday or to split the purchase 40/60% with KGI or to forgo the purchase altogether and let some other company purchase Holiday. Strong candidates also noted that the potential $40,000 decrease in net revenue, should Holiday reduce the room rate attached to its vacation packages, was immaterial to DHC. Strong candidates also recognized that, even though the purchase of Holiday would violate DHC's objective to focus on the core hotel business, the company also had a core value of embracing new ideas and change. As many companies in the industry had already begun to offer all-inclusive vacation packages, it may have been wise for DHC to follow suit and expand its offerings (link to S1). In addition, they integrated their identification of a potential conflict into their analysis. They questioned the validity of the information provided in Appendix IV, given that the information came from Patrick, whom they identified as having a potential conflict or hidden interest in making the purchase. Some strong candidates went further and tried to protect DHC from the potential conflict of interest by suggesting that, if DHC decided to purchase Holiday with KGI, the ownership split should be 50/50%, to ensure that DHC does not lose the ability to control Holiday's direction.

Weak candidates often failed to organize their response in an effective way; the discussion of whether to purchase 100% or a part ownership with KGI was often blended together under the same heading, making it difficult to distinguish the pros and cons that related to each. Others only discussed one aspect of the option, whether 100%, 40/60%, or to forgo the purchase altogether. Weak candidates also failed to acknowledge the high upfront cost of Holiday and the fact that DHC may struggle to finance the purchase. Quantitatively, weak candidates periodically tried to recalculate Holiday's income figures or simply failed to provide an estimated cost calculation of Holiday.

Major Issue #2 (AO3): Convert Northern Ontario hotel to a Global franchise?

In the simulation, DHC's Northern Ontario hotel has continued to struggle relative to the company's other locations and the Board of Directors is considering whether to convert the hotel into a FitzGeralds brand through a franchise agreement with Global Stay N Play Corp (Global). Candidates were provided with the proposed franchise agreement from Global (Appendix V) and were expected to analyze this strategic option from both a qualitative and quantitative perspective. Qualitatively, candidates were to recognize that, while converting to a franchise would limit the board's ability to freely govern the Northern Ontario hotel, that sacrifice might be worth it because DHC would gain access through this agreement to the FitzGeralds brand as well as to Global's processes (especially marketing and hiring of managers). Quantitively, candidates were expected to calculate the rate of return that DHC could expect to make on the investment. Candidates were also expected to comment on the proposed terms of the franchise agreement and to offer potential revisions that would make the agreement fairer and less restrictive for DHC.

Most candidates did a good job on this AO, recognizing that converting to a franchise would change DHC's business model at the Northern Ontario location. Most candidates also displayed the adequate level of numeracy skill by illustrating how the franchise option appears to increase the hotel's performance relative to the status quo.

Strong candidates emphasized how the hotel's operations would change, given the terms of the franchise agreement. Strong discussions acknowledged both the potentially advantageous (such as access to improved processes) and adverse (such as the loss of autonomy) aspects of the conversion. Strong candidates also highlighted the strategic importance of the interest-free loan that Global was offering, especially given DHC's apparent liquidity issues. Strong candidates identified that this option represented a way to potentially improve a historically struggling hotel with little upfront cost. Finally, strong candidates also provided a discussion of how Global's franchise proposal should be renegotiated to make it more favourable/flexible for DHC, such as ensuring that advanced notice was provided by Global for any future property inspections.

Weak candidates often recognized that converting the hotel to a franchise would be a departure from DHC's normal course of business but then failed to explain the implications of that change in structure. Weak candidates also attempted to provide overly complicated calculations, such as attempting to recalculate the net revenue that could be expected from the hotel after conversion, even though that number was provided in the case.

Major Issue #3 (AO4): Cooking retreats with Chef Norman?

DHC was presented with a further opportunity that may have helped the Northern Ontario hotel improve its performance—whether to offer cooking retreats with Chef Norman. In Appendix VI, candidates were provided with a forecast prepared by DHC's accounting department, with information provided by Chef Norman. Candidates were to assess both qualitatively and quantitatively whether this option would help DHC achieve its objectives. Qualitatively, candidates were to recognize that much of the success of the cooking retreats depended on Chef Norman and that this increased the risk of the venture. Quantitatively, candidates were expected to critique the information that Chef Norman provided to accounting in order to produce the forecast in Appendix VI. Candidates were also expected to provide some kind of profitability analysis, for example, a payback period analysis or breakeven analysis.

Many candidates struggled to provide a balanced qualitative assessment of this option, frequently offering many more pros than cons. The pros were more obvious, but it was also important to consider how DHC had no experience in this area and that cooking retreats fell well outside of DHC's core hotel operations, which many candidates failed to do. Many candidates also failed to discuss the $1 million upfront cost of the renovations and how that cash requirement was a major drawback to the option, given DHC's apparent lack of financing. Quantitatively, most candidates recognized that the increase in operating income that would be provided through this option, and that the projected performance of the cooking retreats, would satisfy the board's return requirement of 12%.

Strong candidates realized that this option presented a significant amount of risk because much of the success of the project depended upon Chef Norman. Strong candidates also acknowledged that this venture fell outside the normal scope of DHC's hotel business, and that, should DHC decide to convert the hotel to a FitzGeralds, Global might not allow this type of offering, demonstrating good integration of the various elements of the simulation. Although most candidates provided some type of profitability analysis, strong candidates went a step further and questioned the assumptions that were used to build the forecast.

Weak candidates did not question the assumptions of the forecast in Appendix VI and frequently used the seven-month forecast to determine the project's profitability instead of using the 12-month figures. Using the annualized figure provided a more accurate assessment of the return that DHC could expect from the project and provided a better comparison to the other investment options that DHC had available.

Major Issue #4 (AO5): HHH's proposed conference centre – revised management contract?

As an extension of the management contract proposal with Huron Heights Hotel (HHH) from Capstone 1, DHC is deliberating whether to manage the new conference centre that Martha and HHH propose building. In Appendix VII, candidates were provided with information concerning the proposal as well as a performance forecast prepared by Martha. Candidates were to assess how DHC should approach the situation with HHH, from both a qualitative and quantitative perspective. Candidates were expected to scrutinize and comment on any potential deficiencies or inaccuracies that may exist within the information made available for analysis. For example, candidates could have linked the information in Appendix VII back to Capstone 1 to see how

Martha's original forecast was overly optimistic and then commented on how the present proposal also appeared to be overly optimistic.

