

CHOICE HOTELS INTERNATIONAL INC /DE  
Form 10-Q  
August 05, 2015  
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, 2015  
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.)

(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  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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

CLASS SHARES OUTSTANDING AT JUNE 30, 2015  
Common Stock, Par Value \$0.01 per share 57,608,088



Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES  
INDEX

PAGE NO.

PART I. FINANCIAL INFORMATION:

<u>Item 1—Financial Statements (Unaudited)</u>	<u>3</u>
<u>Consolidated Statements of Income - For the three and six months ended June 30, 2015 and 2014</u>	<u>3</u>
<u>Consolidated Statements of Comprehensive Income - For the three and six months ended June 30, 2015 and 2014</u>	<u>4</u>
<u>Consolidated Balance Sheets - As of June 30, 2015 and December 31, 2014</u>	<u>5</u>
<u>Consolidated Statements of Cash Flow - For the six months ended June 30, 2015 and 2014</u>	<u>6</u>
<u>Notes to Consolidated Financial Statements</u>	<u>7</u>
<u>Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>39</u>
<u>Item 3—Quantitative and Qualitative Disclosures About Market Risk</u>	<u>60</u>
<u>Item 4—Controls and Procedures</u>	<u>60</u>

PART II. OTHER INFORMATION:

<u>Item 1—Legal Proceedings</u>	<u>61</u>
<u>Item 1A—Risk Factors</u>	<u>61</u>
<u>Item 2—Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>61</u>
<u>Item 3—Defaults Upon Senior Securities</u>	<u>61</u>
<u>Item 4—Mine Safety Disclosures</u>	<u>61</u>
<u>Item 5—Other Information</u>	<u>61</u>
<u>Item 6—Exhibits</u>	<u>62</u>

<u>SIGNATURE</u>	<u>63</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,	
	2015	2014	2015	2014
<b>REVENUES:</b>				
Royalty fees	\$81,183	\$77,670	\$143,614	\$136,210
Initial franchise and relicensing fees	5,816	4,722	11,533	8,462
Procurement services	8,589	8,020	13,396	12,798
Marketing and reservation	133,122	103,766	231,835	193,372
Other	3,446	3,486	7,023	6,558
Total revenues	232,156	197,664	407,401	357,400
<b>OPERATING EXPENSES:</b>				
Selling, general and administrative	33,122	31,413	65,560	58,093
Depreciation and amortization	2,995	2,332	5,685	4,610
Marketing and reservation	133,122	103,766	231,835	193,372
Total operating expenses	169,239	137,511	303,080	256,075
Operating income	62,917	60,153	104,321	101,325
<b>OTHER INCOME AND EXPENSES, NET:</b>				
Interest expense	11,057	10,710	21,236	20,881
Interest income	(277)	(347)	(623)	(850)
Other (gains) and losses	(1,173)	(474)	(1,641)	(533)
Equity in net loss of affiliates	431	30	1,436	65
Total other income and expenses, net	10,038	9,919	20,408	19,563
Income from continuing operations before income taxes	52,879	50,234	83,913	81,762
Income taxes	17,066	14,955	26,506	25,014
Income from continuing operations, net of income taxes	35,813	35,279	57,407	56,748
Income from discontinued operations, net of income taxes	—	121	—	1,762
Net income	\$35,813	\$35,400	\$57,407	\$58,510
<b>Basic earnings per share</b>				
Continuing operations	\$0.62	\$0.61	\$1.00	\$0.97
Discontinued operations	—	—	—	0.03
	\$0.62	\$0.61	\$1.00	\$1.00
<b>Diluted earnings per share</b>				
Continuing operations	\$0.62	\$0.60	\$0.99	\$0.96
Discontinued operations	—	—	—	0.03
	\$0.62	\$0.60	\$0.99	\$0.99

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Cash dividends declared per share	\$0.195	\$0.185	\$0.39	\$0.37
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The accompanying notes are an integral part of these consolidated financial statements.

3

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net income	\$35,813	\$35,400	\$57,407	\$58,510
Other comprehensive income (loss), net of tax:				
Amortization of loss on cash flow hedge	216	216	431	431
Foreign currency translation adjustment	175	509	(1,272	) 1,030
Other comprehensive income (loss), net of tax	391	725	(841	) 1,461
Comprehensive income	\$36,204	\$36,125	\$56,566	\$59,971

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, 2015	December 31, 2014
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$230,650	\$214,879
Receivables (net of allowance for doubtful accounts of \$9,510 and \$10,084, respectively)	118,989	91,681
Deferred income taxes	26,734	23,860
Income taxes receivable	—	1,458
Investments, employee benefit plans, at fair value	174	214
Other current assets	21,030	19,322
Total current assets	397,577	351,414
Property and equipment, at cost, net	82,375	77,309
Goodwill	65,813	65,813
Franchise rights and other identifiable intangibles, net	7,268	8,912
Notes receivable, net of allowances	51,228	40,441
Investments, employee benefit plans, at fair value	18,274	17,539
Deferred income taxes	19,729	20,546
Other assets	60,329	65,296
Total assets	\$702,593	\$647,270
<b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>		
Current liabilities		
Accounts payable	\$72,207	\$57,124
Accrued expenses	56,537	63,530
Deferred revenue	70,402	66,382
Current portion of long-term debt	1,124	12,349
Deferred compensation and retirement plan obligations	174	628
Income taxes payable	1,242	85
Total current liabilities	201,686	200,098
Long-term debt	800,035	782,082
Deferred compensation and retirement plan obligations	24,237	23,987
Other liabilities	62,102	69,904
Total liabilities	1,088,060	1,076,071
Commitments and Contingencies		
Common stock, \$0.01 par value, 160,000,000 shares authorized; 95,065,638 shares issued at June 30, 2015 and December 31, 2014 and 57,608,088 and 57,337,720 shares outstanding at June 30, 2015 and December 31, 2014, respectively	576	573
Additional paid-in-capital	134,144	127,661
Accumulated other comprehensive loss	(7,812	) (6,971
Treasury stock (37,457,550 and 37,727,918 shares at June 30, 2015 and December 31, 2014, respectively), at cost	(979,211	) (982,463
Retained earnings	466,836	432,399
Total shareholders' deficit	(385,467	) (428,801
Total liabilities and shareholders' deficit	\$702,593	\$647,270

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





Table of Contents

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

	Six Months Ended	
	June 30,	
	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$57,407	\$58,510
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,685	4,610
Gain on sale of assets	(1,595)	(2,849)
Provision for bad debts, net	1,197	1,383
Non-cash stock compensation and other charges	5,399	4,711
Non-cash interest and other (income) loss	1,340	719
Deferred income taxes	(2,095)	(9,273)
Equity (earnings) losses from unconsolidated joint ventures, net of distributions received	2,781	611
Changes in assets and liabilities:		
Receivables	(28,856)	(39,518)
Advances to/from marketing and reservation activities, net	3,724	31,522
Forgivable notes receivable, net	(19,186)	(6,692)
Accounts payable	16,990	8,316
Accrued expenses	(6,969)	(5,247)
Income taxes payable/receivable	2,450	15,198
Deferred revenue	4,041	6,231
Other assets	(5,152)	(1,102)
Other liabilities	769	(1,298)
Net cash provided by operating activities	37,930	65,832
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Investment in property and equipment	(14,554)	(7,314)
Proceeds from sales of assets	6,283	12,216
Contributions to equity method investments	(2,446)	(6,946)
Distributions from equity method investments	270	—
Purchases of investments, employee benefit plans	(1,736)	(1,220)
Proceeds from sales of investments, employee benefit plans	1,087	641
Issuance of mezzanine and other notes receivable	(1,500)	(2,223)
Collections of mezzanine and other notes receivable	3,567	9,743
Other items, net	(261)	(296)
Net cash provided (used) by investing activities	(9,290)	4,601
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net borrowings pursuant to revolving credit facility	13,000	—
Proceeds from issuance of long term debt	—	26
Principal payments on long-term debt	(6,169)	(4,112)
Purchases of treasury stock	(6,244)	(4,544)
Dividends paid	(22,940)	(21,957)
Excess tax benefits from stock-based compensation	4,613	1,319
Proceeds from exercise of stock options	5,696	1,547
Net cash used by financing activities	(12,044)	(27,721)

