

CHOICE HOTELS INTERNATIONAL INC /DE  
Form 10-Q  
August 11, 2014  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED June 30, 2014  
OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
COMMISSION FILE NO. 001-13393

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CHOICE HOTELS INTERNATIONAL, INC.  
(Exact name of registrant as specified in its charter)

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DELAWARE (State or other jurisdiction of incorporation or organization) 1 CHOICE HOTELS CIRCLE, SUITE 400 ROCKVILLE, MD 20850 (Address of principal executive offices) (Zip Code) (301) 592-5000 (Registrant's telephone number, including area code)	52-1209792 (I.R.S. Employer Identification No.)
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(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Table of Contents

CLASS	SHARES OUTSTANDING AT JUNE 30, 2014
Common Stock, Par Value \$0.01 per share	58,433,234

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Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES  
INDEX

PAGE NO.

PART I. FINANCIAL INFORMATION:

<u>Item 1—Financial Statements (Unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Income—For the three and six months ended June 30, 2014 and 2013</u>	<u>4</u>
<u>Consolidated Statements of Comprehensive Income—For the three and six months ended June 30, 2014 and 2013</u>	<u>2</u>
<u>Consolidated Balance Sheets—As of June 30, 2014 and December 31, 2013</u>	<u>6</u>
<u>Consolidated Statements of Cash Flows—For the six months ended June 30, 2014 and 2013</u>	<u>7</u>
<u>Notes to Consolidated Financial Statements</u>	<u>8</u>
<u>Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>46</u>
<u>Item 3—Quantitative and Qualitative Disclosures About Market Risk</u>	<u>67</u>
<u>Item 4—Controls and Procedures</u>	<u>68</u>

PART II. OTHER INFORMATION:

<u>Item 1—Legal Proceedings</u>	<u>69</u>
<u>Item 1A—Risk Factors</u>	<u>70</u>
<u>Item 2—Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>70</u>
<u>Item 3—Defaults Upon Senior Securities</u>	<u>70</u>
<u>Item 4—Mine Safety Disclosures</u>	<u>70</u>
<u>Item 5—Other Information</u>	<u>70</u>
<u>Item 6—Exhibits</u>	<u>71</u>

<u>SIGNATURE</u>	<u>72</u>
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Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
(UNAUDITED, IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
REVENUES:		(Restated)		(Restated)
Royalty fees	\$77,670	\$72,638	\$136,210	\$128,746
Initial franchise and relicensing fees	4,722	4,416	8,462	8,193
Procurement services	8,020	7,546	12,798	11,496
Marketing and reservation	103,766	104,072	193,372	186,395
Other	3,486	2,258	6,558	4,271
Total revenues	197,664	190,930	357,400	339,101
OPERATING EXPENSES:				
Selling, general and administrative	31,413	29,731	58,093	56,399
Depreciation and amortization	2,332	2,388	4,610	4,429
Marketing and reservation	103,766	104,072	193,372	186,395
Total operating expenses	137,511	136,191	256,075	247,223
Operating income	60,153	54,739	101,325	91,878
OTHER INCOME AND EXPENSES, NET:				
Interest expense	10,710	10,807	20,881	21,577
Interest income	(347)	(659)	(850)	(1,303)
Other (gains) and losses	(474)	147	(533)	(563)
Equity in net (income) loss of affiliates	30	(60)	65	81
Total other income and expenses, net	9,919	10,235	19,563	19,792
Income from continuing operations before income taxes	50,234	44,504	81,762	72,086
Income taxes	14,955	12,880	25,014	20,686
Income from continuing operations, net of income taxes	35,279	31,624	56,748	51,400
Income from discontinued operations, net of income taxes	121	183	1,762	150
Net income	\$35,400	\$31,807	\$58,510	\$51,550
Basic earnings per share				
Continuing operations	\$0.61	\$0.54	\$0.97	\$0.88
Discontinued operations	—	—	0.03	—
	\$0.61	\$0.54	\$1.00	\$0.88
Diluted earnings per share				
Continuing operations	\$0.60	\$0.54	\$0.96	\$0.88
Discontinued operations	—	—	0.03	—
	\$0.60	\$0.54	\$0.99	\$0.88

Cash dividends declared per share	\$0.185	\$0.185	\$0.37	\$0.37
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The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (UNAUDITED, IN THOUSANDS)

	Three Months Ended		Six Months Ended		
	June 30		June 30		
	2014	2013	2014	2013	
Net income	\$35,400	\$31,807	\$58,510	\$51,550	
Other comprehensive income (loss), net of tax:		(Restated)		(Restated)	
Amortization of loss on cash flow hedge	216	216	431	431	
Foreign currency translation adjustment	509	(2,082	) 1,030	(2,327	)
Other comprehensive income (loss), net of tax	725	(1,866	) 1,461	(1,896	)
Comprehensive income	\$36,125	\$29,941	\$59,971	\$49,654	

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

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(UNAUDITED, IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	June 30, 2014	December 31, 2013
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$211,542	\$167,795
Receivables (net of allowance for doubtful accounts of \$13,188 and \$12,187, respectively)	119,763	82,385
Deferred income taxes	29,733	26,684
Investments, employee benefit plans, at fair value	176	400
Other current assets	23,789	29,710
Total current assets	385,003	306,974
Property and equipment, at cost, net	58,238	67,852
Goodwill	65,813	65,813
Franchise rights and other identifiable intangibles, net	8,389	9,953
Advances, marketing and reservation activities	—	5,844
Notes receivable, net of allowances	34,492	31,872
Investments, employee benefit plans, at fair value	17,270	15,950
Deferred income taxes	1,121	—
Other assets	58,116	52,164
Total assets	\$628,442	\$556,422
<b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>		
Current liabilities		
Accounts payable	\$50,892	\$41,663
Accrued expenses	52,398	56,625
Deferred revenue	67,365	61,188
Current portion of long-term debt	11,970	10,088
Deferred compensation and retirement plan obligations	579	2,492
Income taxes payable	17,459	2,282
Total current liabilities	200,663	174,338
Long-term debt	777,536	783,471
Deferred compensation and retirement plan obligations	23,260	22,527
Deferred income taxes	—	5,149
Other liabilities	39,493	23,808
Total liabilities	1,040,952	1,009,293
Commitments and Contingencies		
Common stock, \$0.01 par value, 160,000,000 shares authorized; 95,065,638 shares issued at June 30, 2014 and December 31, 2013 and 58,433,234 and 58,638,863 shares outstanding at June 30, 2014 and December 31, 2013, respectively	584	586
Additional paid-in-capital	118,976	117,768
Accumulated other comprehensive loss	(4,756	) (6,217 )
Treasury stock (36,632,404 and 36,426,775 shares at June 30, 2014 and December 31, 2013, respectively), at cost	(916,893	) (918,031 )
Retained earnings	389,579	353,023
Total shareholders' deficit	(412,510	) (452,871 )
Total liabilities and shareholders' deficit	\$628,442	\$556,422

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

6

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Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED, IN THOUSANDS)

	Six Months Ended	
	June 30	
	2014	2013 (Restated)
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$58,510	\$51,550
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,610	4,695
Gain on sale of assets	(2,849)	) —
Provision for bad debts, net	1,383	1,753
Non-cash stock compensation and other charges	4,711	5,566
Non-cash interest and other (income) loss	719	967
Deferred income taxes	(9,273)	) 8,236
Dividends received from equity method investments	546	535
Equity in net loss of affiliates	65	81
Changes in assets and liabilities:		
Receivables	(39,518)	) (40,349)
Advances to/from marketing and reservation activities, net	31,522	5,631
Forgivable notes receivable, net	(6,692)	) (3,595)
Accounts payable	8,316	9,893
Accrued expenses	(5,247)	) (18,463)
Income taxes payable/receivable	15,198	1,198
Deferred revenue	6,231	(3,318)
Other assets	(1,102)	) (1,664)
Other liabilities	(1,298)	) 7,271
Net cash provided by operating activities	65,832	29,987
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Investment in property and equipment	(7,314)	) (22,035)
Proceeds from sales of assets	12,216	—
Equity method investments	(6,946)	) (1,851)
Purchases of investments, employee benefit plans	(1,220)	) (1,580)
Proceeds from sales of investments, employee benefit plans	641	3,934
Issuance of mezzanine and other notes receivable	(2,223)	) —
Collections of mezzanine and other notes receivable	9,743	201
Other items, net	(296)	) (304)
Net cash provided (used) in investing activities	4,601	(21,635)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net borrowings pursuant to revolving credit facility	—	15,200
Principal payments on long-term debt	(4,112)	) (4,095)
Proceeds from the issuance of long-term debt	26	—
Purchases of treasury stock	(4,544)	) (3,651)
Dividends paid	(21,957)	) (11,261)
Excess tax benefits from stock-based compensation	1,319	1,146
Proceeds from exercise of stock options	1,547	5,973
Net cash provided (used) by financing activities	(27,721)	) 3,312
Net change in cash and cash equivalents	42,712	11,664

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Effect of foreign exchange rate changes on cash and cash equivalents	1,035	(2,051	)
Cash and cash equivalents at beginning of period	167,795	134,177	
Cash and cash equivalents at end of period	\$211,542	\$143,790	
Supplemental disclosure of cash flow information:			
Cash payments during the period for:			
Income taxes, net of refunds	\$19,594	\$11,652	
Interest	\$20,595	\$22,033	
Non-cash investing and financing activities:			
Dividends declared but not paid	\$10,810	\$10,766	
Issuance of common stock pursuant to share based compensation plans	\$8,024	\$9,395	
Investment in property and equipment acquired in accounts payable	\$688	\$6,096	
The accompanying notes are an integral part of these consolidated financial statements.			

7

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Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Company Information and Significant Accounting Policies

The accompanying unaudited consolidated financial statements of Choice Hotels International, Inc. and subsidiaries (together the "Company") have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These unaudited consolidated financial statements include all adjustments that are necessary, in the opinion of management, to fairly present our financial position and results of operations. Except as otherwise disclosed, all adjustments are of a normal recurring nature.

Certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted. The Company believes the disclosures made are adequate to make the information presented not misleading.

The consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2013 and notes thereto included in the Company's Form 10-K, filed with the SEC on March 3, 2014 (the "10-K") as well as the information provided below under the heading "Revision to Prior Annual Financial Statements and Restatement of Prior Interim Financial Statements". The Company intends to amend its 10-K as soon as administratively practical to revise its previously issued audited financial statements and amend its report on internal control over financial reporting. Interim results are not necessarily indicative of the entire year results. All inter-company transactions and balances between Choice Hotels International, Inc. and its subsidiaries have been eliminated in consolidation.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revision to Prior Annual Financial Statements and Restatement of Prior Interim Financial Statements

In connection with the preparation of the consolidated financial statements for the second quarter of 2014, the Company reviewed its accounting policies and practices, including the historical practice of reporting royalty and certain marketing and reservation fees one month in arrears as compared to when the gross room revenues (on which the fees are based) are earned by the Company's franchisees. The Company previously determined that the impact of the revenue recognition timing related to these revenues on its annual financial statements was not material and therefore reported these revenues one month in arrears despite the fact that these fees meet the definition of being earned and realizable in the same period that the underlying gross room revenues are earned by its franchisees. However, during the current period, the Company reassessed the impact of reporting these revenues one month in arrears on interim periods and determined that this revenue recognition practice, which was not in accordance with GAAP, was material to interim periods due to the seasonality of the Company's business. As a result, the Company has corrected its revenue recognition method to recognize royalty and certain marketing and reservation system fees as revenue in the same period as the gross room revenues are earned by its franchisees.

In accordance with Accounting Standards Codification ("ASC") 250 (SEC's Staff Accounting Bulletin 99, "Materiality"), the Company assessed the materiality of the misapplication of GAAP and concluded that the restatement of revenues was not material to any of its previously issued annual financial statements but was material to certain interim periods. In accordance with the accounting guidance in ASC 250 (SEC Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements"), the Company will restate its previously issued interim financial statements for the periods ended March 31, 2014 and 2013 and September 30, 2013 and 2012 through the filing of amended quarterly filings on Form 10-Q and has restated the interim financial periods for June 30, 2013 in this interim financial report. In addition, the Company will revise its previously issued audited financial statements for the years ended December 31, 2011, 2012, and 2013 to correct the presentation of revenues and amend its report on internal control over financial reporting.

The following tables present the effect of this and other immaterial errors for the financial statement line items impacted in the affected periods included within this interim financial report. In addition, these amounts have been adjusted to reflect the Company's discontinued operations reported in the first quarter of 2014.

Table of Contents

## Consolidated Statements of Income

	Three Months Ended June 30, 2013				Six Months Ended June 30, 2013			
	As Previously Reported	Discontinued Operations	Adjustment	As Restated	As Previously Reported	Discontinued Operations	Adjustment	As Restated
	(in thousands, except per share amounts)							
Royalty fees	\$68,379	\$—	\$4,259	\$72,638	\$118,115	\$—	\$10,631	\$128,746
Marketing and reservation revenues	99,645	—	4,427	104,072	176,085	—	10,310	186,395
Hotel operations	1,334	(1,334)	) —	—	2,290	(2,290)	) —	—
Total revenues	183,578	(1,334)	) 8,686	190,930	320,450	(2,290)	) 20,941	339,101
Selling, general and administrative	30,180	—	(449)	) 29,731	57,096	—	(697)	) 56,399
Depreciation and amortization	2,520	(132)	) —	2,388	4,695	(266)	) —	4,429
Marketing and reservation expenses	99,645	—	4,427	104,072	176,085	—	10,310	186,395
Hotel operations	911	(911)	) —	—	1,786	(1,786)	) —	—
Total operating expenses	133,256	(1,043)	) 3,978	136,191	239,662	(2,052)	) 9,613	247,223
Operating income	50,322	(291)	) 4,708	54,739	80,788	(238)	) 11,328	91,878
Income from continuing operations before income taxes	40,087	(291)	) 4,708	44,504	60,996	(238)	) 11,328	72,086
Income taxes	11,853	(108)	) 1,135	12,880	17,239	(88)	) 3,535	20,686
Income from continuing operations, net of income taxes	28,234	(183)	) 3,573	31,624	43,757	(150)	) 7,793	51,400
Basic earnings per share, continuing operations	\$0.48	\$—	\$0.06	\$0.54	\$0.75	\$—	\$0.13	\$0.88
Diluted earnings per share, continuing operations	\$0.48	\$—	\$0.06	\$0.54	\$0.74	\$—	\$0.14	\$0.88

Table of Contents

	Six Months Ended June 30, 2013		
	As Previously Reported	Adjustment	As Restated
Consolidated Statement of Cash Flows	(in thousands)		
Net income	\$43,757	\$7,793	\$51,550
Provision for bad debts, net	1,420	333	1,753
Non-cash stock compensation and other charges	5,581	(15	) 5,566
Deferred income taxes	4,169	4,067	8,236
Change in assets and liabilities			
Receivables	(21,156	) (19,193	) (40,349 )
Advances to/from marketing and reservation activities, net	(2,945	) 8,576	5,631
Income taxes payable/receivable	1,729	(531	) 1,198
Net cash provided by operating activities	28,957	1,030	29,987
Investment in property and equipment	(21,005	) (1,030	) (22,035 )
Net cash used in investing activities	(20,605	) (1,030	) (21,635 )

	As of December 31, 2013		
	As Previously Reported	Adjustment	As Revised
Consolidated Balance Sheet	(in thousands)		
Receivables	\$53,521	\$28,864	\$82,385
Deferred income taxes	7,220	19,464	26,684
Total current assets	258,646	48,328	306,974
Property and equipment, at cost, net	66,092	1,760	67,852
Advances, marketing and reservation activities	19,127	(13,283	) 5,844
Deferred income taxes	20,282	(20,282	) —
Total assets	539,899	16,523	556,422
Deferred income taxes	—	5,149	5,149
Total liabilities	1,004,144	5,149	1,009,293
Retained earnings	341,649	11,374	353,023
Total shareholders' deficit	(464,245	) 11,374	(452,871 )

The following tables present the effect of this and other immaterial errors for the financial statement line items impacted in the Company's quarterly reports on Form 10-Q which will be amended for the interim periods ended March 31, 2014 and September 30, 2013 and corresponding prior year periods. These amended reports will be filed with the SEC as soon as administratively possible. In addition, these amounts have been adjusted to reflect the Company's discontinued operations reported in the first quarter of 2014.