Many candidates struggled with this AO. They failed to apply skepticism and critique the projections that were provided by Martha. Instead, most took the information at face value. This led some candidates to conclude that the venture appeared to be profitable; these candidates did not recognize or comment on the potential issues in the projection provided. In addition, many candidates focused solely on Martha's apparent lack of cooperation when assessing the viability of this option without addressing the business considerations of revising the management contract to include a conference centre.

Strong candidates addressed Martha's lack of cooperation alongside an analysis of whether managing a conference centre made good business sense for DHC, integrating the projected low growth rates of business travellers relative to leisure travellers into their analysis (link to S1). Strong candidates questioned specific aspects of Martha's projection, such as the variance between Martha's projection that gross conference revenue would approximate 30% of gross room revenue and the industry data that suggested this figure would be closer to 10%. Also, with the caveat that the forecast may be flawed, strong candidates provided a reasonable comparison of the existing management contract to the revised version of the contract that had been proposed.

Weak candidates tended to repeat case facts without providing the implications of those case facts to the decision at hand. For example, some weak candidates mentioned that Martha had not yet renovated HHH as was originally agreed upon without providing a relevant implication, such as that Martha may continue with that sort of uncooperative behavior in the future. Weak candidates also tended to focus solely on Martha and her apparent lack of cooperation and neglected to discuss the business considerations relevant to the decision.

Major Issue #5 (AO6): Governance – Conflict of Interest with Patrick/Derek and KGI?

Although not explicitly stated, there are hints in the board dialogue that Patrick and Derek may have entered into an agreement subsequent to Capstone that creates a potential conflict of interest between them and DHC. In the simulation, Derek and Patrick seem very elusive in their explanations for their investment recommendations, and Kelvin asks directly about a possible conflict when he asks whether Derek owns a percentage of KGI, a company owned by Patrick. Again, Derek evades answering Kelvin. Candidates were expected to pick up on these hints and assimilate them to identify what the potential underlying issue could be, and provide a reasonable course of action that DHC may take.

Most candidates recognized the issue and provided some form of guidance on what action could be taken by DHC to address the concern. Many candidates suggested that Derek should be made to disclose the details of his ownership interest in KGI and that Patrick and Derek should spend the time necessary to explain to the rest of the board why they wanted to invest as they did.

Some weaker candidates provided the bulk of this discussion in conjunction with AO2 (whether to purchase Holiday in part with KGI). These candidates often failed to recognize the entity-level issues that this potential conflict may have created. Some weak candidates also often failed to identify the underlying potential conflict of interest and instead simply discussed how DHC's board appeared to be having communication issues. These candidates suggested that the board slow down with their meetings and communicate their ideas more clearly; while these were relevant suggestions, many of these candidates missed seeing the larger issue, that being the potential conflict of interest.

Overall

Most candidates did a good job of analyzing the major issues that were presented in the simulation. Within this summative assessment opportunity, there were three main differentiating factors that separated strong candidates from weak candidates. First, strong candidates tended to recognize the more important decision factors of each assessment opportunity and then provide a quality discussion about how that factor would affect the decision. Important decision factors included: the possible conflict between Derek and KGI in conjunction with AO2, the potential change in business structure in AO3, the key role Chef Norman in AO4, and Martha's lack of cooperation in AO5. Second, strong candidates provided the implications of the case fact, not just the case fact itself, within their analysis. Weak candidates tended to simply list case facts without providing the "so what?" Third, strong candidates provided clear and straightforward calculations, whereas weak candidates tended to make the calculations far more complicated than they needed to be and often got lost in them. Many weak candidates struggled to provide an adequate amount of depth within the qualitative discussions; in many cases, this appeared to be due to the candidate spending too much time trying to provide complicated calculations.

SO#3 (Conclude and Advise)

Candidates were expected to conclude on each issue analyzed. These conclusions and recommendations were expected to be consistent with the analysis performed. Candidates were also required to make an overall, integrated conclusion that would address the company's apparent financial constraint.

Almost all candidates provided an issue-by-issue conclusion. In addition, most realized that DHC had limited funds to invest and acknowledged that limitation while making their recommendations. Weak candidates often failed to recognize this limitation.

SO#4 (Communication)

Most candidates approached their response in a coherent and organized fashion. Only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax and an unorganized response approach.

Some candidates also tended to organize their response in a cumbersome fashion, which made communicating in a clear and effective way more difficult. For instance, some candidates used tables and decision matrices within their qualitative responses, which often made their response a challenge to understand.

SO#5 (Overall Assessment)

Overall, in order to obtain a "Pass" on the Day 1 linked case, candidates were expected to meet the minimum acceptable standards in each of the four summative opportunities listed in this report. Candidates also had to demonstrate a minimum level of numeracy skill. For each major issue, the board expected an in-depth analysis before candidates proceeded to a reasonable conclusion. Candidates were also expected to recognize the apparent financial constraint and to provide a recommendation that did not ignore the apparent lack of investment dollars available. The BOE also sought evidence of candidates having incorporated information from Capstone 1, and the major considerations that were identified, in their situational analysis.

BOARD OF EXAMINERS' COMMENTS ON DAY 1 (continued)

Paper/Simulation: Day 1 – Linked Case, DHC Version 2 (on May 2021 CFE)

Estimated time to complete: 240 minutes

Simulation difficulty: Average

Competency Map coverage: N/A; Enabling Skills

Examiners' comments by Summative Assessment Opportunity (SO)

SO#1 (Situational Analysis)

Candidates were expected to highlight the factors, both internal and external to DHC, that would influence the strategic decisions presented in the simulation. There were two prominent issues relative to DHC's internal environment that should have been identified: issues surfacing related to DHC's new advisory board and DHC's governance; and DHC having limited cash resources when considering the substantial preferred share redemption that is to occur. Externally, DHC has an opportunity to take advantage of the growth expected within the business traveller market whereas, within the leisure traveller market, DHC must contend with increasing competition due to factors such as the growing popularity of VRBOs. Any significant changes since Capstone 1, such as the addition of a new shareholder/director, Kelvin and Alyson's son, could have also been noted as factors that were relevant to the advisory board discussion. In the simulation, DHC intends to take the company public in 2025, and sets the objective of improving both the occupancy rate and operating margin metrics while maintaining the company's current ADR. The advisory board provides several suggestions with respect to going public. The objectives set by both DHC's directors and the advisory board should have been used as a point of reference and discussed throughout the candidate's response in SO#2 and SO#3. Candidates were rewarded when they made relevant links between their situational analysis and their analysis in SO#2 and recommendations in SO#3.