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Net change in cash and cash equivalents	16,596	42,712
Effect of foreign exchange rate changes on cash and cash equivalents	(825	) 1,035
Cash and cash equivalents at beginning of period	214,879	167,795
Cash and cash equivalents at end of period	\$230,650	\$211,542
Supplemental disclosure of cash flow information:		
Cash payments during the period for:		
Income taxes, net of refunds	\$21,052	\$19,594
Interest, net of capitalized interest	\$19,800	\$20,595
Non-cash investing and financing activities:		
Dividends declared but not paid	\$11,233	\$10,810
Issuance of common stock pursuant to share based compensation plans	\$8,244	\$8,024
Investment in property and equipment acquired in accounts payable	\$1,658	\$688

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

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, 2014 and notes thereto included in the Company's Form 10-K, filed with the SEC on March 2, 2015 (the "10-K"). 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.

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. For additional information regarding discontinued operations, see Note 18, 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, 2015 and December 31, 2014, \$7.3 million and \$5.4 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.

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, 2015, the Company maintains cash balances of \$205 million in international banks and money market funds which do not provide deposit insurance.

Recently Adopted Accounting Guidance

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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 No. 2014-08"). ASU No. 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 No. 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 adopted this ASU on January 1, 2015 and it did not have a material impact on its financial statements.

Future Adoption of Recently Announced Accounting Guidance

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

7

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Table of Contents

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. On July 9, 2015 the FASB voted to defer ASU No. 2014-09 for one year, and with that deferral, the standard will be effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, which will be our 2018 first quarter. However, early adoption is permitted to the original effective date of January 1, 2017. We are permitted to use either the retrospective or modified retrospective method when adopting ASU No. 2014-09. We are still assessing the potential impact that ASU No. 2014-09 will have on our financial statements and disclosures.

In January 2015, the FASB issued ASU No. 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20) ("ASU No. 2015-01"). ASU No. 2015-01 was issued changing the requirements for reporting extraordinary and unusual items in the income statement. The update eliminates the concept of extraordinary items. The presentation and disclosure guidance for items that are unusual in nature or occur infrequently will be retained and will be expanded to include items that are both unusual in nature and infrequently occurring. ASU No. 2015-01 is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The adoption of this newly issued guidance is not expected to have an impact to our consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810) ("ASU No. 2015-02"). ASU No. 2015-02 changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. This guidance must be applied using one of two retrospective application methods and will be effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The Company is currently evaluating the impact, if any, the adoption of this newly issued guidance will have on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30) ("ASU No. 2015-03"). ASU No. 2015-03 changes the presentation of debt issuance costs in the financial statements to present such costs as a direct deduction from the related debt liability rather than as an asset. Amortization of debt issuance costs will continue to be reported as interest expense. This standard is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. Early adoption is permitted and the standard is to be applied on retrospective basis. The Company currently does not believe that ASU No. 2015-03 will have a material impact on its consolidated financial position, results of operations, or cash flows.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles-Goodwill - Internal Use Software (Subtopic 350-40) ("ASU No. 2015-05"). ASU No. 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license or should be accounted for as a service contract. The standard is effective for annual reporting periods, including interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and an entity can elect to adopt the amendment either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The adoption of this newly issued guidance is not expected to have a material impact to our consolidated financial statements.

## 2. Other Current Assets

Other current assets consist of the following:

June 30, 2015	December 31, 2014
(in thousands)	

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Notes receivable, net of allowances (See Note 3)	\$2,089	\$3,961
Prepaid expenses	16,568	12,280
Other current assets	2,373	3,081
Total	\$21,030	\$19,322

8

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Table of Contents

## 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, 2015 (in thousands)			December 31, 2014 (in thousands)		
	Forgivable Notes Receivable	Mezzanine & Other Notes Receivable	Total	Forgivable Notes Receivable	Mezzanine & Other Notes Receivable	Total
Senior	\$—	\$11,650	\$11,650	\$—	\$10,152	\$10,152
Subordinated	—	466	466	—	3,863	3,863
Unsecured	44,360	3,795	48,155	32,379	3,995	36,374
Total notes receivable	44,360	15,911	60,271	32,379	18,010	50,389
Allowance for losses on non-impaired loans	4,688	1,480	6,168	3,661	1,540	5,201
Allowance for losses on receivables specifically evaluated for impairment	—	786	786	—	786	786
Total loan reserves	4,688	2,266	6,954	3,661	2,326	5,987
Net carrying value	\$39,672	\$13,645	\$53,317	\$28,718	\$15,684	\$44,402
Current portion, net	\$164	\$1,925	\$2,089	\$124	\$3,837	\$3,961
Long-term portion, net	39,508	11,720	51,228	28,594	11,847	40,441
Total	\$39,672	\$13,645	\$53,317	\$28,718	\$15,684	\$44,402

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

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, 2015:

	Forgivable Notes Receivable (in thousands)	Mezzanine & Other Notes Receivable
Beginning balance	\$3,661	\$2,326

Provisions	1,353	—	
Recoveries	(383	)	(60 )
Write-offs	(330	)	—
Other <sup>(1)</sup>	387	—	
Ending balance	\$4,688		\$2,266

(1) Consists of default rate assumption changes

9

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Table of Contents

## Forgivable Notes Receivable

As of June 30, 2015 and December 31, 2014, the unamortized balance of the Company's forgivable notes receivable totaled \$44.4 million and \$32.4 million, respectively. The Company recorded an allowance for credit losses on these forgivable notes receivable of \$4.7 million and \$3.7 million at June 30, 2015 and December 31, 2014, respectively. Amortization expense included in the accompanying consolidated statements of income related to the notes for the three months ended June 30, 2015 and 2014 was \$2.1 million and \$1.2 million, respectively. Amortization expense for the six months ended June 30, 2015 and 2014 was \$3.9 million and \$2.4 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, 2015					
Forgivable Notes	\$—	\$ 1,238	\$ 1,238	\$ 43,122	\$ 44,360
	\$—	\$ 1,238	\$ 1,238	\$ 43,122	\$ 44,360
As of December 31, 2014					
Forgivable Notes	\$—	\$ 1,227	\$ 1,227	\$ 31,152	\$ 32,379
	\$—	\$ 1,227	\$ 1,227	\$ 31,152	\$ 32,379

## Mezzanine and Other Notes Receivable

The Company determined that approximately \$0.8 million of its mezzanine and other notes receivable were impaired at both June 30, 2015 and December 31, 2014, respectively. The Company recorded allowance for credit losses on these impaired loans at both June 30, 2015 and December 31, 2014 totaling \$0.8 million. For the six months ended June 30, 2015 and 2014, the average mezzanine and other notes receivable on non-accrual status was approximately \$0.8 million and \$12.2 million, respectively. The Company recognized approximately \$0 and \$33 thousand of interest income on impaired loans during the three and six months ended June 30, 2015, respectively, on the cash basis. 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. The Company provided loan reserves on non-impaired loans totaling \$1.5 million at both June 30, 2015 and December 31, 2014.