Table of Contents

## Consolidated Statements of Income

	Three Months Ended March 31, 2014			Three Months Ended March 31, 2013		
	As Previously Reported	Adjustment	As Restated	As Previously Reported	Adjustment	As Restated
	(in thousands, except per share amounts)					
Royalty fees	\$51,681	\$6,859	\$58,540	\$49,736	\$6,372	\$56,108
Marketing and reservation revenues	84,012	5,594	89,606	76,440	5,883	82,323
Total revenues	147,283	12,453	159,736	135,916	12,255	148,171
Selling, general and administrative	26,463	217	26,680	26,916	(248 )	26,668
Depreciation and amortization	2,122	156	2,278	2,041	—	2,041
Marketing and reservation expenses	84,012	5,594	89,606	76,440	5,883	82,323
Total operating expenses	112,597	5,967	118,564	105,397	5,635	111,032
Operating income	34,686	6,486	41,172	30,519	6,620	37,139
Income from continuing operations before income taxes	25,042	6,486	31,528	20,962	6,620	27,582
Income taxes	7,711	2,348	10,059	5,406	2,400	7,806
Income from continuing operations, net of income taxes	17,331	4,138	21,469	15,556	4,220	19,776
Basic earnings per share, continuing operations	\$0.30	\$0.07	\$0.37	\$0.27	\$0.07	\$0.34
Diluted earnings per share, continuing operations	\$0.29	\$0.07	\$0.36	\$0.26	\$0.08	\$0.34
	Three Months Ended March 31, 2014			Three Months Ended March 31, 2013		
Consolidated Statements of Cash Flow	As Previously Reported	Adjustment	As Restated	As Previously Reported	Adjustment	As Restated
	(in thousands)					
Net cash provided by operating activities	\$5,264	\$—	\$5,264	\$145	\$450	\$595
Investment in property and equipment	(3,015 )	—	(3,015 )	(13,645 )	(450 )	(14,095 )
Net cash provided (used) by investing activities	1,027	—	1,027	(12,087 )	(450 )	(12,537 )

Table of Contents

	As of March 31, 2014							
	As Previously Reported	Adjustment	As Restated					
Consolidated Balance Sheet								
	(in thousands)							
Receivables	\$59,241	\$40,906	\$100,147					
Deferred income taxes	7,220	21,202	28,422					
Total current assets	277,714	62,108	339,822					
Property and equipment, at cost, net	56,664	1,604	58,268					
Advances, marketing and reservation activities	18,856	(18,696)	) 160					
Deferred income taxes	20,321	(20,321)	) —					
Total assets	554,900	24,695	579,595					
Deferred income taxes	—	9,196	9,196					
Total liabilities	1,009,533	9,196	1,018,729					
Retained earnings	349,458	15,511	364,969					
Total shareholders' deficit	(454,633)	) 15,499	(439,134)		)			
Consolidated Statements of Income								
	Three Months Ended September 30, 2013				Nine Months Ended September 30, 2013			
	As Previously Reported	Discontinued Operations	Adjustment	As Restated	As Previously Reported	Discontinued Operations	Adjustment	As Restated
	(in thousands, except per share amounts)							
Royalty fees	\$83,107	\$—	\$(3,647)	) \$79,460	\$201,222	\$—	\$6,984	\$208,206
Marketing and reservation revenues	126,296	—	(1,487)	) 124,809	302,381	—	8,823	311,204
Hotel operations	1,310	(1,310)	) —	—	3,600	(3,600)	) —	—
Total revenues	223,162	(1,310)	) (5,134)	) 216,718	543,612	(3,600)	) 15,807	555,819
Selling, general and administrative	26,982	—	(573)	) 26,409	84,078	—	(1,270)	) 82,808
Depreciation and amortization	2,379	(127)	) 20	2,272	7,074	(393)	) 20	6,701
Marketing and reservation expenses	126,296	—	(1,487)	) 124,809	302,381	—	8,823	311,204
Hotel operations	956	(956)	) —	—	2,742	(2,742)	) —	—
Total operating expenses	156,613	(1,083)	) (2,040)	) 153,490	396,275	(3,135)	) 7,573	400,713
Operating income	66,549	(227)	) (3,094)	) 63,228	147,337	(465)	) 8,234	155,106
Income from continuing operations before income taxes	57,592	(227)	) (3,094)	) 54,271	118,588	(465)	) 8,234	126,357
Income taxes	16,080	(84)	) (298)	) 15,698	33,319	(172)	) 3,237	36,384
Income from continuing	41,512	(143)	) (2,796)	) 38,573	85,269	(293)	) 4,997	89,973



operations, net of  
income taxes

Basic earnings per share, continuing operations	\$0.71	\$—	\$(0.05)	) \$0.66	\$1.46	\$—	\$0.08	\$1.54
Diluted earnings per share, continuing operations	\$0.70	(0.01	) \$(0.04	) \$0.65	\$1.45	\$—	\$0.08	\$1.53

12

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Table of Contents

	Three Months Ended September 30, 2012				Nine Months Ended September 30, 2012			
	As Previously Filed	Discontinued Operations	Adjustment	As Restated	As Previously Filed	Discontinued Operations	Adjustment	As Restated
	(in thousands, except per share amounts)							
Royalty fees	\$80,845	\$—	\$ (2,807 )	\$78,038	\$194,762	\$—	\$ 8,225	\$202,987
Marketing and reservation revenues	119,062	—	(1,097 )	117,965	284,624	—	9,721	294,345
Hotel operations	1,238	(1,238 )	—	—	3,440	(3,440 )	—	—
Total revenues	210,413	(1,238 )	(3,904 )	205,271	513,203	(3,440 )	17,946	527,709
Selling, general and administrative	23,170	—	(98 )	23,072	72,073	—	249	72,322
Depreciation and amortization	1,995	(135 )	—	1,860	5,989	(401 )	—	5,588
Marketing and reservation expenses	119,062	—	(1,097 )	117,965	284,624	—	9,721	294,345
Hotel operations	933	(933 )	—	—	2,609	(2,609 )	—	—
Total operating expenses	145,160	(1,068 )	(1,195 )	142,897	365,295	(3,010 )	9,970	372,255
Operating income	65,253	(170 )	(2,709 )	62,374	147,908	(430 )	7,976	155,454
Income from continuing operations before income taxes	55,668	(170 )	(2,709 )	52,789	133,840	(430 )	7,976	141,386
Income taxes	11,291	(63 )	(1,076 )	10,152	37,604	(160 )	3,303	40,747
Income from continuing operations, net of income taxes	44,377	(107 )	(1,633 )	42,637	96,236	(270 )	4,673	100,639
Basic earnings per share, continuing operations	\$0.77	\$—	\$ (0.03 )	\$0.74	\$1.66	\$ (0.01 )	\$ 0.08	\$1.73
Diluted earnings per share, continuing operations	\$0.76	\$—	\$ (0.03 )	\$0.73	\$1.65	\$—	\$ 0.08	\$1.73
	Nine Months Ended September 30, 2013							
Consolidated Statement of Cash Flows	As Previously Filed	Adjustment	As Restated					
	(in thousands)							
	\$105,009	\$1,480	\$106,489					

Net cash provided by operating  
activities

Investment in property and equipment	(26,442	) (1,480	) (27,922 )
Net cash used in investing activities	(28,350	) (1,480	) (29,830 )

13

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Table of Contents

	As of September 30, 2013			As of December 31, 2012			
	As Previously Reported	Adjustment	As Restated	As Previously Reported	Adjustment	As Revised	
Consolidated Balance Sheets	(in thousands)						
Receivables	\$62,605	\$40,282	\$102,887	\$52,270	\$27,729	\$79,999	
Income taxes receivable	—	—	—	2,732	(531	) 2,201	
Deferred income taxes	4,136	23,231	27,367	4,136	22,062	26,198	
Total current assets	258,267	63,513	321,780	233,470	49,260	282,730	
Property and equipment, at cost, net	65,540	1,460	67,000	51,651	—	51,651	
Advances, marketing and reservation activities	32,564	(18,494	) 14,070	42,179	(12,712	) 29,467	
Deferred income taxes	19,496	(19,496	) —	15,418	(15,418	) —	
Total assets	555,709	26,983	582,692	510,772	21,130	531,902	
Deferred income taxes	—	11,722	11,722	—	10,864	10,864	
Total liabilities	1,040,433	11,722	1,052,155	1,059,676	10,864	1,070,540	
Retained earnings	325,005	15,264	340,269	272,260	10,266	282,526	
Total shareholders' deficit	(484,724	) 15,261	(469,463	) (548,904	) 10,266	(538,638	)

The following tables present the effect of this and other immaterial errors for the financial statement line items impacted for the years ended December 31, 2011, 2012, and 2013 which will be revised prospectively in future annual filings. In addition, these amounts have been adjusted to reflect the Company's discontinued operations reported in the first quarter of 2014.

Table of Contents

## Consolidated Statements of Income

	Year Ended December 31, 2013				Year Ended December 31, 2012			
	As Previously Reported	Discontinued Operations	Adjustment	As Revised	As Previously Reported	Discontinued Operations	Adjustment	As Revised
	(in thousands, except per share amounts)							
Royalty fees	\$267,229	\$—	\$583	\$267,812	\$260,782	\$—	\$898	\$261,680
Marketing and reservation revenues	403,099	—	4,534	407,633	384,784	—	4,894	389,678
Hotel operations	4,774	(4,774 )	—	—	4,573	(4,573 )	—	—
Total revenues	724,307	(4,774 )	5,117	724,650	691,509	(4,573 )	5,792	692,728
Selling, general and administrative	113,567	—	(1,854 )	111,713	101,852	—	27	101,879
Depreciation and amortization	9,469	(526 )	113	9,056	8,226	(535 )	—	7,691
Marketing and reservation expenses	403,099	—	4,534	407,633	384,784	—	4,894	389,678
Hotel operations	3,678	(3,678 )	—	—	3,505	(3,505 )	—	—
Total operating expenses	529,813	(4,204 )	2,793	528,402	498,367	(4,040 )	4,921	499,248
Operating income	194,494	(570 )	2,324	196,248	193,142	(533 )	871	193,480
Income from continuing operations before income taxes	156,918	(570 )	2,324	158,672	169,168	(533 )	871	169,506
Income taxes	44,317	(211 )	1,216	45,322	48,481	(198 )	(55 )	48,228
Income from continuing operations, net of income taxes	112,601	(359 )	1,108	113,350	120,687	(335 )	926	121,278
Basic earnings per share, continuing operations	\$1.92	\$—	\$0.02	\$1.94	\$2.08	\$—	\$0.01	\$2.09
Diluted earnings per share, continuing operations	\$1.91	\$(0.01 )	\$0.02	\$1.92	\$2.07	\$(0.01 )	\$0.02	\$2.08

Table of Contents

	Year Ended December 31, 2011			
	As Previously Reported	Discontinued Operations	Adjustment	As Revised
	(in thousands, except per share amounts)			
Royalty fees	\$245,426	\$—	\$1,049	\$246,475
Marketing and reservation revenues	349,036	—	5,116	354,152
Hotel operations	4,356	(4,356	) —	—
Total revenues	638,793	(4,356	) 6,165	640,602
Selling, general and administrative	106,404	—	32	106,436
Depreciation and amortization	8,024	(527	) —	7,497
Marketing and reservation expenses	349,036	—	5,116	354,152
Hotel operations	3,466	(3,466	) —	—
Total operating expenses	466,930	(3,993	) 5,148	468,085
Operating income	171,863	(363	) 1,017	172,517
Income from continuing operations before income taxes	158,057	(363	) 1,017	158,711
Income taxes	47,661	(135	) 352	47,878
Income from continuing operations, net of income taxes	110,396	(228	) 665	110,833
Basic earnings per share, continuing operations	\$1.86	\$(0.01	) \$0.01	\$1.86
Diluted earnings per share, continuing operations	\$1.85	\$(0.01	) \$0.02	\$1.86

	Year Ended December 31, 2013			
	As Previously Reported	Adjustment	As Revised	
	(in thousands)			
Consolidated Statement of Cash Flows				
Net cash provided by operating activities	\$152,040	\$1,873	\$153,913	
Investment in property and equipment	(31,524	) (1,873	) (33,397	)
Net cash used in investing activities	(27,549	) (1,873	) (29,422	)

**Discontinued Operations**

In the first quarter of 2014, the Company's management approved a plan to dispose of the three Company owned Mainstay Suites hotels. As a result, the Company has reported the operations related to these three hotels as discontinued operations in this Quarterly Report on Form 10-Q. The Company's results of operations for the comparative prior year periods have also been restated to account for these operations as discontinued. For additional information regarding discontinued operations, see Note 17, Discontinued Operations.

**Cash and Cash Equivalents**

The Company considers all highly liquid investments purchased with a maturity of three months or less at the date of purchase to be cash equivalents. As of June 30, 2014 and December 31, 2013, \$3.3 million and \$5.0 million, respectively, of book overdrafts representing outstanding checks in excess of funds on deposit are included in accounts payable in the accompanying consolidated balance sheets.

## Table of Contents

The Company maintains cash balances in domestic banks, which at times, may exceed the limits of amounts insured by the Federal Deposit Insurance Corporation. In addition, as of June 30, 2014, the Company maintains cash balances of \$172.5 million in international banks which do not provide deposit insurance.

### Recently Adopted Accounting Guidance

In February 2013, the Financial Accounting Standards Board ("FASB") issued ASU No. 2013-04, "Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date" ("ASU 2013-04"). The ASU requires entities to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, as the sum of the following: (a) The amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and (b) any additional amount the reporting entity expects to pay on behalf of its co-obligors. Required disclosures include a description of the joint-and-several arrangement and the total outstanding amount of the obligation for all joint parties. The ASU permits entities to aggregate disclosures (as opposed to providing separate disclosures for each joint-and-several obligation). ASU 2013-04 was effective for all interim and annual periods beginning after December 15, 2013. The Company adopted this ASU on January 1, 2014 and it did not have a material impact on its financial statements.

In March 2013, the FASB issued ASU No. 2013-05, "Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity" ("ASU 2013-05"). ASU 2013-05 clarifies that when a reporting entity ceases to have a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity, the parent is required to apply the guidance in ASC 830 "Foreign Currency Matters" Subtopic 830-30 to release any related cumulative translation adjustment into net income. Accordingly, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The provisions of ASU 2013-05 are effective prospectively for reporting periods beginning after December 15, 2013 and the Company adopted this ASU on January 1, 2014. The adoption of this ASU did not have a material impact on the Company's financial statements.