Strong candidates tended to identify the governance and cash constraint issues in their situational analysis. For instance, strong candidates typically identified DHC's limited cash resources by linking the upcoming preferred share redemption and the company's comparatively low current ratio. Strong candidates also discussed how DHC may have access to more financing, given its comparatively low debt-to-equity ratio relative to the industry. In their SO#2 response, strong candidates typically linked their discussions back to these issues, and explained how they would affect the strategic options that the company was considering.

In their situational analysis, weak candidates tended to simply list information related to key success factors, mission, and vision, taken from either Capstone 1 or this simulation, without identifying or discussing which of those items would have the most influence on their decision-making process. Weak candidates also tended to restate case facts, such as comparing DHC's performance metrics to the industry metrics provided, without providing the implications of the comparisons or discussing how those factors would affect their issue analysis. Often, weak candidates tended to link their SO#2 analysis back to the situational analysis in a more superficial way. For example, weak candidates regularly linked their AWH discussion to the key success factor of keeping up with technology changes. Although this link is not incorrect, it is less relevant than other links, such as the AWH proposal's emphasis on attracting business travellers and the advisory board's objective of increasing the proportion of business travellers who stay at DHC's hotels.

SO#2 (Analysis of the Issues)

There were four strategic alternatives that candidates were expected to analyze both qualitatively and quantitatively. Candidates were also expected to identify and discuss the governance issues that had arisen around DHC's new advisory board.

AO#2: Lease building in Old Montreal district?

Candidates were expected to evaluate whether DHC should lease and then renovate a property in Old Montreal. Qualitatively, candidates were expected to recognize that this project had a significant amount of risk associated with it, given that the building could be sold at any time to another owner. Quantitatively, candidates were to evaluate and comment on whether this option met the board's objectives of improving the occupancy rate and operating margin metrics while also helping to maintain the company's ADR.

Strong candidates identified the link between the low expected growth in the leisure traveller market and how that expected trend would affect the outcome of this investment, given that this hotel would target leisure travellers. Strong candidates also highlighted this option's advantage of being located in a large metropolitan area, and how that advantage was a trade-off with the low number of rooms that the hotel would have after it was converted. Strong candidates tended to understand and explain the difference between the risk factors associated with the leased model of hotel operations when compared to the managed model (which was a direct ask of the simulation).

Weak candidates tended to restate the case facts with a link to the more obvious elements of their situational analysis (such as the fact that the building has a unique fa ade, meeting the mission, vision, and core values). Relative to different risk factors associated with the managed model versus the leased model, weak candidates tended to misinterpret this statement, and compared the specifics of the Old Montreal proposal with DHC's management contract with HHH instead of commenting on the different inherent risks associated with these types of arrangements.

Quantitatively, strong candidates questioned the assumptions for the data provided ("is the projected ADR realistic?") whereas weak candidates tended to take the data at face value. Most candidates provided a relatively useful quantitative analysis and went on to discuss its relevance within their analysis, for example, discussing how the project's forecast compared with DHC's stated objectives. Weak candidates sometimes spent too much time providing overly complicated calculations that were off topic (e.g., overly complicated and incomplete IRR/NPV calculations).

AO#3: Renovate AWH hotel?

Candidates were expected to evaluate whether DHC should renovate the AWH location, whose performance metrics were suffering, in order to appeal more to business travellers. Quantitatively, candidates were to recalculate the forecast provided and question whether the inputs to the forecast were reasonable ("Will the ADR fall because of the emphasis placed on attracting business travellers?"). Qualitatively, candidates were to recognize that this option aligned with the advisory board's objective of increasing the number of business travellers that stayed at DHC's hotels, identifying that this was a demographic that had a high projected future growth. Candidates were also meant to recognize the potential conflict of interest that existed between DHC and one of the advisory board members who had offered to complete the renovation.

Strong candidates made the link between the advisory board's suggestion of increasing the proportion of business travellers relative to leisure travellers and the stated intent of this renovation. Strong candidates recognized the trade-off between increasing the number of business travellers (an improved occupancy rate) with the lower ADR that would likely result (given that business travellers may only be willing to pay an average of $250/night for a room). Strong candidates also recognized the potential conflict of interest of hiring a company owned by Sean LeBois (an advisory board member) to complete the renovation, and recommended against this choice.

Weak candidates did not link their analysis of this issue to the advisory board's suggestion of increasing the number of business travellers in order to help the company achieve a successful IPO. Instead, weak candidates once again linked their analysis to the more superficial aspects of the situational analysis (such as explaining how this option would help the company achieve the key success factor of keeping the hotel in good condition).

Quantitatively, most candidates calculated either the expected operating margin of the hotel after the renovation, or the NPV/IRR of the investment. However, the candidates who calculated an NPV/IRR often failed to tie their calculation to a meaningful metric (such as the industry's return on equity). Strong candidates provided calculations and discussions that were directly tied to the company's stated objectives, concluding that the post-renovation operating margin of the hotel was likely lower than Jessica's forecast, whereas weak candidates struggled to provide a revised forecast, failing to scrutinize the data provided.

AO#4: Renovate or sell Northern Ontario hotel?

Candidates were asked to assess whether DHC should either renovate, to appeal more to families, or sell the Northern Ontario hotel. Qualitatively, candidates were expected to link to Capstone 1 and draw on the fact that, despite all of DHC's effort and the money spent to improve the performance of this location, nothing has worked. Quantitatively, candidates were expected to recognize that the sale of this location could help alleviate DHC's apparent cash constraint. Candidates were also expected to analyze whether the renovation would help improve the performance metrics of the hotel, such as the hotel's operating margin.

Strong candidates discussed how DHC risked losing even more time and money on this hotel if the company decided to renovate. Strong candidates recognized that this hotel had been historically unsuccessful and that, with the proceeds of the sale, DHC could redeploy that capital into other, more promising, projects. Strong candidates also recognized that selling the hotel would alleviate the cash constraint.
Weak candidates tended to blend their analysis of whether to renovate or sell this property within one discussion rather than provide a separate analysis of each issue, which usually meant that the analysis was harder to follow and less complete. Rather than questioning Jennifer's comment in the board narrative ("selling might negatively impact DHC's IPO plans"), weak candidates also sometimes took that as the reason to renovate the property rather than sell it.

Quantitatively, most candidates provided a relevant calculation pertaining to the forecast effect of the renovation, and went on to discuss how that outcome compared to the company's stated objectives. Strong candidates went further and questioned the assumptions of the data provided (e.g., questioning whether the projected ADR/Occ rate was too optimistic), concluding that, even post-renovation, the hotel's metrics were unlikely to meet DHC's stated objectives. Weak candidates instead tended to take the data provided at face value.

AO#5: Invest in /develop Luxury Stays website?