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, 2015					
Senior	\$—	\$—	\$—	\$ 11,650	\$ 11,650
Subordinated	—	—	—	466	466
Unsecured	—	47	47	3,748	3,795
	\$—	\$ 47	\$ 47	\$ 15,864	\$ 15,911
As of December 31, 2014					
Senior	\$—	\$—	\$—	\$ 10,152	\$ 10,152
Subordinated	—	—	—	3,863	3,863
Unsecured	—	47	47	3,948	3,995
	\$—	\$ 47	\$ 47	\$ 17,963	\$ 18,010

## 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

10

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Table of Contents

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 in the current period are deferred and 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 June 30, 2015 and December 31, 2014, cumulative marketing and reservation system fees billed exceeded expenses by \$35.7 million and \$44.3 million, respectively, with the excess reflected as an other long-term liability 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, 2015 were \$5.8 million and \$11.2 million, respectively. Depreciation and amortization expense attributable to marketing and reservation activities for the three and six months ended June 30, 2014 were \$4.3 million and \$8.0 million, respectively. Interest expense attributable to marketing and reservation activities for the three and six months ended June 30, 2015 was \$7 thousand and \$16 thousand, 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.

## 5. Other Assets

Other assets consist of the following:

	June 30, 2015	December 31, 2014
	(in thousands)	
Equity method investments	\$46,541	\$50,605
Deferred financing fees, net	7,376	7,228
Land	2,711	4,011
Other assets	3,701	3,452
Total	\$60,329	\$65,296

## Equity Method Investments - Variable Interest Entities

Equity method investments include investments in joint ventures totaling \$43.8 million and \$47.1 million at June 30, 2015 and December 31, 2014, 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 hotel & 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. Although the Company is not the primary beneficiary of these VIEs, it does exercise significant influence through its equity ownership and 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, 2015, the Company recognized losses totaling \$0.6 million and \$1.8 million, respectively, from these investments. For the three and six months ended June 30, 2014, the Company recognized losses totaling \$22 thousand and \$66 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 16 "Commitments and Contingencies" of these financial statements.

Table of Contents

## 6. Deferred Revenue

Deferred revenue consists of the following:

	June 30, 2015 (in thousands)	December 31, 2014
Loyalty programs	\$62,540	\$57,757
Initial, relicensing and franchise fees	5,724	6,439
Procurement service fees	1,158	1,936
Other	980	250
Total	\$70,402	\$66,382

## 7. Debt

Debt consists of the following at:

	June 30, 2015 (in thousands)	December 31, 2014
\$400 million senior unsecured notes with an effective interest rate of 6.0% at June 30, 2015 and December 31, 2014	\$400,000	\$400,000
\$250 million senior unsecured notes with an effective interest rate of 6.19% less discount of \$0.3 million and \$0.4 million at June 30, 2015 and December 31, 2014, respectively	249,668	249,636
\$350 million senior secured credit facility with an effective interest rate of 2.19% and 2.17% at June 30, 2015 and December 31, 2014, respectively	136,750	129,375
Fixed rate collateralized mortgage plus a fair value adjustment of \$1.1 million and \$1.2 million at June 30, 2015 and December 31, 2014, respectively with an effective interest rate of 4.57%	10,351	10,667
Economic development loans with an effective interest rate of 3.0% at June 30, 2015 and December 31, 2014	3,536	3,536
Capital lease obligations due 2016 with an effective interest rate of 3.18% at June 30, 2015 and December 31, 2014	792	1,149
Other notes payable	62	68
Total debt	\$801,159	\$794,431
Less current portion	1,124	12,349
Total long-term debt	\$800,035	\$782,082

## Senior Unsecured 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 6.0%. 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 borrowings under the Company's senior 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 Unsecured 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 5.70% 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

12

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## Table of Contents

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 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.

As discussed in Note 19 "Subsequent Events," the Company refinanced the Credit Facility on July 21, 2015 with a new facility with a five year term. As a result, the quarterly Term Loan amortization payments that would have been due over the next twelve months have been reflected as a long-term liability.

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



Table of Contents

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, 2015, the Company was in compliance with all financial covenants under the Credit Facility.

At June 30, 2015, the Company had \$123.8 million under the Term Loan and \$13.0 million outstanding under the Revolver. At December 31, 2014, the Company had \$129.4 million outstanding under the Term Loan and no amounts outstanding under the Revolver.

**Fixed Rate Collateralized Mortgage**

On December 30, 2014, a court awarded the Company title to an office building as settlement for a portion of an outstanding loan receivable for which the building was pledged as collateral. In conjunction with the court award, the Company also assumed the \$9.5 million mortgage on the property with a fixed interest rate of 7.26%. The mortgage which is collateralized by the office building requires monthly payments of principal and interest and matures in December 2020 with a balloon payment due of \$6.9 million. At the time of acquisition, the Company determined that the fixed interest rate of 7.26% exceeded market interest rates and therefore the Company increased the carrying value of the debt by \$1.2 million to record the debt at fair value. The fair value adjustment will be amortized over the remaining term of the mortgage utilizing the effective interest method.

**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 headquarters relocation and tenant improvement costs in consideration of the employment of permanent, full-time employees within the jurisdictions. At June 30, 2015, the Company had been advanced approximately \$3.5 million pursuant to these agreements and expects to receive the remaining \$0.9 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, 2015.

Table of Contents

## 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, 2015:

	Loss on Cash Flow Hedge (in thousands)	Foreign Currency Items	Total
Beginning balance, December 31, 2014	\$ (4,884 )	\$ (2,087 )	\$ (6,971 )
Other comprehensive income (loss) before reclassification	—	(1,272 )	(1,272 )
Amounts reclassified from accumulated other comprehensive income (loss)	431	—	431
Net current period other comprehensive income (loss)	431	(1,272 )	(841 )
Ending balance, June 30, 2015	\$ (4,453 )	\$ (3,359 )	\$ (7,812 )

The amounts reclassified from accumulated other comprehensive income (loss) during the three and six months ended June 30, 2015 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, 2015 (in thousands)	Six Months Ended June 30, 2015	
Loss on cash flow hedge			
Interest rate contract	\$ 216	\$ 431	Interest expense
	—	—	Tax (expense) benefit
	\$ 216	\$ 431	Net of tax

## 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 \$10.4 million and \$10.2 million, as of June 30, 2015 and December 31, 2014, 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, 2015 and

15

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Table of Contents

2014 was \$0.1 million and \$0.2 million, respectively. Compensation expense recorded in SG&A related to the EDCP for the six months ended June 30, 2015 and 2014 was \$0.3 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 \$5.3 million and \$4.6 million as of June 30, 2015 and December 31, 2014, respectively, and are recorded at their fair value, based on quoted market prices. At June 30, 2015, 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 and (losses) related to the EDCP during the three months ended June 30, 2015 and 2014 of approximately (\$42 thousand) and \$0.1 million, respectively. The Company recorded investment gains related to the EDCP during the six months ended June 30, 2015 and 2014 of approximately \$0.1 million in each six month period. 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, 2015 and December 31, 2014, 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, 2015 and December 31, 2014, the Company had recorded a deferred compensation liability of \$14.0 million and \$14.4 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, 2015 and 2014 was (\$0.4 million) and \$0.4 million, respectively. The net increase (decrease) in compensation expense recorded in SG&A related to the Non-Qualified Plan for the six months ended June 30, 2015 and 2014 was (\$0.2 million) and \$0.2 million, respectively.