In July 2013, the FASB issued ASU No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" ("ASU 2013-11"). ASU 2013-11 requires an entity to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss ("NOL") carryforward, or similar tax loss or tax credit carryforward, rather than as a liability when (1) the uncertain tax position would reduce the NOL or other carryforward under the tax law of the applicable jurisdiction and (2) the entity intends to use the deferred tax asset for that purpose. The ASU does not require new recurring disclosures. The provisions of ASU 2013-11 are effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. The Company adopted this ASU on January 1, 2014 and the adoption of this ASU did not have a material impact on its financial statements.

### Future Adoption of Recently Announced Accounting Guidance

In April 2014, the FASB issued ASU No. 2014-08, "Presentation of Financial Statements and Property, Plant, and Equipment: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity" ("ASU 2014-08"). ASU 2014-08 changes the definition of a discontinued operation to include only those disposals of components of an entity that represent a strategic shift that has (or will have) a major effect on an entity's operations and financial results. ASU 2014-08 is effective for all disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years. The Company is currently evaluating what impact, if any, the adoption of this ASU will have on the presentation of its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue From Contracts with Customers" ("ASU 2014-09"), which impacts virtually all aspects of an entity's revenue recognition. ASU No. 2014-09 supersedes the revenue



recognition requirements in Topic 605, Revenue Recognition, as well as most industry-specific guidance, and significantly enhances comparability of revenue recognition practices across entities and industries by providing a principles-based, comprehensive framework for addressing revenue recognition issues. In order for a provider of promised goods or services to recognize as revenue the consideration that it expects to receive in exchange for the promised goods or services, the provider should apply the following five steps: (1) identify the contract with a customer(s); (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. ASU No. 2014-09 also specifies the accounting for some costs to obtain or fulfill a contract with a customer and provides enhanced disclosure requirements. ASU No. 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting

Table of Contents

period. The guidance permits the retrospective or modified retrospective method when adopting ASU No. 2014-09. The Company is still assessing the impact that ASU No. 2014-09 will have on its financial statements and disclosures.

## 2. Other Current Assets

Other current assets consist of the following:

	June 30, 2014	December 31, 2013
	(In thousands)	
Notes receivable, net of allowances (See Note 3)	\$6,182	\$12,816
Prepaid expenses	14,534	13,746
Other current assets	3,073	3,148
Total	\$23,789	\$29,710

## 3. Notes Receivable and Allowance for Losses

The Company segregates its notes receivable for the purposes of evaluating allowances for credit losses between two categories: Mezzanine and Other Notes Receivable and Forgivable Notes Receivable. The Company utilizes the level of security it has in the various notes receivable as its primary credit quality indicator (i.e. senior, subordinated or unsecured) when determining the appropriate allowances for uncollectible loans within these categories.

The Company considers loans to be past due and in default when payments are not made when due. Although the Company considers loans to be in default if payments are not received on the due date, the Company does not suspend the accrual of interest until those payments are more than 30 days past due. The Company applies payments received for loans on non-accrual status first to interest and then principal. The Company does not resume interest accrual until all delinquent payments are received. For impaired loans, the Company recognizes interest income on a cash basis.

The following table shows the composition of our notes receivable balances:

Credit Quality Indicator	June 30, 2014 (In thousands)			December 31, 2013 (In thousands)		
	Forgivable Notes Receivable	Mezzanine & Other Notes Receivable	Total	Forgivable Notes Receivable	Mezzanine & Other Notes Receivable	Total
Senior	\$—	\$10,150	\$10,150	\$—	\$18,052	\$18,052
Subordinated	—	13,770	13,770	—	14,152	14,152
Unsecured	25,048	4,131	29,179	20,625	3,405	24,030
Total notes receivable	25,048	28,051	53,099	20,625	35,609	56,234
Allowance for losses on non-impaired loans	2,477	1,600	4,077	1,650	1,607	3,257
Allowance for losses on receivables specifically evaluated for impairment	—	8,348	8,348	—	8,289	8,289
Total loan reserves	2,477	9,948	12,425	1,650	9,896	11,546
Net carrying value	\$22,571	\$18,103	\$40,674	\$18,975	\$25,713	\$44,688

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Current portion, net	\$126	\$6,056	\$6,182	\$361	\$12,455	\$12,816
Long-term portion, net	22,445	12,047	34,492	18,614	13,258	31,872
Total	\$22,571	\$18,103	\$40,674	\$18,975	\$25,713	\$44,688

The Company classifies notes receivable due within one year as other current assets in the Company's consolidated balance sheets.

Table of Contents

The following table summarizes the activity related to the Company's Forgivable Notes Receivable and Mezzanine and Other Notes Receivable allowance for losses for the six months ended June 30, 2014:

	Forgivable Notes Receivable (In thousands)	Mezzanine & Other Notes Receivable
Beginning balance	\$1,650	\$9,896
Provisions	1,129	102
Recoveries	(9	) (50
Write-offs	(95	) —
Other <sup>(1)</sup>	(198	) —
Ending balance	\$2,477	\$9,948

(1) Consists of default rate assumption changes

Forgivable Notes Receivable

As of June 30, 2014 and December 31, 2013, the unamortized balance of the Company's forgivable notes receivable totaled \$25.0 million and \$20.6 million, respectively. The Company recorded an allowance for credit losses on these forgivable notes receivable of \$2.5 million and \$1.7 million at June 30, 2014 and December 31, 2013, respectively. Amortization expense included in the accompanying consolidated statements of income related to the notes for the three months ended June 30, 2014 and 2013 was \$1.2 million and \$1.0 million, respectively. Amortization expense for the six months ended June 30, 2014 and 2013 was \$2.4 million and \$2.0 million, respectively.

Past due balances of forgivable notes receivable are as follows:

	30-89 days Past Due	> 90 days Past Due	Total Past Due	Current	Total Notes Receivable
(In thousands)					
As of June 30, 2014					
Forgivable Notes	\$—	\$1,347	\$1,347	\$23,701	\$25,048
	\$—	\$1,347	\$1,347	\$23,701	\$25,048
As of December 31, 2013					
Forgivable Notes	\$—	\$—	\$—	\$20,625	\$20,625
	\$—	\$—	\$—	\$20,625	\$20,625

Mezzanine and Other Notes Receivable

The Company determined that approximately \$11.8 million and \$12.5 million of its mezzanine and other notes receivable were impaired at June 30, 2014 and December 31, 2013, respectively. The Company recorded allowance for credit losses on these impaired loans at June 30, 2014 and December 31, 2013 totaling \$8.3 million and \$8.3 million, respectively, resulting in a carrying value of impaired loans of \$3.4 million and \$4.2 million, respectively. For the six months ended June 30, 2014 and 2013, the average mezzanine and other notes receivable on non-accrual status was approximately \$12.2 million and \$12.9 million, respectively. The Company recognized approximately \$22 thousand and \$76 thousand of interest income on impaired loans during the three and six months ended June 30, 2014, respectively, on the cash basis. The Company recognized approximately \$73 thousand and \$139 thousand of interest on impaired loans during the three and six months ended June 30, 2013. The Company provided loan reserves on non-impaired loans totaling \$1.6 million at both June 30, 2014 and December 31, 2013.

Table of Contents

Past due balances of mezzanine and other notes receivable by credit quality indicators are as follows:

	30-89 days Past Due	> 90 days Past Due	Total Past Due	Current	Total Notes Receivable
(In thousands)					
As of June 30, 2014					
Senior	\$—	\$—	\$—	\$10,150	\$10,150
Subordinated	1,368	9,629	10,997	2,773	13,770
Unsecured	—	47	47	4,084	4,131
	\$1,368	\$9,676	\$11,044	\$17,007	\$28,051
As of December 31, 2013					
Senior	\$—	\$—	\$—	\$18,052	\$18,052
Subordinated	—	9,629	9,629	4,523	14,152
Unsecured	—	47	47	3,358	3,405
	\$—	\$9,676	\$9,676	\$25,933	\$35,609

#### Loans Acquired with Deteriorated Credit Quality

On December 2, 2011, the Company acquired an \$11.5 million mortgage, held on a franchisee hotel asset, from a financial institution for \$7.9 million. At the time of acquisition, the Company determined that it would be unable to collect all contractually required payments under the original mortgage terms. The contractually required payments receivable, including principal and interest, under the terms of the acquired mortgage totaled \$12.0 million. During the three months ended June 30, 2014, the borrower repaid the Company an amount equal to its original loan acquisition cost of \$7.9 million and the Company does not expect to receive further payments. At December 31, 2013, the carrying amount of this loan, which is reported under senior mezzanine and other notes receivables, was \$7.9 million and there was no allowance for uncollectable amounts. The Company's accretable yield at acquisition was \$1.8 million or 7.36% and a reconciliation of the accretable yield for the six months ended June 30, 2014 is as follows:

	Accretable Yield (In thousands)
Beginning balance	\$582
Additions	—
Accretion	(143 )
Disposals	(439 )
Reclassifications from nonaccretable yield	—
Ending balance	\$—

#### 4. Marketing and Reservation Activities

The Company's franchise agreements require the payment of franchise fees, which include marketing and reservation system fees. The Company is obligated to use the marketing and reservation system revenues it collects from the current franchisees comprising its various hotel brands to provide marketing and reservation services appropriate to support the operation of the overall system. In discharging its obligation to provide sufficient and appropriate marketing and reservation services, the Company has the right to expend funds in an amount reasonably necessary to ensure the provision of such services, whether or not such amount is currently available to the Company for reimbursement. The franchise agreements provide the Company the right to advance monies to the franchise system when the needs of the system surpass the balances currently available. As a result, expenditures by the Company in support of marketing and reservation services in excess of available revenues are deferred and recorded as an asset in the Company's financial statements. Conversely, cumulative marketing and reservation system revenues not expended are recorded as a liability in the financial statements and are carried over to the next fiscal year and expended in accordance with the franchise agreements or utilized to reimburse the Company for prior year advances.

Under the terms of these agreements, the Company has the contractually enforceable right to assess and collect from its current franchisees, fees sufficient to pay for the marketing and reservation services the Company has procured for the benefit of the

franchise system, including fees to reimburse the Company for past services rendered. The Company has the contractual authority to require that the franchisees in the system at any given point repay any deficits related to marketing and reservation activities. The Company's current franchisees are contractually obligated to pay any assessment the Company imposes on its franchisees to obtain reimbursement of such deficit regardless of whether those constituents continue to generate gross room revenue and whether or not they joined the system following the deficit's occurrence.

At December 31, 2013, the Company incurred marketing and reservation system expenses in excess of cumulative marketing and reservation system fees earned of \$5.8 million. Based on the Company's analysis of projected net cash flows from marketing and reservation activities, the Company concluded that the cumulative advances for marketing and reservation activities recorded as an asset on the balance sheet as of December 31, 2013 were fully recoverable and as a result no reserves were necessary.

At June 30, 2014, cumulative marketing and reservation system fees collected exceeded expenses by \$15.9 million with the excess reflected as an other long-term liabilities in the accompanying consolidated balance sheets. Depreciation and amortization expense attributable to marketing and reservation activities for the three and six months ended June 30, 2014 was \$4.3 million and \$8.0 million, respectively. Depreciation and amortization expense attributable to marketing and reservation activities for the three and six months ended June 30, 2013 was \$4.1 million and \$8.1 million, respectively. Interest expense attributable to marketing and reservation activities for the three and six months ended June 30, 2014 was \$0.3 million and \$1.0 million, respectively. Interest expense attributable to marketing and reservation activities for the three and six months ended June 30, 2013 was \$0.9 million and \$1.8 million, respectively.

#### 5. Other Assets

Other assets consist of the following:

	June 30, 2014	December 31, 2013
	(In thousands)	
Equity method investments	\$38,594	\$32,257
Deferred financing fees, net	8,295	8,954
Land	10,234	10,097
Other assets	993	856
Total	\$58,116	\$52,164

Land represents the Company's purchase of real estate as part of its program to incent franchise development in strategic markets for certain brands. The Company has acquired this real estate with the intent to either resell it to third-party developers for the construction of hotels operated under the Company's brands or contribute the land into joint ventures for the same purpose. The real estate is carried at the lower of its carrying value or its estimated fair value (based on comparable sales).

#### Equity Method Investments - Variable Interest Entities

Equity method investments include investments in joint ventures totaling \$34.8 million and \$28.9 million at June 30, 2014 and December 31, 2013, respectively that the Company determined to be variable interest entities ("VIEs"). These investments relate to the Company's program to offer equity support to qualified franchisees to develop and operate Cambria Suites hotels in strategic markets. Based on an analysis of who has the power to direct the activities that most significantly impact these entities performance and who has an obligation to absorb losses of these entities or a right to receive benefits from these entities that could potentially be significant to the entity, the Company determined that it is not the primary beneficiary of any of its VIEs. The Company based its qualitative analysis on its review of the design of the entity, its organizational structure including decision-making ability and the relevant

development, operating management and financial agreements. As a result, the Company's investment in these entities is accounted for under the equity method. For the three and six months ended June 30, 2014, the Company recognized losses totaling \$22 thousand and \$66 thousand, respectively from these investments. For the three and six months ended June 30, 2013, the Company recognized losses totaling \$7 thousand and \$72 thousand, respectively, from these investments. The Company's maximum exposure to losses related to its investments in VIEs is limited to its equity investments as well as certain guarantees described in Note 17 "Commitments and Contingencies" of these financial statements.

Table of Contents

## 6. Deferred Revenue

Deferred revenue consists of the following:

	June 30, 2014	December 31, 2013
	(In thousands)	
Loyalty programs	\$60,427	\$53,875
Initial, relicensing and franchise fees	4,477	5,354
Procurement service fees	1,254	1,504
Other	1,207	455
Total	\$67,365	\$61,188

## 7. Debt

Debt consists of the following at:

	June 30, 2014	December 31, 2013
	(In thousands)	
\$400 million senior unsecured notes with an effective interest rate of 5.94% at June 30, 2014 and December 31, 2013	\$400,000	\$400,000
\$250 million senior unsecured notes with an effective interest rate of 6.19% less discount of \$0.4 million at June 30, 2014 and December 31, 2013	249,604	249,572
\$350 million senior secured credit facility with an effective interest rate of 2.15% and 2.17% at June 30, 2014 and December 31, 2013, respectively	135,000	138,750
Economic development loans with an effective interest rate of 3.00% at June 30, 2014 and December 31, 2013	3,360	3,360
Capital lease obligations due 2016 with an effective interest rate of 3.18% at June 30, 2014 and December 31, 2013	1,499	1,848
Other notes payable	43	29
Total debt	\$789,506	\$793,559
Less current portion	11,970	10,088
Total long-term debt	\$777,536	\$783,471
Senior Notes Due 2022		

On June 27, 2012, the Company issued unsecured senior notes in the principal amount of \$400 million (the "2012 Senior Notes") at par, bearing a coupon of 5.75% with an effective rate of 5.94%. The 2012 Senior Notes will mature on July 1, 2022, with interest to be paid semi-annually on January 1<sup>st</sup> and July 1<sup>st</sup>. The Company used the net proceeds of this offering, after deducting underwriting discounts and commissions and other offering expenses, together with a portion of the proceeds from a new credit facility, to pay a special cash dividend in 2012 totaling approximately \$600.7 million. The Company's 2012 Senior Notes are guaranteed jointly, severally, fully and unconditionally, subject to certain customary limitations by certain of the Company's domestic subsidiaries.