Candidates were expected to analyze whether DHC should diversify its operations by developing a new website similar to AirBNB or VRBO. Qualitatively, candidates were to recognize that this project aligned with the advisory board's suggestions, but that this option also posed a risk to the company's reputation. Quantitatively, candidates were expected to calculate the projected operating margin for the project and compare it to DHC's stated objectives.

Strong candidates tied their analysis to the advisory's board suggestion of diversifying the company's revenues stream, while also recognizing the disadvantage of the project not becoming profitable until 2025, the year the company planned to go public. They often stated that there was a risk that this investment could hinder DHC's ability to attract investors. Strong candidates also questioned the potential logistical challenges of the proposal. For example, given the number of listings required across five major cities, strong candidates questioned whether DHC would be able to effectively coordinate the extra services promoted by the company in a cost-effective way. Strong candidates also recognized that this option posed a reputational risk to DHC, given that the accommodations listed on Luxury would likely not be inspected by DHC, and therefore, DHC would be unable to confirm the quality of the accommodation prior to guests staying there.

Weak candidates tended to take the case facts at face value. For example, a board member mentioned that guests of Luxury would not be typical guests of DHC and therefore, Luxury would not cannibalize any of DHC's current guests. However, this conclusion was far from certain and should have been questioned by candidates. Weak candidates also failed to recognize that this option required a large upfront investment and would likely not become profitable for at least two years.

Quantitatively, strong candidates provided a basic calculation that compared the project's forecast operating margin to the board's objectives. Weak candidates sometimes provided a four-year NPV or IRR, which had limited value as it did not reflect the higher income earned after the fourth year in the valuation, and failed to consider that the life of the projection would almost certainly exceed four years if DHC chose to invest in development of the website. Other weak candidates derived hugely inflated projections, given that they attributed 100% of the operations to DHC rather than the commission percentage that was provided in the case.

AO#6: Governance issues

Candidates were expected to address the issues that had arisen between DHC and its new advisory board. Candidates could have discussed several issues relative to the new advisory board, such as the potential conflict of interest that was apparent in the Northern Ontario and AWH proposals, the composition of the advisory board, and whether Derek was using the proper channel to communicate with members of the advisory board.

Although this AO was undirected, a majority of candidates recognized that at least some kind of issue was present, based on the board dialogue, but a surprising number of candidates failed to provide a separate and complete discussion related to these issues.

Strong candidates provided a separate discussion that addressed many of the issues described above, and attempted to provide steps to help address the immediate conflicts while also reducing the chance of similar issues arising in the future. For example, they recommended against using the professional services of any board member in order to maintain the independence of the advisory board. Strong candidates discussed the composition of the advisory board, for example, pointing out that all the advisory board members are personal friends of DHC's board, and how that might affect their independence.

Weak candidates seldom provided a separate governance discussion, and instead treated the governance-related points as single pros or cons in their analysis of the strategic issues discussed in SO#2; therefore, they often did not discuss how the governance structure was being affected by the new advisory board. If they addressed the broader governance of DHC, they tended to focus on the "communication issues" that were apparent in the board narrative rather than identifying and discussing the more important issues that were presented in the case, such as whether the composition of the advisory board was appropriate. Weak candidates often discussed only one of the governance issues, and commonly failed to go the next step by providing a useful recommendation on how it might be resolved.

Overall

The focus of the case was on the candidate's ability to integrate both of DHC's board's objectives within their qualitative and quantitative analysis of each AO while also considering how the apparent governance and cash constraint issues might affect the decision-making process. For each AO, most candidates did a good job of providing a balanced qualitative discussion of both the advantages and disadvantages of each option, which included sufficient links back to the company's situational analysis (SO#1). One of the main differentiating factors between strong and weak candidates was the ability to identify and discuss in depth the most relevant aspects of each decision. Rather than discuss the more pertinent implications associated with the case facts, weak candidates instead tended to provide superficial links back to SO#1, for example, stating that it links to a key success factor without elaborating. Strong candidates, on the other hand, scrutinized and considered the importance of each case fact, and focused their discussion on the most relevant considerations. Most candidates attempted to analyze each strategic option from a quantitative perspective; however, weak candidates struggled to identify and use a relevant quantitative tool, and often opted to apply the same analysis to all options, that being an NPV or IRR, even though that was not always appropriate.

Strong candidates routinely incorporated a discussion of DHC's and the advisory board's objectives within their SO#2 analysis, and identified and discussed how the important entity-level issues and constraints could affect the outcome of each strategic objective. Strong candidates also demonstrated strong numeracy skills by being able to choose the quantitative analysis that was most suited to the information being analyzed in the context of the stated objectives (e.g., an operating margin comparison), while also clearly interpreting how the results of their calculations would affect their recommendations, given the objectives of the company.

Weak candidates often missed integrating and discussing how the stated objectives in the simulation had influenced their decision-making process. Weak candidates also struggled to integrate the entity-level governance and cash constraint issues into their analysis in SO#2.

SO#3 (Conclude and Advise)

For each of the strategic options available to DHC, candidates were expected to provide a conclusion or recommendation that was consistent with their analysis. Candidates were also expected to at least identify DHC's apparent financial constraint in conjunction with their analysis of the AOs in SO#2. Candidates were also expected to provide an overall conclusion that incorporated the company's objectives (such as going public in 2025 or the related metrics) into their discussion. Only strong candidates consistently discussed DHC's cash constraint throughout their analysis in SO#2, and incorporated it into their conclusions. Strong candidates also typically tied their recommendations to the company's longer-term objective of going public. Weak candidates often failed to conclude on how their recommendations would affect the company's cash constraint, and often failed to discuss how their analysis or recommendations would affect the company's objectives. As mentioned above, instead of providing a separate discussion or conclusion of these issues, weak candidates tended to discuss these issues as part of their SO#2 analysis.

SO#4 (Communication)
Most candidates approached their response in a coherent and organized fashion. Only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax, and an unorganized response approach.

SO#5 (Overall Assessment)

Overall, candidates were expected to meet the minimum acceptable standards in each of the four summative opportunities listed in this report in order to obtain a "Pass" on the Day 1 linked case. Candidates also had to demonstrate a minimum level of numeracy skill. For each major issue, an in-depth analysis was expected before candidates proceeded to a reasonable conclusion that was consistent with the analysis performed. Candidates were also expected to provide a reasonable amount of discussion over a combination of both the governance issues and the cash constraint. The board also sought evidence that candidates incorporated the important elements of Capstone 1, as well as the main elements of this simulation's situational analysis, into their analysis of the major issues.