The diversified investments held in the trusts were \$13.1 million at June 30, 2015 and December 31, 2014 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, 2015 and 2014 of approximately (\$0.1 million) and \$0.3 million, respectively. The Company recorded investment gains (losses) related to the Non-Qualified Plan during the six months ended June 30, 2015 and 2014 of approximately (\$11 thousand) and \$0.4 million, respectively. In addition, the Non-Qualified Plan held shares of the Company's common stock with a market value of \$0.9 million and \$1.3 million at June 30, 2015 and December 31, 2014, 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.

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, 2015.

Table of Contents

As of June 30, 2015 and December 31, 2014, the Company had the following assets measured at fair value on a recurring basis:

	Fair Value Measurements at			
	Total	Level 1	Level 2	Level 3
Assets	(in thousands)			
As of June 30, 2015				
Money market funds, included in cash and cash equivalents	\$50,001	\$—	\$50,001	\$—
Mutual funds <sup>(1)</sup>	17,275	17,275	—	—
Money market funds <sup>(1)</sup>	1,173	—	1,173	—
	\$68,449	\$17,275	\$51,174	\$—
As of December 31, 2014				
Money market funds, included in cash and cash equivalents	\$50,001	\$—	\$50,001	\$—
Mutual funds <sup>(1)</sup>	16,405	16,405	—	—
Money market funds <sup>(1)</sup>	1,348	—	1,348	—
	\$67,754	\$16,405	\$51,349	\$—

(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, the notes receivable 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, see Note 3. The fair value of the Company's \$250 million and \$400 million senior notes are classified as Level 2 as the significant inputs are observable in an active market. At June 30, 2015 and December 31, 2014, the \$250 million senior notes had an approximate fair value of \$271.3 million and \$268.9 million, respectively. At June 30, 2015 and December 31, 2014, the \$400 million senior notes had an approximate fair value of \$435.0 million and \$437.7 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.

11. Income Taxes

The effective income tax rates from continuing operations were 32.3% and 29.8% for the three months ended June 30, 2015 and 2014, respectively. The effective income tax rates from continuing operations were 31.6% and 30.6% for the six months ended June 30, 2015 and 2014, respectively.

The effective income tax rates from continuing operations for the three and six months ended June 30, 2015 and 2014 were lower than the U.S. federal income tax rate of 35.0% due to the recurring impact of foreign operations, partially offset by state income taxes. The effective income tax rate for the six months ended June 30, 2015 was further reduced due to the settlement of uncertain tax positions.

Table of Contents

## 12. Share-Based Compensation and Capital Stock

No stock options were granted during the three months ended June 30, 2015 and 2014. The Company granted 0.5 million and 0.7 million options to certain employees of the Company at a fair value of \$6.2 million and \$5.7 million for the six months ended June 30, 2015 and 2014, 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:

	2015 Grants		2014 Grants	
Risk-free interest rate	1.45	%	1.56	%
Expected volatility	23.94	%	25.01	%
Expected life of stock option	4.6 years		4.5 years	
Dividend yield	1.23	%	1.62	%
Requisite service period	4 years		4 years	
Contractual life	7 years		7 years	
Weighted average fair value of options granted (per option)	\$12.39		\$8.82	

The expected life of the options and volatility are based on historical data which is believed to be indicative of future exercise patterns or actual volatility. Historical volatility is calculated based on a period that corresponds to the expected term 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, 2015 was \$33.4 million and \$26.5 million, respectively. The total intrinsic value of options exercised during the three months ended June 30, 2015 was approximately \$0.1 million. There were no options exercised during the three months ended June 30, 2014. The total intrinsic value of options exercised during the six months ended June 30, 2015 and 2014 was approximately \$8.6 million and \$1.3 million, respectively.

The Company received approximately \$5.7 million and \$1.5 million in proceeds from the exercise of 232,792 and 58,749 employee stock options during the six months ended June 30, 2015 and 2014, respectively. The Company received approximately \$0.1 million in proceeds from the exercise of 3,829 employee stock options during the three months ended June 30, 2015.

## Restricted Stock

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

	Three Months Ended		Six Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Restricted share grants	20,653	17,262	106,445	147,055
Weighted average grant date fair value per share	\$62.57	\$44.62	\$63.29	\$46.46
Aggregate grant date fair value (\$000)	\$1,292	\$770	\$6,737	\$6,833
Restricted shares forfeited	3,664	2,964	8,442	4,296
Vesting service period of shares granted	12 - 48 months	12 - 36 months	12 - 48 months	12 - 48 months
Fair value of shares vested (\$000)	1,054	935	11,739	8,203

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.





Table of Contents

## 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 180% 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, 2015	2014	June 30, 2015	2014
Performance vested restricted stock units granted at target	20,956	—	51,309	24,678
Weighted average grant date fair value per share	\$57.27	\$—	\$60.94	\$45.59
Aggregate grant date fair value (\$000)	\$1,200	\$—	\$3,126	\$1,125
Stock units forfeited	—	—	—	—
Requisite service period	36 - 43 months	—	36 - 43 months	36 months

During the three months ended June 30, 2015 and 2014, no PVRSU grants vested. During the six months ended June 30, 2015, a total of 42,326 PVRSU grants vested at a grant date fair value of \$1.5 million. These PVRSU grants were initially granted at a target of 38,476 units. However, since the Company achieved 110% of the targeted performance conditions contained in the stock awards granted in prior periods, an additional 3,850 shares were earned and issued.

During the six months ended June 30, 2014, a total of 28,886 PVRSU grants vested at a grant date 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.

Table of Contents

A summary of stock-based award activity as of June 30, 2015 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, 2015	1,903,177	\$33.03		479,556	\$40.14	200,286	\$38.28
Granted	498,911	\$63.47		106,445	\$63.29	51,309	\$60.94
Performance based leveraging <sup>(1)</sup>	—	\$—		—	\$—	3,850	\$35.60
Exercised/Vested	(232,792 )	\$24.47		(189,592 )	\$39.15	(42,326 )	\$35.60
Expired	—	\$—					
Forfeited	(5,569 )	\$51.64		(8,442 )	\$44.72	—	\$—
Outstanding at June 30, 2015	2,163,727	\$40.92	4.4 years	387,967	\$46.88	213,119	\$44.22
Options exercisable at June 30, 2015	1,053,447	\$29.11	2.7 years				

<sup>(1)</sup>PVRSU units outstanding have been increased by 3,850 units due to the Company exceeding the targeted performance conditions contained in PVRSUs granted in prior periods during the six months ended June 30, 2015. 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, 2015 and 2014:

(in millions)	Three Months Ended		Six Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Stock options	\$0.9	\$0.7	\$1.6	\$1.1
Restricted stock	1.7	1.9	3.5	3.8
Performance vested restricted stock units	0.3	(0.8 )	0.6	(0.1 )
Total	\$2.9	\$1.8	\$5.7	\$4.8
Income tax benefits	\$1.1	\$0.7	\$2.1	\$1.8

During the three and six months ended June 30, 2015, 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 \$0.2 million and \$0.2 million for the three and six months ended June 30, 2015.

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 \$0.195 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, 2015, the Company's board of directors declared dividends totaling \$0.195 and \$0.39 per share or approximately \$11.2 million and \$22.5 million, respectively, in the aggregate. 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, respectively, in the aggregate.



Table of Contents

In addition, during the six months ended June 30, 2015 and 2014, the Company recorded dividends totaling \$0.5 million and \$0.4 million, respectively, related to previously declared dividends that were contingent upon the vesting of performance vested restricted stock units.