## Senior Notes Due 2020

On August 25, 2010, the Company issued unsecured senior notes in the principal amount of \$250 million (the "2010 Senior Notes") at a discount of \$0.6 million, bearing a coupon of 5.7% with an effective rate of 6.19%. The 2010 Senior Notes will mature on August 28, 2020, with interest to be paid semi-annually on February 28<sup>th</sup> and August 28<sup>th</sup>. The Company used the net proceeds from the offering, after deducting underwriting discounts and other offering expenses, to repay outstanding borrowings and for other general corporate purposes. The Company's 2010 Senior Notes are guaranteed jointly, severally, fully and unconditionally, subject to certain customary limitations by certain of the Company's domestic subsidiaries.

## Revolving Credit Facility

On July 25, 2012, the Company entered into a \$350 million senior secured credit facility, comprised of a \$200 million revolving credit tranche (the "Revolver") and a \$150 million term loan tranche (the "Term Loan") with Deutsche Bank



AG New York Branch, as administrative agent, Wells Fargo Bank, National Association, as administrative agent and a syndication of

21

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Table of Contents

lenders (the "Credit Facility"). The Credit Facility has a final maturity date of July 25, 2016, subject to an optional one-year extension provided certain conditions are met. Up to \$25 million of the borrowings under the Revolver may be used for letters of credit, up to \$10 million of borrowings under the Revolver may be used for swing-line loans and up to \$35 million of borrowings under the Revolver may be used for alternative currency loans. The Term Loan requires quarterly amortization payments (a) during the first two years, in equal installments aggregating 5% of the original principal amount of the Term Loan per year, (b) during the second two years, in equal installments aggregating 7.5% of the original principal amount of the Term Loan per year, and (c) during the one-year extension period (if exercised), equal installments aggregating 10% of the original principal amount of the Term Loan.

The Credit Facility is unconditionally guaranteed, jointly and severally, by certain of the Company's domestic subsidiaries. The subsidiary guarantors currently include all subsidiaries that guarantee the obligations under the Company's Indenture governing the terms of its 2010 and 2012 Senior Notes.

The Credit Facility is secured by first priority pledges of (i) 100% of the ownership interests in certain domestic subsidiaries owned by the Company and the guarantors, (ii) 65% of the ownership interests in (a) the top-tier foreign holding company of the Company's foreign subsidiaries, and (b) the domestic subsidiary that owns the top-tier foreign holding company of the Company's foreign subsidiaries and (iii) all presently existing and future domestic franchise agreements (the "Franchise Agreements") between the Company and individual franchisees, but only to the extent that the Franchise Agreements may be pledged without violating any law of the relevant jurisdiction or conflicting with any existing contractual obligation of the Company or the applicable franchisee. At the time that the maximum total leverage ratio is required to be no greater than 4.0 to 1.0 (beginning of year 4 of the Credit Facility), the security interest in the Franchise Agreements will be released.

The Company may at any time prior to the final maturity date increase the amount of the Credit Facility by up to an additional \$100 million to the extent that any one or more lenders commit to being a lender for the additional amount and certain other customary conditions are met. Such additional amounts may take the form of an increased revolver or term loan.

The Company may elect to have borrowings under the Credit Facility bear interest at a rate equal to (i) LIBOR, plus a margin ranging from 200 to 425 basis points based on the Company's total leverage ratio or (ii) a base rate plus a margin ranging from 100 to 325 basis points based on the Company's total leverage ratio.

The Credit Facility requires the Company to pay a fee on the undrawn portion of the Revolver, calculated on the basis of the average daily unused amount of the Revolver multiplied by 0.30% per annum.

The Company may reduce the Revolver commitment and/or prepay the Term Loan in whole or in part at any time without penalty, subject to reimbursement of customary breakage costs, if any. Any Term Loan prepayments made by the Company shall be applied to reduce the scheduled amortization payments in direct order of maturity.

Additionally, the Credit Facility requires that the Company and its restricted subsidiaries comply with various covenants, including with respect to restrictions on liens, incurring indebtedness, making investments, paying dividends or repurchasing stock, and effecting mergers and/or asset sales. With respect to dividends, the Company may not make any payment if there is an existing event of default or if the payment would create an event of default. In addition, if the Company's total leverage ratio exceeds 4.50 to 1.00, the Company is generally restricted from paying aggregate dividends in excess of \$50.0 million during any calendar year.

The Credit Facility also imposes financial maintenance covenants requiring the Company to maintain:

- a total leverage ratio of not more than 5.75 to 1.00 in year 1, 5.00 to 1.00 in year 2, 4.50 to 1.00 in year 3 and 4.00 to 1.00 thereafter,
- a maximum secured leverage ratio of not more than 2.50 to 1.00 in year 1, 2.25 to 1.00 in year 2, 2.00 to 1.00 in year 3 and 1.75 to 1.00 thereafter, and
- a minimum fixed charge coverage ratio of not less than 2.00 to 1.00 in years 1 and 2, 2.25 to 1.00 in year 3 and 2.50 to 1.00 thereafter.

The Credit Facility includes customary events of default, the occurrence of which, following any applicable cure period, would permit the lenders to, among other things, declare the principal, accrued interest and other obligations of the Company under the Credit Facility to be immediately due and payable. At June 30, 2014, the Company was in

compliance with all financial covenants under the Credit Facility.

At June 30, 2014, the Company had \$135.0 million under the Term Loan and no amounts outstanding under the Revolver. At December 31, 2013, the Company had \$138.8 million outstanding under the Term Loan and no amounts outstanding under the Revolver.

Table of Contents

## Economic Development Loans

The Company entered into economic development agreements with various governmental entities in conjunction with the relocation of its corporate headquarters in April 2013. In accordance with these agreements, the governmental entities agreed to advance approximately \$4.4 million to the Company to offset a portion of the corporate headquarter relocation and tenant improvement costs in consideration of the employment of permanent, full-time employees within the jurisdictions. At June 30, 2014, the Company had been advanced approximately \$3.4 million pursuant to these agreements and expects to receive the remaining \$1 million over the next several years, subject to annual appropriations by the governmental entities. These advances bear interest at a rate of 3% per annum.

Repayment of the advances is contingent upon the Company achieving certain performance conditions. Performance conditions are measured annually on December 31<sup>st</sup> and primarily relate to maintaining certain levels of employment within the various jurisdictions. If the Company fails to meet an annual performance condition, the Company may be required to repay a portion or all of the advances including accrued interest by April 30<sup>th</sup> following the measurement date. Any outstanding advances at the expiration of the Company's 10 year corporate headquarters lease in 2023 will be forgiven in full. The advances will be included in long-term debt in the Company's consolidated balance sheets until the Company determines that the future performance conditions will be met over the entire term of the agreement and the Company will not be required to repay the advances. The Company accrues interest on the portion of the advances that it expects to repay. The Company was in compliance with all current performance conditions as of June 30, 2014.

## 8. Accumulated Other Comprehensive Income (Loss)

The following represents the changes in accumulated other comprehensive loss, net of tax, by component for the six months ended June 30, 2014:

	Loss on Cash Flow Hedge (In thousands)	Foreign Currency Items	Total
Beginning balance, December 31, 2013	\$ (5,745 )	\$ (472 )	\$ (6,217 )
Other comprehensive income (loss) before reclassification	—	1,030	1,030
Amounts reclassified from accumulated other comprehensive income (loss)	431	—	431
Net current period other comprehensive income (loss)	431	1,030	1,461
Ending balance, June 30, 2014	\$ (5,314 )	\$ 558	\$ (4,756 )

The amounts reclassified from accumulated other comprehensive income (loss) during the three and six months ended June 30, 2014 were reclassified to the following line items in the Company's Consolidated Statements of Income.

Component	Amount Reclassified from Accumulated Other Comprehensive Income(Loss)		Affected Line Item in the Consolidated Statement of Net Income
	Three Months Ended June 30, 2014 (In thousands)	Six Months Ended June 30, 2014	
Loss on cash flow hedge			

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Interest rate contract	\$216	\$431	Interest expense
	—	—	Tax (expense) benefit
	\$216	\$431	Net of tax

23

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Table of Contents**9. Non-Qualified Retirement, Savings and Investment Plans**

The Company sponsors two non-qualified retirement savings and investment plans for certain employees and senior executives. Employee and Company contributions are maintained in separate irrevocable trusts. Legally, the assets of the trusts remain those of the Company; however, access to the trusts' assets is severely restricted. The trusts cannot be revoked by the Company or an acquirer, but the assets are subject to the claims of the Company's general creditors.

The participants do not have the right to assign or transfer contractual rights in the trusts.

In 2002, the Company adopted the Choice Hotels International, Inc. Executive Deferred Compensation Plan ("EDCP") which became effective January 1, 2003. Under the EDCP, certain executive officers may defer a portion of their salary into an irrevocable trust. Prior to January 1, 2010, participants could elect an investment return of either the annual yield of the Moody's Average Corporate Bond Rate Yield Index plus 300 basis points, or a return based on a selection of available diversified investment options. Effective January 1, 2010, the Moody's Average Corporate Bond Rate Yield Index plus 300 basis points is no longer an investment option for salary deferrals made on compensation earned after December 31, 2009. The Company recorded current and long-term deferred compensation liabilities of \$9.7 million and \$11.3 million, as of June 30, 2014 and December 31, 2013, respectively, related to these deferrals and credited investment returns. Compensation expense is recorded in SG&A expense on the Company's consolidated statements of income based on the change in the deferred compensation obligation related to earnings credited to participants as well as changes in the fair value of diversified investments. Compensation expense recorded in SG&A related to the EDCP for the three months ended June 30, 2014 and 2013 was \$0.2 million and \$0.1 million, respectively. Compensation expense recorded in SG&A related to the EDCP for the six months ended June 30, 2014 and 2013 was \$0.4 million and \$0.4 million, respectively.

The Company has invested the employee salary deferrals in diversified long-term investments which are intended to provide investment returns that partially offset the earnings credited to the participants. The diversified investments held in the trusts totaled \$4.4 million and \$4.1 million as of June 30, 2014 and December 31, 2013, respectively, and are recorded at their fair value, based on quoted market prices. At June 30, 2014, the Company expects \$0.2 million of the assets held in the trusts to be distributed to participants during the next twelve months. These investments are considered trading securities and therefore the changes in the fair value of the diversified assets is included in other gains and losses in the accompanying consolidated statements of income. The Company recorded investment gains (losses) related to the EDCP during the three months ended June 30, 2014 and 2013 of approximately \$109 thousand and (\$36) thousand, respectively. The Company recorded investment gains related to the EDCP during the six months ended June 30, 2014 and 2013 of approximately \$139 thousand and \$87 thousand, respectively. In addition, the EDCP Plan held shares of the Company's common stock with a market value of \$0.2 million at both June 30, 2014 and December 31, 2013, which were recorded as a component of shareholders' deficit.

In 1997, the Company adopted the Choice Hotels International, Inc. Non-Qualified Retirement Savings and Investment Plan ("Non-Qualified Plan"). The Non-Qualified Plan allows certain employees who do not participate in the EDCP to defer a portion of their salary and invest these amounts in a selection of available diversified investment options. As of June 30, 2014 and December 31, 2013, the Company had recorded a deferred compensation liability of \$14.2 million and \$13.7 million, respectively, related to these deferrals. Compensation expense is recorded in SG&A expense on the Company's consolidated statements of income based on the change in the deferred compensation obligation related to earnings credited to participants as well as changes in the fair value of diversified investments. The net increase (decrease) in compensation expense recorded in SG&A related to the Non-Qualified Plan for the three months ended June 30, 2014 and 2013 was \$0.4 million and \$(0.2) million, respectively. The net increase in compensation expense recorded in SG&A related to the Non-Qualified Plan for the six months ended June 30, 2014 and 2013 was \$0.2 million and \$0.7 million, respectively.

The diversified investments held in the trusts were \$13.0 million and \$12.3 million as of June 30, 2014 and December 31, 2013, respectively, and are recorded at their fair value, based on quoted market prices. These investments are considered trading securities and therefore the changes in the fair value of the diversified assets is included in other gains and losses in the accompanying consolidated statements of income. The Company recorded investment gains (losses) related to the Non-Qualified Plan during the three months ended June 30, 2014 and 2013 of

approximately \$0.3 million and (\$0.1) million, respectively. The Company recorded investment gains related to the Non-Qualified Plan during the six months ended June 30, 2014 and 2013 of approximately \$0.4 million and \$0.5 million, respectively. In addition, the Non-Qualified Plan held shares of the Company's common stock with a market value of \$1.2 million and \$1.4 million at June 30, 2014 and December 31, 2013, respectively, which are recorded as a component of shareholders' deficit.

#### 10. Fair Value Measurements

The Company estimates the fair value of its financial instruments utilizing a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. The following summarizes the three levels of inputs, as well as the assets that the Company values using those levels of inputs.

Table of Contents

Level 1: Quoted prices in active markets for identical assets and liabilities. The Company's Level 1 assets consist of marketable securities (primarily mutual funds) held in the Company's EDCP and Non-Qualified Plan deferred compensation plans.

Level 2: Observable inputs, other than quoted prices in active markets for identical assets and liabilities, such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable. The Company's Level 2 assets consist of money market funds held in the Company's EDCP and Non-Qualified Plan deferred compensation plans and those recorded in cash and cash equivalents.

Level 3: Unobservable inputs, supported by little or no market data available, where the reporting entity is required to develop its own assumptions to determine the fair value of the instrument.

The Company's policy is to recognize transfers in and transfers out of the three levels of the fair value hierarchy as of the end of each quarterly reporting period. There were no transfers between Level 1, 2 and 3 assets during the three and six months ended June 30, 2014.

As of June 30, 2014 and December 31, 2013, the Company had the following assets measured at fair value on a recurring basis:

	Fair Value Measurements at Reporting Date Using			
	Total	Level 1	Level 2	Level 3
Assets	(In thousands)			
As of June 30, 2014				
Money market funds, included in cash and cash equivalents	\$50,001	\$—	\$50,001	\$—
Mutual funds <sup>(1)</sup>	15,810	15,810	—	—
Money market funds <sup>(1)</sup>	1,636	—	1,636	—
	\$67,447	\$15,810	\$51,637	\$—
As of December 31, 2013				
Money market funds, included in cash and cash equivalents	\$50,001	\$—	\$50,001	\$—
Mutual funds <sup>(1)</sup>	14,564	14,564	—	—
Money market funds <sup>(1)</sup>	1,786	—	1,786	—
	\$66,351	\$14,564	\$51,787	\$—

(1)Included in Investments, employee benefit plans fair value on the consolidated balance sheets.