BOARD OF EXAMINERS' COMMENTS ON DAY 1 (continued)

Paper/Simulation: Day 1 – Linked Case, DHC Version 3 (on Sept 2021 CFE)

Estimated time to complete: 240 minutes

Simulation difficulty: Average

Competency Map coverage: N/A; Enabling Skills

Examiners' comments by Summative Assessment Opportunity (SO)

SO#1 (Situational Analysis)

Candidates were expected to highlight the factors, both internal and external to DHC, that would influence the strategic decisions presented in the simulation. Candidates were informed that DHC decided against taking the company public, and that it internally set the objective of improving the company's overall ADR and occupancy rate. DHC's shareholders also stated that they will give preference to investments that will help DHC increase its brand visibility and brand loyalty. DHC also identified a new key success factor: offering guests discounted activities that are affiliated with DHC's hotels. DHC also noted having a defined amount of cash available for investments ($18 million). Externally, DHC must contend with the bad publicity that has been generated by Doug Mallette and the trend of increased growth in the leisure travel market versus a decline in business travellers. Significant changes since Capstone 1, such as the increased popularity of vacation packages, were also relevant to setting DHC's overall strategic direction. The objectives set by DHC's Board of Directors should have been used as a point of reference throughout the response. Candidates were rewarded when they made relevant links between their situational analysis and their analysis in SO#2 and recommendations in SO#3.

The majority of candidates provided a sufficient discussion of DHC's situation at the beginning of their response. Most candidates provided an updated SWOT analysis that highlighted the changes in the company's situation that had occurred since Capstone 1, and identified the board's main objectives, to be considered in relation to the strategic options presented in the simulation. Most candidates also provided a reasonable discussion of DHC's financial performance in relation to the rest of the industry, which highlighted the company's occupancy rate as the one metric that continued to lag behind.

Strong candidates more often identified the importance of the reputational issue that DHC is facing as a result of Doug Mallette's actions, and discussed the increased significance of this issue, given the importance that social media and viral news stories have on the public's perception of a company. Strong candidates also highlighted DHC's available cash resources within their situational analysis and brought it into their analysis of the investment options, exploring ways that DHC could use the cash most effectively. For example, strong candidates typically compared the cash resources necessary to renovate the Cape Breton hotel versus the renovation of the Tofino Castle. Within their analysis of each strategic option, strong candidates also discussed how the company's overall occupancy rate and ADR would be impacted, and commented on how each option would affect the company's brand loyalty and visibility.

Strong candidates also considered how each investment option would likely affect DHC's reputation, in light of their understanding of the Doug Mallette issue. Strong candidates linked their analysis back to the company's existing mission and vision when discussing each investment option, but also went on to suggest that DHC consider altering its mission/vision, due to the new opportunities available.

Weak candidates tended to simply list information related to key success factors, mission, and vision, taken from either Capstone 1 or the simulation, without identifying or discussing which of those items would have the most influence on their decision-making process. Weak candidates often presented a comparison of DHC's performance metrics to the industry metrics provided, without discussing either the implications of the differences, or how those differences would affect their issue analysis or overall recommendations. Weak candidates also linked their analysis of the issues back to their situational analysis in a more superficial way, often taking the case facts at face value rather than questioning the validity of what was presented. For example, weak candidates regularly linked their Tofino Castle discussion to the company's objectives of increasing its ADR without first questioning whether Derek's projections were realistic. Others concluded that the Peak Revie and HHH investments were poor choices, solely on the basis that they did not align with the historical element of DHC's brand, based on DHC's mission and vision. Although this link was not incorrect, there were other significant factors for each of those investment options that should have played a role in a candidate's analysis.

SO#2 (Analysis of the Issues)

Candidates were expected to analyze five strategic alternatives, both qualitatively and quantitatively. Candidates were also expected to identify and discuss the reputation issue that had arisen as a consequence of Doug Mallette's actions.

AO#2: Purchase equity interest in Peak Revie?

Candidates were expected to evaluate whether DHC should purchase 35% of the outstanding common shares of Peak Revie. Qualitatively, candidates were expected to recognize that, by using the vans owned by Peak Revie, this project would allow DHC to offer guests a variety of vacation packages that could include multiple hotels and activities. Quantitatively, candidates were expected to evaluate and comment on whether this option met the board's objectives of improving the company's ADR and occupancy rate, while also considering the rate of return that DHC could expect from this potential investment in comparison to the other options.

Most candidates identified and discussed a few qualitative considerations for this strategic investment option. Most discussed both the potential performance of the project, as well as the conditions of the proposal, such as Miranda's right to sell her shares to other parties, and the requirement that all decisions must have the support of all the hotel's shareholders. Most candidates also identified and discussed the value of Peak Revie's vans in relation to the hotel itself, but failed to make the broader link to the potential for using the vans to create the Western Corridor. Quantitatively, most candidates quantified the revenue and the profit margin that DHC could expect from the project but failed to translate those figures into the expected rate of return of the project.

Qualitatively, strong candidates identified and discussed how Peak Revie's performance metrics might be affected by including the hotel in a Western Corridor vacation package with the other DHC hotels in the surrounding area (specifically, the Canmore and Kelowna hotels). Strong candidates also discussed how rebranding Peak Revie as a DHC location would increase the company's brand visibility, and that DHC's brand loyalty might be improved due to Peak Revie's high guest retention. As a risk for this potential investment, strong candidates discussed how Miranda, as the majority shareholder, would have ultimate control over the hotel even though it would be branded as a DHC hotel. Weak candidates often failed to make the link between Peak Revie (and their vans) and DHC's Western Corridor proposal. Instead, weak candidates tended to focus their analysis on Peak Revie's lack of historical appeal, and on how the hotel's performance metrics were currently below the company's overall ADR and occupancy rate. Although these considerations were relevant, there were opportunities for DHC to improve these metrics through the changes being considered, while at the same time increasing the company's brand visibility.

Quantitatively, strong candidates calculated an expected rate of return if DHC invested in Peak Revie, based on the hotel's projected first-year metrics. They then went on to discuss the relevance of this expected rate of return. For example, strong candidates commented on how the expected rate of return from this investment compared to DHC's return-on-equity objective of 11%, from Capstone 1. Even though DHC's board specifically asked for this, weak candidates often failed to perform an expected rate of return calculation. Instead, they tended to base their quantitative analysis on the expected ADR and occupancy rates that were presented in Appendix IV, without discussing how those metrics may have been affected by other elements of the proposal (such as by linking the hotel to the proposed Western Corridor, or through potentially forming an agreement with the nearby ski hill to offer guests discounts).

AO#3: Purchase HHH hotel?