**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, 2015 and 2014.

During the three and six months ended June 30, 2015, the Company redeemed 296 and 102,753 shares of common stock at a total cost of approximately \$19 thousand and \$6.2 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. During the three and six 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.

Table of Contents

## 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		Six Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
<b>Computation of Basic Earnings Per Share:</b>				
Numerator:				
Net income from continuing operations	35,813	\$35,279	57,407	\$56,748
Net income from discontinued operations	—	121	—	1,762
Net income	35,813	35,400	57,407	58,510
Income allocated to participating securities	(243	) (324	) (413	) (523
Net income available to common shareholders	\$35,570	\$35,076	\$56,994	\$57,987
Denominator:				
Weighted average common shares outstanding – basic	57,212	57,893	57,108	57,850
Basic earnings per share - Continuing operations	\$0.62	\$0.61	\$1.00	\$0.97
Basic earnings per share - Discontinued operations	—	—	—	0.03
	\$0.62	\$0.61	\$1.00	\$1.00
<b>Computation of Diluted Earnings Per Share:</b>				
Numerator:				
Net income from continuing operations	\$35,813	\$35,279	\$57,407	\$56,748
Net income from discontinued operations	—	121	—	1,762
Net income	35,813	35,400	57,407	58,510
Income allocated to participating securities	(241	) (322	) (411	) (521
Net income available to common shareholders	\$35,572	\$35,078	\$56,996	\$57,989
Denominator:				
Weighted average common shares outstanding – basic	57,212	57,893	57,108	57,850
Diluted effect of stock options and PVRsUs	476	492	525	491
Weighted average common shares outstanding – diluted	57,688	58,385	57,633	58,341
Diluted earnings per share - Continuing operations	\$0.62	\$0.60	\$0.99	\$0.96
Diluted earnings per share - Discontinued operations	—	—	—	0.03
	\$0.62	\$0.60	\$0.99	\$0.99

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 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, 2015 and 2014, the Company had 2.2 million and 2.3 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 and six months ended June 30, 2015, the Company excluded 0.5 million of anti-dilutive stock options from the diluted earnings per share calculation. 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, the Company did not exclude any anti-dilutive stock options from the diluted EPS calculation.



Table of Contents

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, 2015 and 2014, PVRSUs totaling 213,119 and 222,385, 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.

Choice Hotels International, Inc.

Condensed Consolidating Statement of Income

For the Three Months Ended June 30, 2015

(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>REVENUES:</b>					
Royalty fees	\$75,564	\$39,280	\$10,549	\$(44,210 )	\$81,183
Initial franchise and relicensing fees	5,624	—	192	—	5,816
Procurement services	8,440	—	149	—	8,589
Marketing and reservation	122,627	124,342	3,951	(117,798 )	133,122
Other	2,973	—	473	—	3,446
Total revenues	215,228	163,622	15,314	(162,008 )	232,156
<b>OPERATING EXPENSES:</b>					
Selling, general and administrative	36,705	35,307	5,320	(44,210 )	33,122
Marketing and reservation	127,748	119,617	3,555	(117,798 )	133,122
Depreciation and amortization	794	1,952	249	—	2,995
Total operating expenses	165,247	156,876	9,124	(162,008 )	169,239
Operating income	49,981	6,746	6,190	—	62,917
<b>OTHER INCOME AND EXPENSES, NET:</b>					
Interest expense	10,947	1	109	—	11,057
Equity in earnings of consolidated subsidiaries	(10,533 )	240	—	10,293	—
Other items, net	(254 )	(825 )	60	—	(1,019 )
Total other income and expenses, net	160	(584 )	169	10,293	10,038
Income from continuing operations before income taxes	49,821	7,330	6,021	(10,293 )	52,879
Income taxes	14,008	3,206	(148 )	—	17,066
Income from continuing operations, net of income taxes	35,813	4,124	6,169	(10,293 )	35,813
Net income from discontinued operations, net of income taxes	—	—	—	—	—
Net income	\$35,813	\$4,124	\$6,169	\$(10,293 )	\$35,813





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 Six Months Ended June 30, 2015  
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>REVENUES:</b>					
Royalty fees	\$133,151	\$70,520	\$21,704	\$(81,761)	) \$143,614
Initial franchise and relicensing fees	11,120	—	413	—	) 11,533
Procurement services	13,106	—	290	—	) 13,396
Marketing and reservation	210,863	214,727	7,572	(201,327)	) 231,835
Other	6,075	—	948	—	) 7,023
Total revenues	374,315	285,247	30,927	(283,088)	) 407,401
<b>OPERATING EXPENSES:</b>					
Selling, general and administrative	75,404	63,359	8,558	(81,761)	) 65,560
Marketing and reservation	219,772	206,428	6,962	(201,327)	) 231,835
Depreciation and amortization	1,568	3,657	460	—	) 5,685
Total operating expenses	296,744	273,444	15,980	(283,088)	) 303,080
Operating income	77,571	11,803	14,947	—	) 104,321
<b>OTHER INCOME AND EXPENSES, NET:</b>					
Interest expense	20,979	1	256	—	) 21,236
Equity in earnings of consolidated subsidiaries	(21,865)	) 378	—	21,487	—
Other items, net	(546)	) (528)	) 246	—	(828)
Total other income and expenses, net	(1,432)	) (149)	) 502	21,487	20,408
Income from continuing operations before income taxes	79,003	11,952	14,445	(21,487)	) 83,913
Income taxes	21,596	5,490	(580)	) —	26,506
Income from continuing operations, net of income taxes	57,407	6,462	15,025	(21,487)	) 57,407
Income from discontinued operations, net of income taxes	—	—	—	—	—
Net income	\$57,407	\$6,462	\$15,025	\$(21,487)	) \$57,407

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 Comprehensive Income  
 For the Three Months Ended June 30, 2015  
 (Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income	\$35,813	\$4,124	\$6,169	\$(10,293 )	\$35,813
Other comprehensive income (loss), net of tax:					
Amortization of loss on cash flow hedge	216	—	—	—	216
Foreign currency translation adjustment	175	—	175	(175 )	175
Other comprehensive income (loss), net of tax	391	—	175	(175 )	391
Comprehensive income	\$36,204	\$4,124	\$6,344	\$(10,468 )	\$36,204

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 Six Months Ended June 30, 2015  
 (Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income	\$57,407	\$6,462	\$15,025	\$(21,487 )	\$57,407
Other comprehensive income (loss), net of tax:					
Amortization of loss on cash flow hedge	431	—	—	—	431
Foreign currency translation adjustment	(1,272 )	—	(1,272 )	1,272	(1,272 )
Other comprehensive income (loss), net of tax	(841 )	—	(1,272 )	1,272	(841 )
Comprehensive income	\$56,566	\$6,462	\$13,753	\$(20,215 )	\$56,566