#### Other Financial Instruments

The Company believes that the fair value of its current assets and current liabilities approximate their reported carrying amounts due to the short-term nature of these items. In addition, the interest rates of the Company's Credit Facility adjust frequently based on current market rates; accordingly its carrying amount approximates fair value. The Company estimates the fair value of notes receivable which approximate their carrying value, utilizing an analysis of future cash flows and credit worthiness for similar types of arrangements. Based upon the availability of market data, these notes receivables have been classified as Level 3 inputs. The primary sensitivity in these calculations is based on the selection of appropriate interest and discount rates. For further information on the notes receivables, which are included in both other current assets and notes receivable in the consolidated balance sheets, see Note 3. The fair value of the Company's 2010 and 2012 Senior Notes are classified as Level 2 as the significant inputs are observable in an active market. At June 30, 2014 and December 31, 2013, the 2010 Senior Notes had an approximate fair value of \$271.3 million and \$261.3 million, respectively. At June 30, 2014 and December 31, 2013, the 2012 Senior Notes had an approximate fair value of \$434.0 million and \$416.0 million, respectively.

Fair values estimated are made at a specific point in time, are subjective in nature and involve uncertainties and matters of significant judgment. Settlement of such fair value amounts may not be possible and may not be a prudent



management decision.

25

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Table of Contents

## 11. Income Taxes

The effective income tax rates for income from continuing operations were 29.8% and 28.9% for the three months ended June 30, 2014 and restated June 30, 2013, respectively. The effective income tax rates for income from continuing operations were 30.6% and 28.7% for the six months ended June 30, 2014 and and restated June 30, 2013, respectively. The effective income tax rate for discontinued operations was 37.1% for the three and six months ended June 30, 2014 and restated June 30, 2013.

The effective income tax rate for continuing operations for the three and six months ended June 30, 2014 and restated June 30, 2013 was lower than the U.S federal income tax rate of 35% due to the recurring impact of foreign operations, partially offset by state income taxes. The effective income tax rates for the restated three and six months ended June 30, 2013 reflect the release of a valuation allowance on local country tax refunds received by a foreign subsidiary. The effective income tax rate for the restated six months ended June 30, 2013 was further reduced by settlements of unrecognized tax positions and legislation retroactively extending the U.S. controlled foreign corporation look-through rules.

## 12. Share-Based Compensation and Capital Stock

## Stock Options

No stock options were granted during the three month periods ended June 30, 2014 and 2013. The Company granted 0.7 million and 0.2 million options to certain employees of the Company at a fair value of \$5.7 million and \$1.7 million for the six months ended June 30, 2014 and 2013, respectively. The stock options granted by the Company had an exercise price equal to the market price of the Company's common stock on the date of grant. The fair value of the options granted was estimated on the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2014 Grants	2013 Grants	
Risk-free interest rate	1.56	% 0.73	%
Expected volatility	25.01	% 38.14	%
Expected life of stock option	4.5 years	4.5 years	
Dividend yield	1.62	% 2.01	%
Requisite service period	4 years	4 years	
Contractual life	7 years	7 years	
Weighted average fair value of options granted	\$8.82	\$9.89	

The expected life of the options and volatility are based on historical data and are not necessarily indicative of exercise patterns or actual volatility that may occur. Historical volatility is calculated based on a period that corresponds to the expected life of the stock option. The dividend yield and the risk-free rate of return are calculated on the grant date based on the then current dividend rate and the risk-free rate of return for the period corresponding to the expected life of the stock option. Compensation expense related to the fair value of these awards is recognized straight-line over the requisite service period based on those awards that ultimately vest.

The aggregate intrinsic value of the stock options outstanding and exercisable at June 30, 2014 was \$34.1 million and \$29.0 million, respectively. The total intrinsic value of options exercised during the six months ended June 30, 2014 and 2013 was approximately \$1.3 million and \$2.9 million, respectively. There were no options exercised during the three months ended June 30, 2014. The total intrinsic value of options exercised during the three months ended June 30, 2013 was approximately \$0.6 million.

The Company received approximately \$1.5 million and \$6.0 million in proceeds from the exercise of 58,749 and 234,065 employee stock options during the six month periods ended June 30, 2014 and 2013, respectively. The Company received approximately \$0.6 million in proceeds from the exercise of 29,742 employee stock options during the three months ended June 30, 2013.

Table of Contents

## Restricted Stock

The following table is a summary of activity related to restricted stock grants:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2014	2013	2014	2013
Restricted share grants	17,262	20,858	147,055	215,399
Weighted average grant date fair value per share	\$44.62	\$45.32	\$46.46	\$37.59
Aggregate grant date fair value (\$000)	\$770	\$945	\$6,833	8,097
Restricted shares forfeited	2,964	6,429	4,296	27,928
Vesting service period of shares granted	12 - 36 months	12 - 48 months	12 - 48 months	12 - 48 months
Grant date fair value of shares vested (\$000)	\$935	\$660	\$8,203	\$7,659

Compensation expense related to the fair value of these awards is recognized straight-line over the requisite service period based on those restricted stock grants that ultimately vest. The fair value of grants is measured by the market price of the Company's stock on the date of grant. Restricted stock awards generally vest ratably over the service period beginning with the first anniversary of the grant date. Awards granted to retirement eligible non-employee directors are recognized over the shorter of the requisite service period or the length of time until retirement since the terms of the grant provide that the awards will vest upon retirement.

## Performance Vested Restricted Stock Units

The Company has granted performance vested restricted stock units ("PVRSU") to certain employees. The fair value is measured by the market price of the Company's common stock on the date of the grant. The vesting of these stock awards is contingent upon the Company achieving performance targets at the end of specified performance periods and the employees' continued employment. The performance conditions affect the number of shares that will ultimately vest. The range of possible stock-based award vesting is generally between 0% and 200% of the initial target. If minimum performance targets are not attained then no awards will vest under the terms of the various PVRSU agreements. Compensation expense related to these awards is recognized over the requisite service period based on the Company's estimate of the achievement of the various performance targets. The Company has currently estimated that between 0% and 150% of the various award targets will be achieved. Compensation expense is recognized ratably over the requisite service period only on those PVRSUs that ultimately vest.

The following table is a summary of activity related to PVRSU grants:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2014	2013	2014	2013
Performance vested restricted stock units granted at target	—	—	24,678	58,902
Weighted average grant date fair value per share	\$—	\$—	\$45.59	\$36.76
Aggregate grant date fair value (\$000)	\$—	\$—	\$1,125	\$2,165
Stock units forfeited	—	—	—	—
Requisite service period	—	—	36 months	22-36 months

During the three months ended June 30, 2014 and 2013, no PVRSU grants vested. During the six months ended June 30, 2014, a total of 28,886 PVRSU grants vested at a fair value of \$1.4 million. These PVRSU grants were initially granted at a target of 18,635 units. However, since the Company achieved 155% of the targeted performance conditions contained in the stock awards granted in prior periods, an additional 10,251 shares were earned and issued. During the six months ended June 30, 2013, a total of 39,816 PVRSU grants vested at a fair value of \$1.3 million. These PVRSU grants were initially granted at a target of 30,624 units. However, since the Company achieved 130% of the targeted performance conditions contained in the stock awards granted in prior periods, an additional 9,192 shares were earned and issued.



Table of Contents

A summary of stock-based award activity as of June 30, 2014 and changes during the six months ended are presented below:

	Stock Options			Restricted Stock		Performance Vested Restricted Stock Units	
	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2014	1,661,952	\$26.44		563,345	\$36.64	216,342	\$37.34
Granted	651,757	\$45.59		147,055	\$46.46	24,678	\$45.59
Performance based leveraging <sup>(1)</sup>	—	\$—		—	\$—	10,251	\$41.25
Exercised/Vested	(58,749 )	\$26.33		(172,997 )	\$37.04	(28,886 )	\$41.25
Expired	—	\$—		—	\$—	—	\$—
Forfeited	—	\$—		(4,296 )	\$39.18	—	\$—
Outstanding at June 30, 2014	2,254,960	\$31.98	3.7	533,107	\$39.20	222,385	\$37.93
Options exercisable at June 30, 2014	1,326,714	\$25.24	2.1				

<sup>(1)</sup>PVRSU units outstanding have been increased by 10,251 units due to the Company exceeding the targeted performance conditions contained in PVRSUs granted in prior periods during the six months ended June 30, 2014. The components of the Company's pretax share-based compensation expense and associated income tax benefits are as follows for the three and six months ended June 30, 2014 and 2013:

(in millions)	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Stock options	\$0.7	\$0.5	\$1.1	\$1.0
Restricted stock	1.9	1.8	3.8	3.6
Performance vested restricted stock units	(0.8 )	0.6	(0.1 )	1.2
Total	\$1.8	\$2.9	\$4.8	\$5.8
Income tax benefits	\$0.7	\$1.1	\$1.8	\$2.1

During the three and six months ended June 30, 2014, the Company revised its estimate of the projected achievement of various performance conditions that affect the number of PVRSUs that will ultimately vest. As a result, previously recognized share-based compensation costs related to these PVRSUs has been decreased by \$1.2 million and \$1.0 million for the three and six months ended June 30, 2014.

**Dividends**

The Company currently pays a quarterly dividend on its common stock of \$0.185 per share, however the declaration of future dividends are subject to the discretion of the board of directors. During the three and six months ended June 30, 2014, the Company's board of directors declared dividends totaling \$0.185 and \$0.37 per share or approximately \$10.8 million and \$21.6 million in the aggregate, respectively.

In addition, during the six months ended June 30, 2014, the Company recorded dividends totaling \$0.4 million related to previously declared dividends that were contingent upon the vesting of performance vested restricted stock units. No dividends on performance vested restricted units were paid during the three months ended June 30, 2014.

**Share Repurchases and Redemptions**

No shares of common stock were purchased by the Company under the share repurchase program during the three and six months ended June 30, 2014.

Table of Contents

During the three and six months ended June 30, 2014, the Company redeemed 302 and 94,745 shares of common stock at a total cost of approximately \$13 thousand and \$4.5 million, respectively, from employees to satisfy the option exercise price and statutory minimum tax-withholding requirements related to the exercising of stock options and vesting of performance vested restricted stock units and restricted stock grants. These redemptions were outside the share repurchase program.

## Other

Effective January 1, 2014, the Company reduced its reported number of common shares outstanding by 0.3 million shares to address a reconciling item with the Company's share transfer agent.

## 13. Earnings Per Share

The computation of basic and diluted earnings per common share is as follows:

(In thousands, except per share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013 (Restated)	2014	2013 (Restated)
<b>Computation of Basic Earnings Per Share:</b>				
Numerator:				
Net income from continuing operations	\$35,279	\$31,624	\$56,748	\$51,400
Net income from discontinued operations	121	183	1,762	150
Net income	35,400	31,807	58,510	51,550
Income allocated to participating securities	(324)	(310)	(523)	(521)
Net income available to common shareholders	\$35,076	\$31,497	\$57,987	\$51,029
Denominator:				
Weighted average common shares outstanding – basic	57,893	57,953	57,850	57,837
Basic earnings per share - Continuing operations	\$0.61	\$0.54	\$0.97	\$0.88
Basic earnings per share - Discontinued operations	—	—	0.03	—
	\$0.61	\$0.54	\$1.00	\$0.88
<b>Computation of Diluted Earnings Per Share:</b>				
Numerator:				
Net income from continuing operations	\$35,279	\$31,624	\$56,748	\$51,400
Net income from discontinued operations	121	183	1,762	150
Net income	35,400	31,807	58,510	51,550
Income allocated to participating securities	(322)	(309)	(521)	(519)
Net income available to common shareholders	\$35,078	\$31,498	\$57,989	\$51,031
Denominator:				
Weighted average common shares outstanding – basic	57,893	57,953	57,850	57,837
Diluted effect of stock options and PVRSUs	492	386	491	376
Weighted average common shares outstanding – diluted	58,385	58,339	58,341	58,213
Diluted earnings per share - Continuing operations	\$0.60	\$0.54	\$0.96	\$0.88
Diluted earnings per share - Discontinued operations	—	—	0.03	—
	\$0.60	\$0.54	\$0.99	\$0.88

The Company's unvested restricted shares contain rights to receive non-forfeitable dividends, and thus are participating securities requiring the two-class method of computing earnings per share ("EPS"). The calculation of EPS for common stock





Table of Contents

shown above excludes the income attributable to the unvested restricted share awards from the numerator and excludes the dilutive impact of those awards from the denominator.

At June 30, 2014 and 2013, the Company had 2.3 million and 1.8 million outstanding stock options, respectively. Stock options are included in the diluted earnings per share calculation using the treasury stock method and average market prices during the period, unless the stock options would be anti-dilutive. For the three months ended June 30, 2014, the Company excluded 0.7 million of anti-dilutive stock options from the diluted EPS calculation. For the six months ended June 30, 2014 and the three and six months ended June 30, 2013, the Company did not exclude any anti-dilutive stock options from the diluted EPS calculation.

PVRSUs are also included in the diluted earnings per share calculation when the performance conditions have been met at the reporting date. However, at June 30, 2014 and 2013, PVRSUs totaling 222,385 and 198,394, respectively, were excluded from the computation since the performance conditions had not been met.

14. Condensed Consolidating Financial Statements

The Company's 2010 and 2012 Senior Notes are guaranteed jointly, severally, fully and unconditionally, subject to certain customary limitations, by certain of the Company's domestic subsidiaries. There are no legal or regulatory restrictions on the payment of dividends to Choice Hotels International, Inc. from subsidiaries that do not guarantee the Senior Notes. As a result of the guarantee arrangements, the following condensed consolidating financial statements are presented. Investments in subsidiaries are accounted for under the equity method of accounting.

The condensed consolidating financial statements have been restated for the three and six months ended June 30, 2013 and the consolidated balance sheet as of December 31, 2013 has been revised from previously issued interim and annual financial statements to reflect the correction of an error discussed in Note 1 under the heading "Revision to Prior Annual Financial Statements and Restatement of Prior Interim Financial Statements" and other immaterial errors. In addition, the condensed consolidating statements of income for the three and six months ended June 30, 2013 have been reclassified to account for discontinued operations as discussed in Note 17, "Discontinued Operations".

Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Statement of Income  
For the Three Months Ended June 30, 2014  
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>REVENUES:</b>					
Royalty fees	\$71,090	\$36,759	\$12,360	\$(42,539 )	\$77,670
Initial franchise and relicensing fees	4,435	—	287	—	4,722
Procurement services	7,842	—	178	—	8,020
Marketing and reservation	92,289	94,301	5,034	(87,858 )	103,766
Other	3,342	1	143	—	3,486
Total revenues	178,998	131,061	18,002	(130,397 )	197,664
<b>OPERATING EXPENSES:</b>					
Selling, general and administrative	37,137	33,503	3,312	(42,539 )	31,413
Marketing and reservation	96,232	90,658	4,734	(87,858 )	103,766
Depreciation and amortization	756	1,416	160	—	2,332
Total operating expenses	134,125	125,577	8,206	(130,397 )	137,511
Operating income	44,873	5,484	9,796	—	60,153
<b>OTHER INCOME AND EXPENSES, NET:</b>					
Interest expense	10,703	1	6	—	10,710
Equity in earnings of consolidated subsidiaries	(13,188 )	(11 )	—	13,199	—
Other items, net	(297 )	(450 )	(44 )	—	(791 )
Total other income and expenses, net	(2,782 )	(460 )	(38 )	13,199	9,919
Income from continuing operations before income taxes	47,655	5,944	9,834	(13,199 )	50,234
Income taxes	12,255	2,380	320	—	14,955
Income from continuing operations, net of income taxes	35,400	3,564	9,514	(13,199 )	35,279
Income from discontinued operations, net of income taxes	—	121	—	—	121
Net income	\$35,400	\$3,685	\$9,514	\$(13,199 )	\$35,400

Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Statement of Income  
For the Three Months Ended June 30, 2013 (Restated)  
(Unaudited, in thousands)

	Parent (Restated)	Guarantor Subsidiaries (Restated)	Non-Guarantor Subsidiaries (Restated)	Eliminations (Restated)	Consolidated (Restated)
<b>REVENUES:</b>					
Royalty fees	\$66,228	\$35,111	\$11,191	\$(39,892)	) \$72,638
Initial franchise and relicensing fees	4,087	—	329	—	4,416
Procurement services	7,384	—	162	—	7,546
Marketing and reservation	92,381	94,569	5,037	(87,915)	) 104,072
Other	2,015	—	243	—	2,258
Total revenues	172,095	129,680	16,962	(127,807)	) 190,930
<b>OPERATING EXPENSES:</b>					
Selling, general and administrative	35,121	31,394	3,108	(39,892)	) 29,731
Marketing and reservation	96,364	91,251	4,372	(87,915)	) 104,072
Depreciation and amortization	759	1,426	203	—	2,388
Total operating expenses	132,244	124,071	7,683	(127,807)	) 136,191
Operating income	39,851	5,609	9,279	—	54,739
<b>OTHER INCOME AND EXPENSES, NET:</b>					
Interest expense	10,783	17	7	—	10,807
Equity in earnings of consolidated subsidiaries	(13,215)	) —	—	13,215	—
Other items, net	(564)	) 147	(155)	) —	(572)
Total other income and expenses, net	(2,996)	) 164	(148)	) 13,215	10,235
Income from continuing operations before income tax	42,847	5,445	9,427	(13,215)	) 44,504
Income taxes	11,040	2,222	(382)	) —	12,880
Income from continuing operations, net of income taxes	31,807	3,223	9,809	(13,215)	) 31,624
Income from discontinued operations, net of income taxes	—	183	—	—	183
Net income	\$31,807	\$3,406	\$9,809	\$(13,215)	) \$31,807

Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Statement of Income  
For the Six Months Ended June 30, 2014  
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>REVENUES:</b>					
Royalty fees	\$124,085	\$60,974	\$22,882	\$(71,731)	) \$136,210
Initial franchise and relicensing fees	8,019	—	443	—	8,462
Procurement services	12,473	—	325	—	12,798
Marketing and reservation	171,110	168,200	9,169	(155,107)	) 193,372
Other	6,298	1	259	—	6,558
Total revenues	321,985	229,175	33,078	(226,838)	) 357,400
<b>OPERATING EXPENSES:</b>					
Selling, general and administrative	67,711	55,594	6,519	(71,731)	) 58,093
Marketing and reservation	177,817	161,602	9,060	(155,107)	) 193,372
Depreciation and amortization	1,507	2,734	369	—	4,610
Total operating expenses	247,035	219,930	15,948	(226,838)	) 256,075
Operating income	74,950	9,245	17,130	—	101,325
<b>OTHER INCOME AND EXPENSES, NET:</b>					
Interest expense	20,871	2	8	—	20,881
Equity in earnings of consolidated subsidiaries	(24,114)	) 50	—	24,064	—
Other items, net	(725)	) (517)	) (76)	)	(1,318)
Total other income and expenses, net	(3,968)	) (465)	) (68)	) 24,064	19,563
Income from continuing operations before income taxes	78,918	9,710	17,198	(24,064)	) 81,762
Income taxes	20,408	4,184	422	—	25,014
Income from continuing operations, net of income taxes	58,510	5,526	16,776	(24,064)	) 56,748
Income from discontinued operations, net of income taxes	—	1,762	—	—	1,762
Net income	\$58,510	\$7,288	\$16,776	\$(24,064)	) \$58,510

Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Statement of Income  
For the Six Months Ended June 30, 2013 (Restated)  
(Unaudited, in thousands)

	Parent (Restated)	Guarantor Subsidiaries (Restated)	Non-Guarantor Subsidiaries (Restated)	Eliminations (Restated)	Consolidated (Restated)
<b>REVENUES:</b>					
Royalty fees	\$ 116,644	\$ 59,316	\$ 20,578	\$(67,792)	) \$ 128,746
Initial franchise and relicensing fees	7,655	—	538	—	8,193
Procurement services	11,184	—	312	—	11,496
Marketing and reservation	163,426	170,732	9,584	(157,347)	) 186,395
Other	3,803	—	468	—	4,271
Total revenues	302,712	230,048	31,480	(225,139)	) 339,101
<b>OPERATING EXPENSES:</b>					
Selling, general and administrative	64,405	53,382	6,404	(67,792)	) 56,399
Marketing and reservation	169,956	164,413	9,373	(157,347)	) 186,395
Depreciation and amortization	1,473	2,553	403	—	4,429
Total operating expenses	235,834	220,348	16,180	(225,139)	) 247,223
Operating income	66,878	9,700	15,300	—	91,878
<b>OTHER INCOME AND EXPENSES, NET:</b>					
Interest expense	21,519	50	8	—	21,577
Equity in earnings of consolidated subsidiaries	(21,660)	) —	—	21,660	—
Other items, net	(1,112)	) (564)	) (109)	) —	(1,785)
Total other income and expenses, net	(1,253)	) (514)	) (101)	) 21,660	19,792
Income from continuing operations before income taxes	68,131	10,214	15,401	(21,660)	) 72,086
Income taxes (benefit)	16,581	4,300	(195)	) —	20,686
Income from continuing operations, net of income taxes	51,550	5,914	15,596	(21,660)	) 51,400
Income from discontinued operations, net of income taxes	—	150	—	—	150
Net income	\$ 51,550	\$ 6,064	\$ 15,596	\$(21,660)	) \$ 51,550



Table of Contents

Choice Hotels International, Inc.  
 Condensed Consolidating Statement of Comprehensive Income  
 For the Three Months Ended June 30, 2014  
 (Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income	\$35,400	\$3,685	\$9,514	\$(13,199 )	\$35,400
Other comprehensive income (loss), net of tax:					
Amortization of loss on cash flow hedge	216	—	—	—	216
Foreign currency translation adjustment	509	—	509	(509 )	509
Other comprehensive income (loss), net of tax	725	—	509	(509 )	725
Comprehensive income	\$36,125	\$3,685	\$10,023	\$(13,708 )	\$36,125

Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Statement of Comprehensive Income  
For the Three Months Ended June 30, 2013 (Restated)  
(Unaudited, in thousands)

	Parent (Restated)	Guarantor Subsidiaries (Restated)	Non-Guarantor Subsidiaries (Restated)	Eliminations (Restated)	Consolidated (Restated)
Net income	\$31,807	\$3,406	\$9,809	\$(13,215 )	\$31,807
Other comprehensive income (loss), net of tax:					
Amortization of loss on cash flow hedge	216	—	—	—	216
Foreign currency translation adjustment	(2,082 )	—	(2,082 )	2,082	(2,082 )
Other comprehensive income (loss), net of tax	(1,866 )	—	(2,082 )	2,082	(1,866 )
Comprehensive income	\$29,941	\$3,406	\$7,727	\$(11,133 )	\$29,941

36



Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Statement of Comprehensive Income  
For the Six Months Ended June 30, 2014  
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income	\$58,510	\$7,288	\$16,776	\$(24,064 )	\$58,510
Other comprehensive income (loss), net of tax:					
Amortization of loss on cash flow hedge	431	—	—	—	431
Foreign currency translation adjustment	1,030	—	1,030	(1,030 )	1,030
Other comprehensive income (loss), net of tax	1,461	—	1,030	(1,030 )	1,461
Comprehensive income	\$59,971	\$7,288	\$17,806	\$(25,094 )	\$59,971

37

Table of Contents

Choice Hotels International, Inc.  
 Condensed Consolidating Statement of Comprehensive Income  
 For the Six Months Ended June 30, 2013 (Restated)  
 (Unaudited, in thousands)

	Parent (Restated)	Guarantor Subsidiaries (Restated)	Non-Guarantor Subsidiaries (Restated)	Eliminations (Restated)	Consolidated (Restated)
Net income	\$51,550	\$6,064	\$15,596	\$ (21,660 )	\$51,550
Other comprehensive income (loss), net of tax:					
Amortization of loss on cash flow hedge	431	—	—	—	431
Foreign currency translation adjustment	(2,327 )	—	(2,327 )	2,327	(2,327 )
Other comprehensive income (loss), net of tax	(1,896 )	—	(2,327 )	2,327	(1,896 )
Comprehensive income	\$49,654	\$6,064	\$13,269	\$ (19,333 )	\$49,654

Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Balance Sheet  
As of June 30, 2014  
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
Cash and cash equivalents	\$38,962	\$111	\$172,469	\$—	\$211,542
Receivables, net	107,954	1,646	10,163	—	119,763
Other current assets	14,770	37,976	1,585	(633)	53,698
Total current assets	161,686	39,733	184,217	(633)	385,003
Property and equipment, at cost, net	18,500	38,796	942	—	58,238
Goodwill	60,620	5,193	—	—	65,813
Franchise rights and other identifiable intangibles, net	5,468	1,787	1,134	—	8,389
Notes receivable, net of allowances	12,047	20,936	1,509	—	34,492
Investments, employee benefit plans, at fair value	—	17,270	—	—	17,270
Investment in affiliates	403,500	31,233	—	(434,733)	—
Advances to affiliates	13,060	216,916	11,338	(241,314)	—
Deferred income taxes	—	9,895	917	(9,691)	1,121
Other assets	8,296	14,806	35,014	—	58,116
Total assets	\$683,177	\$396,565	\$235,071	\$(686,371)	\$628,442
<b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>					
Accounts payable	\$7,513	\$39,178	\$4,201	\$—	\$50,892
Accrued expenses	28,591	21,635	2,172	—	52,398
Deferred revenue	6,794	59,811	760	—	67,365
Current portion of long-term debt	11,250	707	13	—	11,970
Deferred compensation and retirement plan obligations	—	579	—	—	579
Other current liabilities	4,572	13,520	—	(633)	17,459
Total current liabilities	58,720	135,430	7,146	(633)	200,663
Long-term debt	773,353	4,153	30	—	777,536
Deferred compensation & retirement plan obligations	—	23,250	10	—	23,260
Advances from affiliates	233,304	318	7,692	(241,314)	—
Other liabilities	30,310	17,984	890	(9,691)	39,493
Total liabilities	1,095,687	181,135	15,768	(251,638)	1,040,952
Total shareholders' (deficit) equity	(412,510)	) 215,430	219,303	(434,733)	(412,510)
Total liabilities and shareholders' deficit	\$683,177	\$396,565	\$235,071	\$(686,371)	\$628,442

Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Balance Sheet  
As of December 31, 2013  
(In thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
Cash and cash equivalents	\$9,785	\$569	\$157,441	\$—	\$167,795
Receivables, net	72,219	1,475	8,691	—	82,385
Other current assets	26,395	34,987	752	(5,340)	56,794
Total current assets	108,399	37,031	166,884	(5,340)	306,974
Property and equipment, at cost, net	11,087	55,963	802	—	67,852
Goodwill	60,620	5,193	—	—	65,813
Franchise rights and other identifiable intangibles, net	6,553	2,096	1,304	—	9,953
Advances, marketing and reservation activities	5,844	—	—	—	5,844
Notes receivable, net of allowances	13,257	17,158	1,457	—	31,872
Investments, employee benefit plans, at fair value	—	15,950	—	—	15,950
Investment in affiliates	376,712	28,312	—	(405,024)	—
Advances to affiliates	14,198	189,833	10,896	(214,927)	—
Deferred income taxes	—	10,710	871	(11,581)	—
Other assets	8,955	13,184	30,025	—	52,164
Total assets	\$605,625	\$375,430	\$212,239	\$(636,872)	\$556,422
<b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>					
Accounts payable	\$6,276	\$30,778	\$4,609	\$—	\$41,663
Accrued expenses	28,215	26,503	1,907	—	56,625
Deferred revenue	7,065	53,414	709	—	61,188
Current portion of long-term debt	9,375	702	11	—	10,088
Deferred compensation and retirement plan obligations	—	2,492	—	—	2,492
Other current liabilities	—	7,401	221	(5,340)	2,282
Total current liabilities	50,931	121,290	7,457	(5,340)	174,338
Long-term debt	778,946	4,507	18	—	783,471
Deferred compensation & retirement plan obligations	—	22,520	7	—	22,527
Advances from affiliates	206,931	362	7,634	(214,927)	—
Other liabilities	21,688	18,216	634	(11,581)	28,957
Total liabilities	1,058,496	166,895	15,750	(231,848)	1,009,293
Total shareholders' (deficit) equity	(452,871)	208,535	196,489	(405,024)	(452,871)
Total liabilities and shareholders' deficit	\$605,625	\$375,430	\$212,239	\$(636,872)	\$556,422

Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Statement of Cash Flows  
For the Six Months Ended June 30, 2014  
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided (used) by operating activities	\$53,132	\$(1,383 )	\$ 14,740	\$(657 )	\$ 65,832
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>					
Investment in property and equipment	(1,797 )	(5,235 )	(282 )	—	(7,314 )
Proceeds from sales of assets	27	12,189	—	—	12,216
Equity method investments	—	(1,283 )	(5,663 )	—	(6,946 )
Purchases of investments, employee benefit plans	—	(1,220 )	—	—	(1,220 )
Proceeds from sales of investments, employee benefit plans	—	641	—	—	641
Issuance of mezzanine and other notes receivable	(2,223 )	—	—	—	(2,223 )
Collections of mezzanine and other notes receivable	9,743	—	—	—	9,743
Advances to and investments in affiliates	(1,000 )	(4,842 )	—	5,842	—
Other items, net	(296 )	—	—	—	(296 )
Net cash provided (used) in investing activities	4,454	250	(5,945 )	5,842	4,601
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>					
Principal payments on long-term debt	(3,750 )	(349 )	(13 )	—	(4,112 )
Proceeds from the issuance of long-term debt	—	—	26	—	26
Proceeds from contributions from affiliates	—	—	5,842	(5,842 )	—
Purchases of treasury stock	(4,544 )	—	—	—	(4,544 )
Dividends paid	(21,957 )	—	(657 )	657	(21,957 )
Excess tax benefits from stock-based compensation	295	1,024	—	—	1,319
Proceeds from exercise of stock options	1,547	—	—	—	1,547
Net cash provided (used) by financing activities	(28,409 )	675	5,198	(5,185 )	(27,721 )
Net change in cash and cash equivalents	29,177	(458 )	13,993	—	42,712
Effect of foreign exchange rate changes on cash and cash equivalents	—	—	1,035	—	1,035
Cash and cash equivalents at beginning of period	9,785	569	157,441	—	167,795
Cash and cash equivalents at end of period	\$38,962	\$ 111	\$ 172,469	\$—	\$211,542

Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Statement of Cash Flows  
For the Six Months Ended June 30, 2013 (Restated)  
(Unaudited, in Thousands)