Candidates were expected to evaluate the opportunity to purchase all of the outstanding shares of HHH. Qualitatively, given that DHC currently lacks a hotel in a major urban core, candidates were expected to identify and discuss how the company could increase its brand visibility by purchasing and rebranding HHH into a DHC hotel. Candidates were also expected to discuss how the HHH hotel deviates from DHC's brand of offering boutique hotels that have an historical element. Quantitatively, candidates were expected to evaluate and comment on whether this option meets the board's objectives of improving the company's ADR and occupancy rate, while also considering the rate of return that DHC could expect from this potential investment in comparison to the other investment options, considering the trends in the industry. Candidates could also discuss how the hotel's current cash flow from operations would be more than enough to cover the debt repayment costs to Martha.

Most candidates identified and discussed some of the qualitative considerations of this strategic investment option. Most candidates discussed either the increased brand visibility that DHC would experience by rebranding HHH as a DHC hotel or the misalignment between the hotel and DHC's established brand. However, most candidates failed to link this project's potential performance to the possibility of including the hotel in DHC's proposed Western Corridor project. Quantitatively, although most candidates estimated the net earnings that DHC could expect from the project, most candidates did not provide a rate of return calculation. In addition, surprisingly few candidates recognized that HHH's current cash flow from operations would be enough to cover the annual debt repayment costs that DHC would need to pay Martha.

Qualitatively, strong candidates recognized the trade-off of increasing the company's brand visibility with a hotel that did not fit well with DHC's established brand. Strong candidates also recognized the opportunity to increase the performance of the hotel by including it in the proposed Western Corridor chain of hotels. Strong candidates also discussed the risk associated with the hotel's current dependence on business travellers, and recognized the opportunity to increase the number of leisure travellers with the abundance of activities within the surrounding area. They understood that it was an opportunity that DHC could capitalize on if Peak Revie was purchased and access to the fleet of vans was obtained. Weak candidates often analyzed this investment proposal in isolation from the rest of DHC's operations, and therefore did not discuss how the hotel's performance could benefit from being rebranded as a DHC hotel. Weak candidates tended to focus their analysis on the fact that HHH was not aligned with DHC's current mission and vision, and the trend of a decreasing number of business travellers. Once again, these links were relevant, but weak candidates often failed to go beyond these two points, or discuss the trade-offs associated with this alternative, such as how this opportunity might be DHC's best chance of acquiring a hotel in an urban core.

Quantitatively, strong candidates provided a rate of return calculation that included all the relevant components, and went on to discuss how that rate of return compared to the other investment alternatives. Weak candidates tended to provide overly complicated and irrelevant calculations, such as providing an NPV, even though the simulation did not provide enough information to effectively calculate one.

AO#4: Purchase and renovate the castle in Tofino?

Candidates were asked to assess whether DHC would be better off selling the Cape Breton hotel in order to purchase and renovate the castle in Tofino, or whether DHC should forgo the Tofino option in order to renovate the Cape Breton hotel (AO#5). Candidates were asked to provide a complete analysis of both options. Relative to the Tofino option, candidates were expected to recognize the substantial risk, both quantitatively and qualitatively, that DHC would assume if the company chose to purchase and renovate the castle. Candidates were expected to recognize the significant reputational risk associated with the castle's renovation because of a rapidly growing petition on social media, which claimed that converting the property to a for-profit business would be against the public interest. Candidates should have also recognized and discussed the significant amount of uncertainty surrounding the quantitative projections and performance of the castle.

Most candidates recognized the risk associated with this project, given the social media petition and the threat of further action from the petitioners. However, most candidates failed to make the link between this risk and the increased importance of a company's online reputation, as well as DHC's already harmed reputation in Ontario and Quebec; therefore, most candidates missed the magnified significance of this risk factor. Quantitatively, most candidates provided a revised net earnings calculation for this project, but failed to adequately discuss the outcome of their calculation in sufficient depth (such as by highlighting the uncertainty of their calculations, given the questionable inputs of the projection).

Qualitatively, strong candidates did a good job of identifying and discussing the risks associated with this proposal. They routinely made the link between DHC's already harmed reputation in Ontario and Quebec, and the potential for increased harm if the company renovates the castle against the wishes of Tofino's local community. Strong candidates also recognized the uniqueness of the castle and how this prospective hotel would fit in nicely with Derek's Western Corridor proposal. However, they recognized the significant amount of risk and uncertainty associated with the project, and therefore recommended not proceeding with this option. Weak candidates typically based their analysis on the apparent strengths of this proposal (for example, stating that, because celebrities and British royals stayed at the castle in the past, this would make the project successful) without addressing the significant inherent risks of the proposal. Weak candidates also tended to highlight the castle's alignment with DHC's mission and vision as the reason to sell Cape Breton in order to pursue the Tofino option. As the Cape Breton hotel also met the company's mission and vision statements, this point was less valuable.

Quantitatively, strong candidates revised the net earnings projection that Derek provided for the project, recognizing that it was optimistic. Strong candidates also provided a discussion that detailed the uncertainty of the project's quantitative performance and initial renovation costs. Weak candidates often used Derek's unadjusted projections in their quantitative analysis, failing to identify the apparent optimism of Derek's projections. Weak candidates also tended to recommend proceeding with the castle's renovation without commenting on how DHC currently lacked the cash resources to do so.

AO#5: Renovate the Cape Breton hotel?

Candidates were expected to analyze whether the renovation of the Cape Breton hotel was a better investment than the castle in Tofino (AO#4). Qualitatively, candidates were expected to recognize that there was little uncertainty associated with Cape Breton's renovations, as DHC had a long history with the hotel and the contract to renovate it had already been negotiated and agreed upon. Quantitatively, candidates were expected to provide an estimated net earnings projection for Cape Breton after the renovations had taken place. This result could have then been compared to the Tofino option, whose performance was not as strong.

Most candidates recognized that DHC's familiarity with the Cape Breton hotel would decrease the risk associated with the renovation (especially when compared to the Tofino option, which was new to DHC, and whose outcome was far more uncertain when compared to the Cape Breton renovation). However, surprisingly few candidates identified and discussed the superior projected financial performance of the Cape Breton hotel, compared to the projected performance of the castle in Tofino.