29

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

Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Balance Sheet  
As of June 30, 2015  
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
Cash and cash equivalents	\$25,613	\$29	\$205,008	\$—	\$230,650
Receivables, net	108,933	1,971	8,085	—	118,989
Other current assets	19,249	39,876	3,675	(14,862 )	47,938
Total current assets	153,795	41,876	216,768	(14,862 )	397,577
Property and equipment, at cost, net	32,691	35,698	13,986	—	82,375
Goodwill	60,620	5,193	—	—	65,813
Franchise rights and other identifiable intangibles, net	3,257	1,168	2,843	—	7,268
Notes receivable, net of allowances	11,720	38,849	659	—	51,228
Investments, employee benefit plans, at fair value	—	18,274	—	—	18,274
Investment in affiliates	449,034	28,675	—	(477,709 )	—
Advances to affiliates	16,581	242,822	7,059	(266,462 )	—
Deferred income taxes	10,635	9,011	83	—	19,729
Other assets	7,376	21,793	31,160	—	60,329
Total assets	\$745,709	\$443,359	\$272,558	\$(759,033 )	\$702,593
<b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>					
Accounts payable	\$10,278	\$58,904	\$3,025	\$—	\$72,207
Accrued expenses	28,797	25,542	2,198	—	56,537
Deferred revenue	7,595	62,077	730	—	70,402
Current portion of long-term debt	—	730	394	—	1,124
Deferred compensation and retirement plan obligations	—	174	—	—	174
Other current liabilities	—	16,104	—	(14,862 )	1,242
Total current liabilities	46,670	163,531	6,347	(14,862 )	201,686
Long-term debt	786,417	3,598	10,020	—	800,035
Deferred compensation and retirement plan obligations	—	24,220	17	—	24,237
Advances from affiliates	256,527	286	9,649	(266,462 )	—
Other liabilities	41,562	17,765	2,775	—	62,102
Total liabilities	1,131,176	209,400	28,808	(281,324 )	1,088,060
Total shareholders' (deficit) equity	(385,467 )	233,959	243,750	(477,709 )	(385,467 )
Total liabilities and shareholders' deficit	\$745,709	\$443,359	\$272,558	\$(759,033 )	\$702,593



Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Balance Sheet  
As of December 31, 2014  
(in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
Cash and cash equivalents	\$25,290	\$25	\$189,564	\$—	\$214,879
Receivables, net	82,195	1,194	8,292	—	91,681
Other current assets	25,152	33,585	1,875	(15,758 )	44,854
Total current assets	132,637	34,804	199,731	(15,758 )	351,414
Property and equipment, at cost, net	25,300	37,675	14,334	—	77,309
Goodwill	60,620	5,193	—	—	65,813
Franchise rights and other identifiable intangibles, net	4,380	1,479	3,053	—	8,912
Notes receivable, net of allowances	11,847	27,895	699	—	40,441
Investments, employee benefit plans, at fair value	—	17,539	—	—	17,539
Investment in affiliates	424,600	31,139	—	(455,739 )	—
Advances to affiliates	15,670	222,500	7,793	(245,963 )	—
Deferred income taxes	9,418	10,429	699	—	20,546
Other assets	7,228	23,891	34,177	—	65,296
Total assets	\$691,700	\$412,544	\$260,486	\$(717,460 )	\$647,270
<b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>					
Accounts payable	\$15,588	\$37,970	\$3,566	\$—	\$57,124
Accrued expenses	28,719	32,649	2,162	—	63,530
Deferred revenue	8,467	57,339	576	—	66,382
Current portion of long-term debt	11,250	718	381	—	12,349
Deferred compensation and retirement plan obligations	—	628	—	—	628
Other current liabilities	—	15,843	—	(15,758 )	85
Total current liabilities	64,024	145,147	6,685	(15,758 )	200,098
Long-term debt	767,760	3,966	10,356	—	782,082
Deferred compensation and retirement plan obligations	—	23,978	9	—	23,987
Advances from affiliates	237,973	341	7,649	(245,963 )	—
Other liabilities	50,744	16,116	3,044	—	69,904
Total liabilities	1,120,501	189,548	27,743	(261,721 )	1,076,071
Total shareholders' (deficit) equity	(428,801 )	222,996	232,743	(455,739 )	(428,801 )
Total liabilities and shareholders' deficit	\$691,700	\$412,544	\$260,486	\$(717,460 )	\$647,270

Table of Contents

Choice Hotels International, Inc.  
Condensed Consolidating Statement of Cash Flows  
For the Six Months Ended June 30, 2015  
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided (used) by operating activities	\$25,842	\$ (5,396 )	\$ 18,141	\$ (657 )	\$ 37,930
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>					
Investment in property and equipment	(11,351 )	(3,187 )	(16 )	—	(14,554 )
Proceeds from sales of assets	29	4,661	1,593	—	6,283
Contributions to equity method investments	—	(1,659 )	(787 )	—	(2,446 )
Distributions from equity method investments	—	—	270	—	270
Purchases of investments, employee benefit plans	—	(1,736 )	—	—	(1,736 )
Proceeds from sales of investments, employee benefit plans	—	1,087	—	—	1,087
Issuance of mezzanine and other notes receivable	(1,500 )	—	—	—	(1,500 )
Collections of mezzanine and other notes receivable	3,567	—	—	—	3,567
Advances to and investment in affiliates	—	(35 )	—	35	—
Divestment in affiliates	—	2,122	—	(2,122 )	—
Other items, net	(261 )	—	—	—	(261 )
Net cash provided (used) by investing activities	(9,516 )	1,253	1,060	(2,087 )	(9,290 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>					
Net borrowings pursuant to revolving credit facility	13,000	—	—	—	13,000
Principal payments on long-term debt	(5,625 )	(356 )	(188 )	—	(6,169 )
Purchases of treasury stock	(6,244 )	—	—	—	(6,244 )
Dividends paid	(22,940 )	—	(657 )	657	(22,940 )
Excess tax benefits from stock-based compensation	110	4,503	—	—	4,613
Proceeds from contributions from affiliates	—	—	35	(35 )	—
Distributions to affiliates	—	—	(2,122 )	2,122	—
Proceeds from exercise of stock options	5,696	—	—	—	5,696
Net cash provided (used) by financing activities	(16,003 )	4,147	(2,932 )	2,744	(12,044 )
Net change in cash and cash equivalents	323	4	16,269	—	16,596
Effect of foreign exchange rate changes on cash and cash equivalents	—	—	(825 )	—	(825 )
	25,290	25	189,564	—	214,879

Cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period	\$25,613	\$29	\$ 205,008	\$—	\$230,650
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33

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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

## 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. Corporate and Other revenue and 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 and activity related to the ownership of a commercial office building leased to a third party. 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, 2015				Three Months Ended June 30, 2014			
	Franchising	SkyTouch Technology	Corporate & Other	Consolidated	Franchising	SkyTouch Technology	Corporate & Other	Consolidated
Revenues	\$231,745	\$223	\$188	\$232,156	\$197,596	\$68	\$—	\$197,664
Operating income (loss)	\$76,573	\$(4,459)	\$(9,197)	\$62,917	\$75,211	\$(4,360)	\$(10,698)	\$60,153
Income (loss) from continuing operations before income taxes	\$76,142	\$(4,459)	\$(18,804)	\$52,879	\$75,203	\$(4,360)	\$(20,609)	\$50,234

(In thousands)	Six Months Ended June 30, 2015				Six Months Ended June 30, 2014			
	Franchising	SkyTouch Technology	Corporate & Other	Consolidated	Franchising	SkyTouch Technology	Corporate & Other	Consolidated
Revenues	\$406,387	\$493	\$521	\$407,401	\$357,279	\$121	\$—	\$357,400
Operating income (loss)	\$134,030	\$(9,889)	\$(19,820)	\$104,321	\$129,421	\$(7,866)	\$(20,230)	\$101,325
Income (loss) from continuing operations	\$132,594	\$(9,889)	\$(38,792)	\$83,913	\$129,422	\$(7,866)	\$(39,794)	\$81,762

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

35

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## Table of Contents

### 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 June 30, 2015, the VIE refinanced the construction loan into a mini-permanent loan with the same lender. In connection with the refinancing, the Company entered into a limited payment guaranty on substantially the same terms as the original limited payment guaranty and reaffirmed its obligations under the environmental indemnity agreement. In addition, the completion guaranty was terminated.

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.

The Company believes the likelihood of having to perform under the aforementioned limited payment guarantees was remote at June 30, 2015 and December 31, 2014.