	Parent (Restated)	Guarantor Subsidiaries (Restated)	Non-Guarantor Subsidiaries (Restated)	Eliminations (Restated)	Consolidated (Restated)
Net cash provided (used) by operating activities	\$ (3,139 )	\$ 15,698	\$ 17,708	\$ (280 )	\$ 29,987
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>					
Investment in property and equipment	(3,775 )	(18,135 )	(125 )	—	(22,035 )
Equity method investments	—	—	(1,851 )	—	(1,851 )
Purchases of investments, employee benefit plans	—	(1,580 )	—	—	(1,580 )
Proceeds from sales of investments, employee benefit plans	—	3,934	—	—	3,934
Collections of mezzanine and other notes receivable	201	—	—	—	201
Advances to and investments in affiliates	(1,000 )	(850 )	—	1,850	—
Other items, net	(304 )	—	—	—	(304 )
Net cash provided (used) in investing activities	(4,878 )	(16,631 )	(1,976 )	1,850	(21,635 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>					
Net borrowings pursuant to revolving credit facility	15,200	—	—	—	15,200
Principal payments on long-term debt	(3,750 )	(335 )	(10 )	—	(4,095 )
Purchases of treasury stock	(3,651 )	—	—	—	(3,651 )
Dividends paid	(11,261 )	—	—	—	(11,261 )
Excess tax benefits from stock-based compensation	20	1,126	—	—	1,146
Proceeds from contributions from affiliates	—	—	1,850	(1,850 )	—
Proceeds from exercise of stock options	5,973	—	—	—	5,973
Net cash provided (used) by financing activities	2,531	791	1,840	(1,850 )	3,312
Net change in cash and cash equivalents	(5,486 )	(142 )	17,572	(280 )	11,664
Effect of foreign exchange rate changes on cash and cash equivalents	—	—	(2,051 )	—	(2,051 )
Cash and cash equivalents at beginning of period	8,420	407	125,350	—	134,177
Cash and cash equivalents at end of period	\$ 2,934	\$ 265	\$ 140,871	\$ (280 )	\$ 143,790



Table of Contents

## 15. Reportable Segment Information

**Franchising:** Franchising includes the Company's hotel franchising operations consisting of its eleven brands. The eleven brands are aggregated within this segment considering their similar economic characteristics, types of customers, distribution channels and regulatory business environments. Revenues from the franchising business include royalty fees, initial franchise and relicensing fees, marketing and reservation system fees, procurement services revenue and other franchising related revenue. The Company is obligated under its franchise agreements to provide marketing and reservation services appropriate for the operation of its systems. These services do not represent separate reportable segments as their operations are directly related to the Company's franchising business. The revenues received from franchisees that are used to pay for part of the Company's ongoing operations are included in franchising revenues and are offset by the related expenses paid for marketing and reservation activities to calculate franchising operating income.

**SkyTouch Technology:** SkyTouch Technology ("SkyTouch") is a division of the Company that develops and markets cloud-based technology products to hoteliers not under franchise agreements with the Company.

The Company evaluates its segments based primarily on the results of the segment without allocating corporate expenses, income taxes or indirect general and administrative expenses. Equity in earnings or losses from franchising related joint ventures is allocated to the Company's franchising segment. All other joint ventures are allocated to corporate & other. Corporate and other expenses consist primarily of overhead selling, general and administrative costs such as finance, legal, human resources and other general administrative expenses that are not allocated to the Company's two segments. As described in Note 4, certain interest expenses related to the Company's marketing and reservation activities are allocated to the franchising segment. The Company does not allocate the remaining interest expense, interest income, other gains and losses or income taxes to its segments.

The following table presents the financial information for the Company's segments:

(In thousands)	Three Months Ended June 30, 2014				Three Months Ended June 30, 2013 (Restated)			
	Franchising	SkyTouch Technology	Corporate & Other	Consolidated	Franchising	SkyTouch Technology	Corporate & Other	Consolidated
Revenues	\$ 197,596	\$ 68	\$ —	\$ 197,664	\$ 190,930	\$ —	\$ —	\$ 190,930
Operating income (loss)	\$ 75,211	\$ (4,360 )	\$ (10,698 )	\$ 60,153	\$ 67,895	\$ (2,661 )	\$ (10,495 )	\$ 54,739
Income (loss) from continuing operations before income taxes	\$ 75,203	\$ (4,360 )	\$ (20,609 )	\$ 50,234	\$ 67,963	\$ (2,661 )	\$ (20,798 )	\$ 44,504

(In thousands)	Six Months Ended June 30, 2014				Six Months Ended June 30, 2013 (Restated)			
	Franchising	SkyTouch Technology	Corporate & Other	Consolidated	Franchising	SkyTouch Technology	Corporate & Other	Consolidated
Revenues	\$ 357,279	\$ 121	\$ —	\$ 357,400	\$ 339,101	\$ —	\$ —	\$ 339,101
Operating income (loss)	\$ 129,421	\$ (7,866 )	\$ (20,230 )	\$ 101,325	\$ 118,253	\$ (4,466 )	\$ (21,909 )	\$ 91,878
Income (loss) from continuing operations	\$ 129,422	\$ (7,866 )	\$ (39,794 )	\$ 81,762	\$ 118,244	\$ (4,466 )	\$ (41,692 )	\$ 72,086



before income  
taxes

16. Commitments and Contingencies

The Company is not a party to any litigation other than litigation in the ordinary course of business. The Company's management and legal counsel do not expect that the ultimate outcome of any of its currently ongoing legal proceedings,

43

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Table of Contents

individually or collectively, will have a material adverse effect on the Company's financial position, results of operations or cash flows.

Contingencies

On October 9, 2012, the Company entered into a limited payment guaranty with regards to a VIE's \$18.0 million bank loan for the construction of a hotel franchised under one of the Company's brands in the United States. Under the terms of the limited guaranty, the Company has agreed to guarantee 25% of the outstanding principal balance for a maximum exposure of \$4.5 million and accrued and unpaid interest, as well as any unpaid expenses incurred by the lender. The limited guaranty shall remain in effect until the maximum amount guaranteed by the Company is paid in full. In addition to the limited guaranty, the Company entered into an agreement in which the Company guarantees the completion of the construction of the hotel and an environmental indemnity agreement which indemnifies the lending institution from and against any damages relating to or arising out of possible environmental contamination issues with regards to the property.

On November 15, 2013, the Company entered into a limited payment guaranty with regards to a VIE's \$46.2 million bank loan for the construction of a hotel franchised under one of the Company's brands in the United States. Under the terms of the limited guaranty, the Company has agreed to unconditionally guarantee and become surety for the full and timely payment of the guaranteed outstanding principal balance, as well as any unpaid expenses incurred by the lender. The guarantee is limited to 25% of the outstanding principal balance of the \$46.2 million loan due at any time for a maximum exposure of \$11.6 million. The limited guaranty shall remain in effect until the maximum amount guaranteed by the Company is repaid in full. The maturity date of the VIE's loan is May 2017. In conjunction with this guaranty, the Company has entered into a reimbursement and guaranty agreement with certain individuals that requires them to reimburse the Company in an amount equal to 75% of any payments made by the Company under this limited payment guaranty.

Commitments

The Company has the following commitments outstanding at June 30, 2014:

The Company occasionally provides financing in the form of forgivable promissory notes or cash incentives to franchisees for property improvements, hotel development efforts and other purposes. At June 30, 2014, the Company had commitments to extend an additional \$13.3 million for these purposes provided certain conditions are met by its franchisees, of which \$6.0 million is expected to be advanced in the next twelve months.

The Company committed to make additional capital contributions totaling \$2.1 million to existing joint ventures related to the construction of various hotels to be operated under the Company's Cambria Suites brand. These commitments are expected to be funded in the next twelve months.

The Company has a property improvement incentive program for its domestic Comfort Inn and Comfort Suites hotels to incent hotel owners to renovate their properties to accelerate improvement of the brand's product quality and consistency, guest satisfaction and brand performance. The Company has committed to provide financing in the form of forgivable promissory notes to qualifying domestic hotels for a portion of their Company approved and completed property improvement expenses. Financing will be provided upon the completion and Company certification of the renovations. At June 30, 2014, the Company had commitments to extended \$25.3 million for this purpose provided certain conditions are met by its franchisees. These commitments are expected to be funded in the next twelve months.

The Company has committed to loan monies totaling approximately \$3.3 million to support the construction of a hotel under the Company's Cambria Suites brand. At June 30, 2014, the Company had funded approximately \$2.2 million of this commitment and is expected to fund the remaining commitment within the next twelve months.

In the ordinary course of business, the Company enters into numerous agreements that contain standard indemnities whereby the Company indemnifies another party for breaches of representations and warranties. Such indemnifications are granted under various agreements, including those governing (i) purchases or sales of assets or businesses, (ii) leases of real estate, (iii) licensing of trademarks, (iv) access to credit facilities, (v) issuances of debt or equity securities, and (vi) certain operating agreements. The indemnifications issued are for the benefit of the (i) buyers in sale agreements and sellers in purchase agreements, (ii) landlords in lease contracts, (iii) franchisees in licensing agreements, (iv) financial institutions in credit facility arrangements, (v) underwriters in debt or equity

security issuances and (vi) parties under certain operating agreements. In addition, these parties are also generally indemnified against any third party claim resulting from the transaction that is contemplated in the underlying agreement. While some of these indemnities extend only for the duration of the underlying agreement, many survive the expiration of the term of the agreement or extend into perpetuity (unless subject to a legal statute of limitations). There are no specific limitations on the maximum potential amount of future payments that the Company could

Table of Contents

be required to make under these indemnities, nor is the Company able to develop an estimate of the maximum potential amount of future payments to be made under these indemnifications as the triggering events are not subject to predictability. With respect to certain of the aforementioned indemnities, such as indemnifications of landlords against third party claims for the use of real estate property leased by the Company, the Company maintains insurance coverage that mitigates potential liability.

## 17. Discontinued Operations

In the first quarter of 2014, the Company's management approved a plan to sell the three Company-owned hotels operated under the MainStay Suites brand and completed the disposal of these hotels at June 30, 2014. The Company determined that this disposal transaction met the definition of a discontinued operation since the operations and cash flows of this component has and will be eliminated from the on-going operations of the Company and the Company will not have significant continuing involvement in the operations of the hotels after the disposal transaction.

The operations related to these three Company-owned hotels were reported as a component of "Corporate and Other" for segment reporting purposes. The results of operations for the three and six months ended June 30, 2014 and the Company's financial position as of June 30, 2014 presented in these Consolidated Financial Statements reflect these three Company-owned hotels as discontinued operations. The results of operations for the three and six months ended June 30, 2013 presented in the Consolidated Financial Statements have been reclassified to account for these operations as discontinued. Summarized financial information related to the discontinued operations is as follows:

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	2013	2013	2013	2013
	(In thousands)			
Revenues				
Hotel operations	\$ 111	\$ 1,334	\$ 801	\$ 2,290
Total revenues	111	1,334	801	2,290
Expenses				
Hotel operations	170	911	832	1,786
Depreciation and amortization	—	132	—	266
Total operating expenses	170	1,043	832	2,052
Operating income (loss)	(59	) 291	(31	) 238
Gain on disposal of discontinued operations	252	—	2,833	—
Income from discontinued operations before income taxes	193	291	2,802	238
Income taxes	72	108	1,040	88
Income from discontinued operations	\$ 121	\$ 183	\$ 1,762	\$ 150

Table of Contents

	As of June 30, 2014	As of December 31, 2013
	(In thousands)	
Cash	\$ 89	\$ 550
Receivables, net	8	106
Other current assets	109	223
Income taxes receivable	—	20
Total current assets	206	899
Property and equipment, at cost, net	—	8,816
Total assets	\$ 206	\$ 9,715
Accounts payable	\$ 9	\$ 425
Accrued expenses	10	10
Income taxes payable	1,040	—
Total liabilities	\$ 1,059	\$ 435
Net assets (liabilities) of discontinued operations	\$ (853	) \$ 9,280

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the consolidated financial condition and results of operations of Choice Hotels International, Inc. and its subsidiaries (together the "Company") contained in this report. MD&A is provided as a supplement to-and should be read in conjunction with-our consolidated financial statements and the accompanying notes.

As described in Note 1 to our consolidated financial statements under the heading "Revision to Financial Statements", the Company has corrected its revenue recognition method for its royalty and certain marketing and reservation system fee revenues. As a result, the Company now recognizes royalty and marketing and reservation system fee revenue in the same period that the gross room revenues are earned by the Company's franchisees, not one month in arrears. As a result, the Company has revised certain operating statistics in MD&A from previously reported amounts.

### Overview

We are a primarily a hotel franchisor with franchise agreements representing 6,372 hotels open and 516 hotels under construction, awaiting conversion or approved for development as of June 30, 2014, with 506,523 rooms and 40,946 rooms, respectively, in 50 states, the District of Columbia and over 35 countries and territories outside the United States. Our brand names include Comfort Inn®, Comfort Suites®, Quality®, Clarion®, Ascend Hotel Collection®, Sleep Inn®, Econo Lodge®, Rodeway Inn®, MainStay Suites®, Suburban Extended Stay Hotel®, and Cambria Suites® (collectively, the "Choice brands").

The Company's domestic franchising operations are conducted through direct franchising relationships while its international franchise operations are conducted through a combination of direct franchising and master franchising relationships. Master franchising relationships are governed by master franchising agreements which generally provide the master franchisee with the right to use our brands and sub-license the use of our brands in a specific geographic region, usually for a fee.

Our business strategy is to conduct direct franchising in those international markets where both franchising is an accepted business model and we believe our brands can achieve significant scale. We elect to enter into master franchise agreements in those markets where direct franchising is currently not a prevalent or viable business model. When entering into master franchising relationships, we strive to select partners that have professional hotel and asset management capabilities together with the financial capacity to invest in building the Choice brands in their respective

markets. Master franchising relationships typically provide lower revenues to the Company as the master franchisees are responsible for managing certain necessary services (such as training, quality assurance, reservations and marketing) to support the franchised hotels in the master franchise area and therefore retain a larger percentage of the hotel franchise fees to cover their expenses. In certain circumstances, the Company has and may continue to make equity investments in our master franchisees.

As a result of our use of master franchising relationships and international market conditions, total revenues from international franchising operations comprised 8% of our total revenues for the six months ended June 30, 2014, while representing

## Table of Contents

approximately 18% of hotels open at June 30, 2014. Therefore, our description of the franchise system is primarily focused on the domestic operations.

Our Company generates revenues, income and cash flows primarily from initial, relicensing and continuing royalty fees attributable to our franchise agreements. Revenues are also generated from qualified vendor arrangements and other sources. The hotel industry is seasonal in nature. For most hotels, demand is lower in December through February than during the remainder of the year. Our principal source of revenues is franchise fees based on the gross room revenues of our franchised properties. The Company's franchise fee revenues and operating income reflect the industry's seasonality and historically have been lower in the first and fourth quarter than in the second or third quarters.

With a focus on hotel franchising instead of ownership, we benefit from the economies of scale inherent in the franchising business. The fee and cost structure of our business provides opportunities to improve operating results by increasing the number of franchised hotel rooms and effective royalty rates of our franchise contracts resulting in increased initial fee and relicensing revenue, ongoing royalty fees and procurement services revenues. In addition, our operating results can also be improved through our company-wide efforts related to improving property level performance. The Company currently estimates, based on its current domestic portfolio of hotels under franchise, a 1% change in revenue per available room ("RevPAR") or rooms under franchise would increase or decrease annual domestic royalty revenues by approximately \$2.6 million and a 1 basis point change in the Company's effective royalty rate would increase or decrease annual domestic royalties by approximately \$0.6 million. In addition to these revenues, we also collect marketing and reservation system fees to support centralized marketing and reservation activities for the franchise system. The Company's hotel franchising business currently has relatively low capital expenditure requirements.