Qualitatively, strong candidates recognized that the Cape Breton hotel was valuable to DHC and that the renovation would likely improve the hotel's performance metrics. Strong candidates linked DHC's objective to increase brand visibility with their discussion about how a potential sale of the hotel would mean that DHC no longer has a presence in Eastern Canada. Strong candidates also discussed that, although it may take a few years, the renovation would likely improve the company's overall ADR and occupancy rate. Strong candidates recognized that the performance of the Cape Breton hotel could also increase if a formal agreement was made with Patrick's Nova Scotia golf course. Weak candidates often focused their analysis on the fact that the hotel was currently underperforming, and on the negative publicity generated by Doug Mallette. Based on these factors, they recommended selling the Cape Breton hotel in order to purchase the castle in Tofino. These candidates failed to recognize that the performance of the hotel was expected to significantly improve after the renovation, and that DHC had a readily available solution to the bad press caused by Doug: hiring the PR firm, Camden and Co., to represent DHC in Eastern Canada. Weak candidates also tended to combine their analysis of whether to renovate the Cape Breton hotel with their analysis of whether to purchase the castle in Tofino rather than first analyzing each on a stand-alone basis before comparing them.

Quantitatively, strong candidates provided a basic post-renovation net earnings projection, using the information provided by Kelvin in Appendix VIII. Strong candidates compared the result of that calculation to their revised projection for the Tofino castle, to conclude that the Cape Breton hotel was projected to be the better performing asset. Weak candidates provided a quantitative analysis that used the Cape Breton hotel's pre-renovation earnings statement.

AO#6: Build the Western Corridor and leave Eastern Canada?

Candidates were directed to comment on DHC's overall strategic direction. Relative to that specific request, candidates were expected to discuss Derek's proposal that DHC divest itself completely from Eastern Canada in order to escape the negative public perception stemming from Doug Mallette's actions. Candidates were also expected to evaluate Derek's proposal for the Western Corridor, and how each of the strategic alternatives in the simulation aligned with the potential for building a linked group of luxury hotels.

Although most candidates discussed both the reputation/Doug Mallette issue in Eastern Canada and the Western Corridor proposal, these discussions often lacked depth. Relative to the Eastern Canada issue, most candidates recommended that DHC hire the public relations firm to combat the negative press, but failed to conclude on whether DHC should leave Eastern Canada in order to focus solely on Western Canada. Relative to the Western Corridor, most candidates did not provide a separate analysis of the proposal, and instead only discussed this strategic proposal within their analysis of the other alternatives available to DHC. These candidates often failed to conclude on whether DHC should proceed with the plan to link their Western Canadian hotels together to create vacation packages.

Strong candidates provided a separate assessment of the Western Corridor's potential for improving the performance of the company's hotels in Western Canada. Strong candidates also discussed different ways to approach the Doug Mallette issue, and recommended a viable course of action. For example, strong candidates recognized that the company had a readily available and viable solution for reversing the damage caused by Doug: hiring the public relations firm, Camden and Co., to represent DHC. Strong candidates recognized that the cost of this engagement ($120,000) was reasonable, given the importance of maintaining a favourable online presence and the risk of viral news stories causing further harm to DHC's reputation. Strong candidates went on to conclude that leaving Eastern Canada due to the Doug Mallette issue was not necessary.

Weak candidates seldom provided a separate discussion of the Western Corridor, or ignored this proposal altogether. When this proposal was discussed by weaker candidates, it was usually only included as a single pro or con in their analysis of the other strategic alternatives. Weak candidates often failed to comment on whether DHC should abandon Eastern Canada in order to focus solely on Western Canada, and therefore missed an opportunity to discuss DHC's overall strategic direction. Instead, weak candidates tended to focus their discussion of this issue on whether DHC should seek legal action against Doug. In addition, when weak candidates attempted a separate discussion of the Western Corridor, they tended to focus on the wrong issue. For example, these candidates sometimes highlighted a potential communication issue between Derek and the rest of the board, or diagnosed some other governance issue/conflict that was not actually present in the simulation.

Overall

The focus of SO#2 was on the candidate's ability to integrate elements of the company's global situation (such as DHC's board's objectives and the reputation issue in Eastern Canada) within their qualitative and quantitative analysis of each AO, and to consider how each strategic alternative would affect the company's overall strategic direction.

Most candidates addressed each of the strategic alternatives available to DHC; however, many candidates failed to provide an in-depth discussion of the Cape Breton renovation and the Western Corridor proposal. The lack of depth on the Cape Breton renovation proposal was mainly due to candidates combining their analysis of the Tofino castle option with the Cape Breton renovation option. The lack of depth on the Western Corridor proposal was mainly due to candidates considering the Western Corridor as a consideration point in each of their discussions of the other strategic alternatives presented in the simulation, which often limited their ability to discuss the issue in sufficient depth.

Strong candidates provided a well-balanced, qualitative discussion of both the advantages and disadvantages of each strategic option, which included numerous links back to the company's situational analysis (SO#1). One of the main differentiating factors between strong and weak candidates was the ability to identify and discuss in depth the most relevant decision factors. Strong candidates considered the importance of each case fact, and focused their discussion on the most relevant ones (such as the significant risk of the Tofino castle purchase/renovation given the amount of uncertainty associated with the project), and highlighted the more pertinent implications associated with the case facts. Weak candidates tended to list case facts as pros and cons, and provided more superficial links back to their situational analysis, for example, stating that the decision linked to a key success factor without elaborating. Weak candidates also tended to tie back to the same point for each discussion, for example, stating that the option aligned or did not align with the mission or vision.

Most candidates discussed how each strategic alternative aligned with DHC's objectives of improving the company's overall ADR and occupancy rate; however, weak candidates tended to take the case facts at face value and did not discuss how those metrics might fluctuate, given the strengths, weaknesses, opportunities, and threats of each strategic option. For example, in Appendix VIII, Kelvin pointed out that it would likely take a few years before the Cape Breton hotel's ADR reached DHC's current average. Weak candidates tended to ignore this point and concluded that, because the current ADR of the Cape Breton hotel (66%) was below the company's overall average, the hotel should be sold.

Most candidates attempted to analyze each strategic option from a quantitative perspective. Strong candidates made good use of their quantitative analyses by attempting to compare the financial merit of each available option to the financial merit of the other options, and to the company's stated objectives. Weak candidates struggled to use the case facts in an effective way and routinely provided quantitative analyses that did not incorporate the potential adjustments to each hotel's performance, given the factors presented in the case. Weak candidates also struggled to effectively discuss the relevance of their quantitative analyses, and how they contributed to the candidate's recommendations to pursue certain strategic alternatives.

SO#3 (Conclude and Advise)

For each of the strategic options available to DHC, candidates were expected to provide recommendations that were consistent with their analysis. Candidates were also expected to provide an overall conclusion that was logical, and that incorporated the company's objectives, such as improving its brand visibility. A logical conclusion was one that did not violate any of the case constraints; candidates were expected to recognize that there was a limit in cash resources for investment ($18 million). If a candidate's overall recommendation required more cash than was available, they were expected to address this shortfall and discuss how DHC could finance the outstanding amount.