### Commitments

The Company has the following commitments outstanding at June 30, 2015:

The Company 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, 2015, the Company had commitments to extend an additional \$49.3 million for these purposes provided certain conditions are met by its franchisees, of which \$9.5 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 hotel & suites brand. These commitments are expected to be funded in 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 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.

Table of Contents

## 17. Transactions with Unconsolidated Joint Ventures

In May 2015, the Company entered into a promissory note with an individual who is a member of one of the Company's unconsolidated joint ventures. The Company initially advanced \$1.5 million to develop and operate a Cambria hotel & suites and may provide up to \$4.0 million provided certain conditions are met. The promissory note initially matures on December 31, 2015 but may be extended until April 30, 2018 provided certain conditions are met. The promissory note bears interest at fixed rates and is payable monthly.

## 18. 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 during 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 been 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, 2015 and 2014 and the Company's financial position as of June 30, 2015 and December 31, 2014 presented in these Consolidated Financial Statements reflect these three Company-owned hotels as discontinued operations. Summarized financial information related to the discontinued operations is as follows:

	Three Months Ended June 30		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Revenues				
Hotel operations	\$—	\$ 111	\$—	\$ 801
Total revenues	—	111	—	801
Expenses				
Hotel operations	—	170	—	832
Total operating expenses	—	170	—	832
Operating income (loss)	—	(59 )	—	(31 )
Gain on disposal of discontinued operations	—	252	—	2,833
Income from discontinued operations before income taxes	—	193	—	2,802
Income taxes	—	72	—	1,040
Income from discontinued operations	\$—	\$ 121	\$—	\$ 1,762

	As of June 30, 2015	As of December 31, 2014
	(in thousands)	
Total assets	\$—	\$—
Accounts payable	\$—	\$45
Income taxes payable	—	994
Total liabilities	\$—	\$ 1,039

Net assets (liabilities) of discontinued operations	\$—	\$(1,039	)
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37

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Table of Contents

19. Subsequent Events

On July 21, 2015, the Company refinanced its existing \$350 million senior secured credit facility, comprised of a \$200 million revolving credit tranche and a \$150 million term loan tranche by entering into a new senior unsecured revolving credit agreement (“Credit Agreement”), with Deutsche Bank AG New York Branch, as administrative agent.

The Credit Agreement provides for a \$450 million unsecured revolving credit facility (the “New Revolver”) with a final maturity date of July 21, 2020, subject to optional one-year extensions that can be requested by the Company prior to each of the first, second and third anniversaries of the closing date of the New Revolver. The effectiveness of any such extensions is subject to the consent of the lenders under the Credit Agreement and certain customary conditions. Up to \$35 million of borrowings under the New Revolver may be used for alternative currency loans and up to \$15 million of borrowings under the New Revolver may be used for swing line loans.

The New Revolver is unconditionally guaranteed, jointly and severally, by certain of the Company’s domestic subsidiaries, which are considered restricted subsidiaries under the Credit Agreement. The subsidiary guarantors currently include all subsidiaries that guarantee the obligations under the Company’s Indenture governing the terms of its 5.75% senior notes due 2020 and its 5.70% senior notes due 2020. If the Company achieves and maintains an Investment Grade Rating, as defined in the Credit Agreement, then the subsidiary guarantees will at the election of the Company be released and the New Revolver will not be guaranteed.

The Company may at any time prior to the final maturity date increase the amount of the New Revolver by up to an additional \$150 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.

The Company currently may elect to have borrowings under the New Revolver bear interest at a rate equal to (i) LIBOR plus a margin ranging from 135 to 175 basis points based on the Company’s total leverage ratio or (ii) a base rate plus a margin ranging from 35 to 75 basis points based on the Company’s total leverage ratio. If the Company achieves an Investment Grade Rating, then the Company may elect to use a different, ratings-based, pricing grid set forth in the Credit Agreement.

The Credit Agreement requires the Company to pay a fee on the undrawn portion of the New Revolver, calculated on the basis of the average daily unused amount of the New Revolver multiplied by 0.20% per annum. If the Company achieves an Investment Grade Rating and it elects to use the ratings-based pricing grid set forth in the Credit Agreement, then the Company will be required to pay a fee on the total commitments under the New Revolver, calculated on the basis of the actual daily amount of the commitments under the New Revolver (regardless of usage) times a percentage per annum ranging from 0.10% to 0.25% (depending on the Company’s senior unsecured long-term debt rating).

The Credit Agreement requires that the Company and its restricted subsidiaries comply with various covenants, including with respect to restrictions on liens, incurring indebtedness, making investments and effecting mergers and/or asset sales. With respect to dividends, the Company may not declare or 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 4.0 to 1.0, the Company is generally restricted from paying aggregate dividends in excess of \$50 million in any calendar year.

The Credit Agreement imposes financial maintenance covenants requiring the Company to maintain a total leverage ratio of not more than 4.5 to 1.0 and a consolidated fixed charge coverage ratio of at least 2.5 to 1.0. If the Company achieves and maintains an Investment Grade Rating, then the Company will not need to comply with the consolidated

fixed charge coverage ratio covenant.

The Credit Agreement 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 Agreement to be immediately due and payable.

The proceeds of the New Revolver are expected to be used for general corporate purposes, including working capital, debt repayment, stock repurchases, dividends, investments and other permitted uses set forth in the Credit Agreement.

38

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Table of Contents

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.

Overview

We are primarily a hotel franchisor with franchise agreements representing 6,376 hotels open and 613 hotels under construction, awaiting conversion or approved for development as of June 30, 2015, with 504,961 rooms and 49,617 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 hotel and 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 6% of our total revenues for the six months ended June 30, 2015, while representing approximately 18% of hotels open at June 30, 2015. 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 November 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 reflect the industry's seasonality and historically have been lower in the first and fourth quarters 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 \$2.8 million and a 1 basis point change in the Company's effective royalty rate would increase or decrease annual domestic royalties by approximately \$0.7 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 or the number of rooms 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

## Table of Contents

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, maintaining a guest loyalty program, 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. 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, 2015, we have repurchased 46.7 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 \$1.2 billion. Considering the effect of the two-for-one stock split, the Company has repurchased 79.7 million shares at an average price of \$14.55 per share. The Company did not purchase any shares of common stock under the share repurchase program during the six months ended June 30, 2015. At June 30, 2015, we had approximately 3.0 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, however the declaration of future dividends are subject to the discretion of the board of directors. During the fourth quarter of 2014, the Company's board of directors announced a 5% increase to the quarterly dividend rate to \$0.195 per common share outstanding. During the six months ended June 30, 2015, we



paid cash dividends totaling approximately \$22.9 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 2015 would be approximately \$45.4 million.

The Company also allocates capital to 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:

40

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## Table of Contents

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. 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 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 continued launch of this new line of business, 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 2015.

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.