The principal factors that affect the Company's results are: the number and relative mix of franchised hotel rooms in the various hotel lodging price categories; growth in the number of hotel rooms under franchise; occupancy and room rates achieved by the hotels under franchise; the effective royalty rate achieved; the level of franchise sales and relicensing activity; and our ability to manage costs. The number of rooms at franchised properties and occupancy and room rates at those properties significantly affect the Company's results because our fees are based upon room revenues at franchised hotels. The key industry standard for measuring hotel-operating performance is RevPAR, which is calculated by multiplying the percentage of occupied rooms by the average daily room rate realized. Our variable overhead costs associated with franchise system growth of our established brands have historically been less than incremental royalty fees generated from new franchises. Accordingly, continued growth of our franchise business should enable us to realize benefits from the operating leverage in place and improve operating results.

We are required by our franchise agreements to use the marketing and reservation system fees we collect for system-wide marketing and reservation activities. These expenditures, which include advertising costs and costs to maintain our central reservations and property management systems, help to enhance awareness and increase consumer preference for our brands. Greater awareness and preference promotes long-term growth in business delivery to our franchisees and increases the desirability of our brands to hotel owners and developers, which ultimately increases franchise fees earned by the Company.

Our Company articulates its mission as a commitment to our franchisees' profitability by providing our franchisees with hotel franchises that strive to generate the highest return on investment of any hotel franchise. We have developed an operating system dedicated to our franchisees' success that focuses on delivering guests to our franchised hotels and reducing costs for our hotel owners.

We believe that executing our strategic priorities creates value for our shareholders. Our Company focuses on two key goals:

**Profitable Growth.** Our success is dependent on improving the performance of our hotels, increasing our system size by selling additional hotel franchises, effective royalty rate improvement and maintaining a disciplined cost structure. We attempt to improve our franchisees' revenues and overall profitability by providing a variety of products and services designed to increase business delivery to and/or reduce operating and development costs for our franchisees. These products and services include national marketing campaigns, a central reservation system, property and yield management systems, quality assurance standards and qualified vendor relationships. We believe that healthy brands,

which deliver a compelling return on investment for franchisees, will enable us to sell additional hotel franchises and raise royalty rates over time. We have established multiple brands that meet the needs of many types of guests, and can be developed at various price points and applied to both new and existing hotels. This is intended to ensure that we have brands suitable for creating growth in a variety of market conditions. Improving the performance of the hotels under franchise, growing the system through additional franchise sales and improving franchise agreement pricing while maintaining a disciplined cost structure are the keys to profitable growth.

**Maximizing Financial Returns and Creating Value for Shareholders.** Our capital allocation decisions, including capital structure and uses of capital, are intended to maximize our return on invested capital and create value for our shareholders. We believe our strong and predictable cash flows create a strong financial position that provides us a competitive advantage.



Table of Contents

Currently, our business does not require significant capital to operate and grow. Therefore, we can maintain a capital structure that generates high financial returns and use our excess cash flow to increase returns to our shareholders primarily through share repurchases, dividends or investing in growth opportunities.

Historically, we have returned value to our shareholders through share repurchases and dividends. In 1998, our board of directors instituted a share repurchase program which has generated substantial value for our shareholders. Since the program's inception through June 30, 2014, we have repurchased 45.3 million shares (including 33.0 million prior to the two-for-one stock split effected in October 2005) of common stock at a total cost of \$1.1 billion. Considering the effect of the two-for-one stock split, the Company has repurchased 78.3 million shares at an average price of \$13.89 per share. At June 30, 2014, we had approximately 1.4 million shares remaining under the current share repurchase authorization. We currently believe that our cash flows from operations will support our ability to complete the current repurchase authorization. Upon completion of the current authorization, our board of directors will evaluate the advisability of additional share repurchases.

The Company commenced paying quarterly dividends in 2004 and in 2012 the Company elected to pay a special cash dividend totaling approximately \$600 million. The Company currently maintains the payment of a quarterly dividend on its common shares outstanding of \$0.185 per share, however the declaration of future dividends are subject to the discretion of the board of directors. During the six months ended June 30, 2014, we paid cash dividends totaling approximately \$22.0 million. We expect to continue to pay dividends in the future, subject to declaration by our board of directors as well as future business performance, economic conditions, changes in income tax regulations and other factors. Based on the present dividend rate and outstanding share count, we expect that aggregate annual regular dividends for 2014 would be approximately \$43.6 million.

The Company also allocates capital to exploring growth opportunities in business areas that are adjacent or complementary to our core hotel franchising business, which leverage our core competencies and are additive to our franchising business model. The timing and amount of these investments are subject to market and other conditions and include the following:

Our board of directors authorized a program which permits us to offer financing, investment and guaranty support to qualified franchisees as well as allows us to acquire and resell real estate to incent franchise development for certain brands in strategic markets. Recent market conditions have resulted in increased opportunities to incentivize development under this program and as a result over the next several years we expect to deploy capital pursuant to this program opportunistically to promote growth of our emerging brands. The amount and timing of the investment in this program will be dependent on market and other conditions. Our current expectation is that our annual investment in this program will range from \$20 million to \$40 million per year and we generally expect to recycle these investments within a five year period.

In March 2013, the Company announced the launch of a new division, SkyTouch Technology ("SkyTouch"), which develops and markets cloud-based technology products for the hotel industry. In conjunction with the establishment of this new division, the Company expects to incur costs in excess of revenues earned as it further develops SkyTouch's product offerings and invests in sales and marketing. During the year ended December 31, 2014, the Company expects to incur selling, general and administrative ("SG&A") expenses in excess of revenues by approximately \$20 million. Notwithstanding investments in SkyTouch and other alternative growth strategies, the Company expects to continue to return value to its shareholders over time through a combination of share repurchases and dividends, subject to the discretion of our board of directors as well as to business performance, economic conditions, changes in income tax regulations and other factors.

We believe these investments and strategic priorities, when properly implemented, will enhance our profitability, maximize our financial returns and continue to generate value for our shareholders. The ultimate measure of our success will be reflected in the items below.

Results of Operation: Royalty fees, operating income, net income and diluted earnings per share ("EPS") represent key measurements of these value drivers. These measurements are primarily driven by the operations of our franchise system and therefore our analysis of the Company's operations is primarily focused on the size, performance and potential growth of the franchise system as well as our variable overhead costs.

Refer to MD&A heading "Operations Review" for additional analysis of our results.

Liquidity and Capital Resources: Historically, the Company has generated significant cash flows from operations. Since our business does not currently require significant reinvestment of capital, we typically utilize cash in ways that management believes provide the greatest returns to our shareholders which include share repurchases and dividends. However, we may determine to utilize cash for acquisitions and other investments in the future. We believe the Company's cash flow from operations and available financing capacity is sufficient to meet the expected future operating, investing and financing needs of the business.

Table of Contents

Refer to MD&A heading "Liquidity and Capital Resources" for additional analysis.

#### Non-GAAP Financial Statement Measurements

The Company utilizes certain measures which do not conform to generally accepted accounting principles accepted in the United States ("GAAP") when analyzing and discussing its results with the investment community. This information should not be considered as an alternative to any measure of performance as promulgated under GAAP. The Company's calculation of these measurements may be different from the calculations used by other companies and therefore comparability may be limited. We have included a reconciliation of these measures to the comparable GAAP measurement below as well as our reasons for reporting these non-GAAP measures.

**Franchising Revenues:** The Company utilizes franchising revenues, which exclude revenues from marketing and reservation system activities and the SkyTouch division, rather than total revenues when analyzing the performance of the business. Marketing and reservation activities are excluded from franchising revenues since the Company is contractually required by its franchise agreements to use the fees collected for marketing and reservation activities; as such, no income or loss to the Company is generated. Cumulative marketing and reservation system fees not expended are recorded as a liability in the Company's financial statements and are carried over to the next fiscal year and expended in accordance with the franchise agreements. Cumulative marketing and reservation expenditures incurred in excess of fees collected for marketing and reservation activities are deferred and recorded as an asset in the Company's financial statements and recovered in future periods. SkyTouch is a division of the Company that develops and markets cloud-based technology products, including inventory management, pricing and connectivity to third party channels, to hoteliers not under franchise agreements with the Company. SkyTouch operations are excluded from franchising revenues since those operations do not reflect the Company's core franchising business but represent an adjacent, complimentary line of business. This non-GAAP measure is a commonly used measure of performance in our industry and facilitates comparisons between the Company and its competitors.

#### Calculation of Franchising Revenues

	Three Months Ended June 30,		Six Months Ended June 30,	
	(in thousands)			
	2014	2013 (Restated)	2014	2013 (Restated)
Franchising Revenues:				
Total Revenues	\$197,664	190,930	\$357,400	\$339,101
Adjustments:				
Marketing and reservation system revenues	(103,766 )	(104,072 )	(193,372 )	(186,395 )
SkyTouch division	(68 )	—	(121 )	—
Franchising Revenues	\$93,830	\$86,858	\$163,907	\$152,706

**Adjusted EBITDA:** We also utilize adjusted earnings before interest, taxes, depreciation and amortization ("Adjusted EBITDA") to analyze our results which reflects earnings from continuing operations excluding the impact of interest expense, interest income, provision for income taxes, depreciation and amortization, other (gains) and losses and equity earnings of unconsolidated affiliates. We consider Adjusted EBITDA to be an indicator of operating performance because we use it to measure our ability to service debt, fund capital expenditures, and expand our business. We also use Adjusted EBITDA, as do analysts, lenders, investors and others, to evaluate companies because it excludes certain items that can vary widely across different industries or among companies within the same industry. For example, interest expense can be dependent on a company's capital structure, debt levels and credit ratings. Accordingly, the impact of interest expense on earnings can vary significantly among companies. The tax positions of companies can also vary because of their differing abilities to take advantage of tax benefits and because of the tax policies of the jurisdictions in which they operate. As a result, effective tax rates and provision for income taxes can vary considerably among companies. Adjusted EBITDA also excludes depreciation and amortization because companies utilize productive assets of different ages and use different methods of both acquiring and depreciating productive assets. These differences can result in considerable variability in the relative costs of

productive assets

49

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Table of Contents

and the depreciation and amortization expense among companies. Additionally, Adjusted EBITDA is also utilized as a performance indicator as it excludes equity in earnings of unconsolidated affiliates and other (gains) and losses which primarily reflect the performance of investments held in the Company's non-qualified retirement, savings and investment plans which can vary widely from period to period based on market conditions.

## Calculation of Adjusted EBITDA

	Three Months Ended June 30, (in thousands)		Six Months Ended June 30,	
	2014	2013 (Restated)	2014	2013 (Restated)
Adjusted EBITDA:				
Income from continuing operations, net of income taxes	\$ 35,279	\$ 31,624	\$ 56,748	\$ 51,400
Income taxes	14,955	12,880	25,014	20,686
Interest expense	10,710	10,807	20,881	21,577
Interest income	(347 )	(659 )	(850 )	(1,303 )
Other (gains) and losses	(474 )	147 )	(533 )	(563 )
Equity in net (income) loss of affiliates	30	(60 )	65	81
Depreciation and amortization	2,332	2,388	4,610	4,429
Adjusted EBITDA	\$ 62,485	\$ 57,127	\$ 105,935	\$ 96,307

## Operations Review

## Comparison of Operating Results for the Three-Month Periods Ended June 30, 2014 and 2013

Summarized financial results for the three months ended June 30, 2014 and 2013 are as follows:

(in thousands)	2014	2013 (Restated)
<b>REVENUES:</b>		
Royalty fees	\$ 77,670	\$ 72,638
Initial franchise and relicensing fees	4,722	4,416
Procurement services	8,020	7,546
Marketing and reservation	103,766	104,072
Other	3,486	2,258
Total revenues	197,664	190,930
<b>OPERATING EXPENSES:</b>		
Selling, general and administrative	31,413	29,731
Depreciation and amortization	2,332	2,388
Marketing and reservation	103,766	104,072
Total operating expenses	137,511	136,191
Operating income	60,153	54,739
<b>OTHER INCOME AND EXPENSES, NET:</b>		
Interest expense	10,710	10,807
Interest income	(347 )	(659 )
Other (gains) and losses	(474 )	147 )
Equity in net (income) loss of affiliates	30	(60 )
Total other income and expenses, net	9,919	10,235
Income from continuing operations before income taxes	50,234	44,504
Income taxes	14,955	12,880
Income from continuing operations, net of income taxes	35,279	31,624
Income from discontinued operations, net of income taxes	121	183

Net income	\$35,400	\$31,807
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### Results of Operations

The Company recorded income from continuing operations before income taxes of \$50.2 million for the three month period ended June 30, 2014, a \$5.7 million, or 13% increase from the same period of the prior year. The increase in income from continuing operations primarily reflects a \$5.4 million increase in operating income.

Operating income increased \$5.4 million as the Company's franchising revenues increased by \$7.0 million or 8% partially offset by a \$1.7 million or 6% increase in SG&A expenses. Adjusted EBITDA for the three months ended June 30, 2014 increased \$5.4 million or 9% to \$62.5 million. The key drivers of these fluctuations are described in more detail below.

**Franchising Revenues:** Franchising revenues were \$93.8 million for the three months ended June 30, 2014 compared to \$86.9 million for the three months ended June 30, 2013, an increase of 8%. The increase in franchising revenues is primarily due to a \$5.0 million or 7% increase in royalty revenues and a \$1.2 million increase in other revenues.

#### Royalty Fees

Domestic royalty fees for the three months ended June 30, 2014 increased \$5.0 million to \$71.2 million, an increase of 7% compared to the three months ended June 30, 2013. The increase in royalties is attributable to a combination of factors including a 7.6% increase in RevPAR and a 0.9% increase in the number of domestic franchised hotel rooms open. These increases were partially offset by a 6 basis point decline in the effective royalty rate from 4.34% to 4.28%. System-wide RevPAR increased due to a combination of a 2.9% increase in average daily rates and a 280 basis point increase in occupancy rates.

A summary of the Company's domestic franchised hotels operating information is as follows:

	For the Three Months Ended June 30, 2014			For the Three Months Ended June 30, 2013 (Restated)			Change			
	Average Daily Rate	Occupancy	RevPAR	Average Daily Rate	Occupancy	RevPAR	Average Daily Rate	Occupancy	RevPAR	
Comfort Inn	\$87.16	67.6	% \$58.94	\$84.31	64.4	% \$54.33	3.4	% 320	bps 8.5	%
Comfort Suites	91.46	70.4	% 64.36	88.11	67.2	% 59.19	3.8	% 320	bps 8.7	%
Sleep	78.40	66.9	% 52.42	75.57	63.5	% 47.94	3.7	% 340	bps 9.3	%
Quality	72.61	59.8	% 43.38	70.96	56.9	% 40.39	2.3	% 290	bps 7.4	%
Clarion	78.36	57.0	% 44.68	76.39	53.9	% 41.19	2.6	% 310	bps 8.5	%
Econo Lodge	58.12	54.9	% 31.90	56.99	52.0	% 29.65	2.0	% 290	bps 7.6	%
Rodeway	56.56	56.7	% 32.05	54.52	54.0					