Aside from the Western Corridor proposal, most candidates made recommendations for each of the other strategic alternatives available to DHC. Most candidates also provided an overall recommendation that did not violate the available cash resources of DHC.

Strong candidates provided useful advice to DHC's board that incorporated the company's objectives. For example, strong candidates discussed how their recommendation to acquire the shares of Peak Revie would increase the company's brand visibility, but would also violate the historical element of DHC's mission and vision. These candidates went on to suggest that DHC revise its mission and vision statements if the hotel was acquired.

Weak candidates struggled to provide a useful conclusion that DHC's board could act on. For example, many weak candidates suggested selling the Cape Breton hotel in order to acquire all three of the available hotels in Western Canada; because DHC would not have sufficient cash, this was an impossibility. Other weak candidates recommended renovating the Cape Breton hotel while also purchasing and renovating the castle in Tofino, an option that the simulation clearly stated was not possible.

SO#4 (Communication)

Most candidates approached their response in a coherent and organized fashion. Only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax, and an unorganized response approach.

SO#5 (Overall Assessment)

Overall, candidates were expected to meet the minimum acceptable standards in each of the five summative opportunities in order to obtain a "Pass" on the Day 1 linked case. Candidates also had to demonstrate a minimum level of numeracy skill.

For each major issue, candidates were expected to perform a sufficient level of analysis, and to then provide a recommendation that was consistent with their analyses and did not violate the constraints presented in the case. The board sought evidence that candidates incorporated the important elements of Capstone 1, as well as the main elements of this simulation's situational analysis, into their analysis of the major issues. Candidates were also expected to provide a reasonable amount of discussion over whether DHC should abandon Eastern Canada, given Doug Mallette's actions, or whether DHC should proceed with the proposal to create the Western Corridor of linked DHC hotels.

APPENDIX K

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

1. PRESENT VALUE OF TAX SHIELD FOR AMORTIZABLE ASSETS

Present value of total tax shield from CCA for a new asset acquired after November 20, 2018

$$= \frac{CdT}{(d+k)}\left(\frac{1+1.5k}{1+k}\right)$$

Notation for above formula:
C = net initial investment
T = corporate tax rate
k = discount rate or time value of money
d = maximum rate of capital cost allowance

2. SELECTED PRESCRIBED AUTOMOBILE AMOUNTS

	2020	2021
Maximum depreciable cost — Class 10.1	$30,000 + sales tax	$30,000 + sales tax
Maximum depreciable cost — Class 54	$55,000 + sales tax	$55,000 + sales tax
Maximum monthly deductible lease cost	$800 + sales tax	$800 + sales tax
Maximum monthly deductible interest cost	$300	$300
Operating cost benefit — employee	28 per km of personal use	27 per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	59 per km	59 per km
— balance	53 per km	53 per km

3. INDIVIDUAL FEDERAL INCOME TAX RATES

For 2020

If taxable income is between			Tax on base amount	Tax on excess
$0	and	$48,535	$0	15%
$48,536	and	$97,069	$7,280	20.5%
$97,070	and	$150,473	$17,230	26%
$150,474	and	$214,368	$31,115	29%
$214,369	and	any amount	$49,644	33%

For 2021

If taxable income is between			Tax on base amount	Tax on excess
$0	and	$49,020	$0	15%
$49,021	and	$98,040	$7,353	20.5%
$98,041	and	$151,978	$17,402	26%
$151,979	and	$216,511	$31,426	29%
$216,512	and	any amount	$50,141	33%

4. SELECTED INDEXED AMOUNTS FOR PURPOSES OF COMPUTING INCOME TAX

Personal tax credits are a maximum of 15% of the following amounts:

	2020	2021
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is greater than or equal to the amount at which the 33% tax bracket begins	$12,298	$12,421
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is less than or equal to the amount at which the 29% tax bracket begins	13,229	13,808
Age amount if 65 or over in the year	7,637	7,713
Net income threshold for age amount	38,508	38,893
Canada employment amount	1,245	1,257
Disability amount	8,576	8,662
Canada caregiver amount for children under age 18	2,273	2,295
Canada caregiver amount for other infirm dependants age 18 or older (maximum amount)	7,276	7,348
Net income threshold for Canada caregiver amount	17,085	17,256
Adoption expense credit limit	16,563	16,729

Other indexed amounts are as follows:

	2020	2021
Medical expense tax credit — 3% of net income ceiling	$2,397	$2,421
Annual TFSA dollar limit	6,000	6,000
RRSP dollar limit	27,230	27,830
Lifetime capital gains exemption on qualified small business corporation shares	883,384	892,218

5. PRESCRIBED INTEREST RATES (base rates)

Year	Jan. 1 – Mar. 31	Apr. 1 – June 30	July 1 – Sep. 30	Oct. 1 – Dec. 31
2021	1	1		
2020	2	2	1	1
2019	2	2	2	2

This is the rate used for taxable benefits for employees and shareholders, low-interest loans, and other related-party transactions. The rate is 4 percentage points higher for late or deficient income tax payments and unremitted withholdings. The rate is 2 percentage points higher for tax refunds to taxpayers, with the exception of corporations, for which the base rate is used.

6. MAXIMUM CAPITAL COST ALLOWANCE RATES FOR SELECTED CLASSES

Class	Rate	Description
Class 1…………………………	4%	for all buildings except those below
Class 1…………………………	6%	for buildings acquired for first use after March 18, 2007 and 90% of the square footage is used for non-residential activities
Class 1…………………………	10%	for buildings acquired for first use after March 18, 2007 and 90% of the square footage is used for manufacturing and processing activities
Class 8…………………………	20%	
Class 10………………………	30%	
Class 10.1……………………	30%	
Class 12………………………	100%	
Class 13………………………	n/a	Straight line over original lease period plus one renewal period (minimum 5 years and maximum 40 years)
Class 14………………………	n/a	Straight line over length of life of property
Class 14.1……………………	5%	For property acquired after December 31, 2016
Class 17………………………	8%	
Class 29………………………	50%	Straight-line
Class 43………………………	30%	
Class 44………………………	25%	
Class 45………………………	45%	
Class 50………………………	55%	
Class 53………………………	50%	
Class 54………………………	30%	

The CPA certification program prepares future CPAs to meet the challenges that await them. For more information on the qualification process, the common final examination (CFE), and the specific education requirements for your jurisdiction, contact your provincial/regional CPA body.

CPA PROVINCIAL/REGIONAL BODIES AND CPA REGIONAL SCHOOLS OF BUSINESS

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