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, the SkyTouch division and revenue generated from the ownership of an office building that is leased to a third-party, 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,

41

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Table of Contents

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, (in thousands)		Six Months Ended June 30,	
	2015	2014	2015	2014
Total Revenues	\$232,156	\$197,664	\$407,401	\$357,400
Adjustments:				
Marketing and reservation system revenues	(133,122 )	(103,766 )	(231,835 )	(193,372 )
SkyTouch and other	(411 )	(68 )	(1,014 )	(121 )
Franchising Revenues	\$98,623	\$93,830	\$174,552	\$163,907

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 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 as well as the sale of assets 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,	
	2015	2014	2015	2014
Income from continuing operations, net of income taxes	\$35,813	\$35,279	\$57,407	\$56,748
Income taxes	17,066	14,955	26,506	25,014
Interest expense	11,057	10,710	21,236	20,881
Interest income	(277 )	(347 )	(623 )	(850 )
Other (gains) and losses	(1,173 )	(474 )	(1,641 )	(533 )
Equity in net loss of affiliates	431	30	1,436	65
Depreciation and amortization	2,995	2,332	5,685	4,610

Adjusted EBITDA	\$65,912	\$62,485	\$110,006	\$105,935
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Table of Contents

## Operations Review

## Comparison of Operating Results for the Three-Month Periods Ended June 30, 2015 and 2014

Summarized financial results for the three months ended June 30, 2015 and 2014 are as follows:

(in thousands)	2015	2014
<b>REVENUES:</b>		
Royalty fees	\$81,183	\$77,670
Initial franchise and relicensing fees	5,816	4,722
Procurement services	8,589	8,020
Marketing and reservation	133,122	103,766
Other	3,446	3,486
Total revenues	232,156	197,664
<b>OPERATING EXPENSES:</b>		
Selling, general and administrative	33,122	31,413
Depreciation and amortization	2,995	2,332
Marketing and reservation	133,122	103,766
Total operating expenses	169,239	137,511
Operating income	62,917	60,153
<b>OTHER INCOME AND EXPENSES, NET:</b>		
Interest expense	11,057	10,710
Interest income	(277)	(347)
Other (gains) and losses	(1,173)	(474)
Equity in net loss of affiliates	431	30
Total other income and expenses, net	10,038	9,919
Income from continuing operations before income taxes	52,879	50,234
Income taxes	17,066	14,955
Income from continuing operations, net of income taxes	35,813	35,279
Income from discontinued operations, net of income taxes	—	121
Net income	\$35,813	\$35,400

Table of Contents

## Results of Operations

The Company recorded income from continuing operations before income taxes of \$52.9 million for the three month period ended June 30, 2015, a \$2.6 million, or 5% increase from the same period of the prior year. The increase in income from continuing operations is primarily due to a \$2.8 million increase in operating income.

Operating income increased \$2.8 million primarily due to a \$4.8 million or 5% increase in the Company's franchise revenues offset by a \$1.7 million or 5% increase in SG&A expenses. Adjusted EBITDA for the three months ended June 30, 2015 increased \$3.4 million or 5% to \$65.9 million. The key drivers of these fluctuations are described in more detail below.

## Franchising Revenues

Franchising revenues were \$98.6 million for the three months ended June 30, 2015 compared to \$93.8 million for the three months ended June 30, 2014, an increase of 5%. The increase in franchising revenues is primarily due to a \$3.5 million or 5% increase in royalty revenues and a \$1.1 million or 23% increase in initial and relicensing fees.

## Royalty Fees

Domestic royalty fees for the three months ended June 30, 2015 increased \$4.6 million to \$75.8 million, an increase of 6.4% compared to the three months ended June 30, 2014. The increase in royalties is attributable to a combination of factors including a 6.7% increase in RevPAR partially offset by a 0.7% decline in the number of domestic franchised hotel rooms open and operating. System-wide RevPAR increased due to a combination of a 3.8% increase in average daily rates and a 170 basis point increase in occupancy rates. The effective royalty rate remained unchanged at 4.28% for the three months ended June 30, 2015 and 2014.

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

	For the Three Months Ended June 30, 2015*			For the Three Months Ended June 30, 2014*			Change					
	Average			Average			Average					
	Daily Rate	Occupancy	RevPAR	Daily Rate	Occupancy	RevPAR	Daily Rate	Occupancy	RevPAR			
Comfort Inn	\$90.92	69.5	% \$63.16	\$87.16	67.6	% \$58.94	4.3	% 190	bps	7.2	%	
Comfort Suites	95.59	71.8	% 68.64	91.46	70.4	% 64.36	4.5	% 140	bps	6.7	%	
Sleep	82.23	68.3	% 56.11	78.40	66.9	% 52.42	4.9	% 140	bps	7.0	%	
Quality	75.52	62.0	% 46.83	72.61	59.8	% 43.38	4.0	% 220	bps	8.0	%	
Clarion	80.54	60.8	% 48.95	78.36	57.0	% 44.68	2.8	% 380	bps	9.6	%	
Econo Lodge	59.86	56.6	% 33.87	58.12	54.9	% 31.90	3.0	% 170	bps	6.2	%	
Rodeway	59.92	58.4	% 35.01	56.56	56.7	% 32.05	5.9	% 170	bps	9.2	%	
MainStay	78.53	70.4	% 55.32	76.33	76.3	% 58.25	2.9	% (590)	bps	(5.0)	%)	
Suburban	47.96	78.9	% 37.86	45.72	75.0	% 34.27	4.9	% 390	bps	10.5	%	
Ascend Hotel Collection	129.04	59.2	% 76.41	122.07	60.1	% 73.32	5.7	% (90)	bps	4.2	%	
Total	\$80.89	64.7	% \$52.36	\$77.92	63.0	% \$49.08	3.8	% 170	bps	6.7	%	

\*Operating statistics exclude Cambria hotel & suites since the operating statistics are not representative of a stabilized brand which the Company defines as having at least 25 units open and operating for a twelve month period.

The number of domestic rooms on-line decreased by 2,656 rooms or 0.7% to 398,198 as of June 30, 2015 from 400,854 as of June 30, 2014. The total number of domestic hotels on-line increased by 0.3% to 5,230 as of June 30, 2015 from 5,212 as of June 30, 2014. The decline in the number of rooms in the domestic system primarily reflects the Company's multi-year strategy to rejuvenate the Comfort family of brands by terminating under-performing hotels that no longer meet the Comfort brand standards. Hotels terminated from the Comfort brand family may be repositioned to a more suitable brand within the Company's family of brands or exit our franchise system. While the total number of domestic units on-line continues to grow, the unit growth has been driven primarily by brands with

lower average room counts than the Comfort brand.

44

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Table of Contents

A summary of domestic hotels and rooms on-line at June 30, 2015 and 2014 by brand is as follows:

	June 30, 2015		June 30, 2014		Variance					
	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms	%	%	%	
Comfort Inn	1,215	93,904	1,281	99,679	(66 )	(5,775 )	(5.2 )%	(5.8 )%	(5.8 )%	
Comfort Suites	575	44,447	590	45,664	(15 )	(1,217 )	(2.5 )%	(2.7 )%	(2.7 )%	
Sleep	377	27,207	375	27,159	2	48	0.5 %	0.2 %	0.2 %	
Quality	1,311	105,761	1,251	102,859	60	2,902	4.8 %	2.8 %	2.8 %	
Clarion	175	24,587	185	26,501	(10 )	(1,914 )	(5.4 )%	(7.2 )%	(7.2 )%	
Econo Lodge	853	52,835	840	51,678	13	1,157	1.5 %	2.2 %	2.2 %	
Rodeway	481	26,544	460	25,366	21	1,178	4.6 %	4.6 %	4.6 %	
MainStay	47	3,629	42	3,304	5	325	11.9 %	9.8 %	9.8 %	
Suburban	62	6,959	64	7,164	(2 )	(205 )	(3.1 )%	(2.9 )%	(2.9 )%	
Ascend Hotel Collection	110	9,408	104	9,076	6	332	5.8 %	3.7 %	3.7 %	
Cambria hotel & suites	24	2,917	20	2,404	4	513	20.0 %	21.3 %	21.3 %	
Total Domestic Franchises	5,230	398,198	5,212	400,854	18	(2,656 )	0.3 %	(0.7 )%	(0.7 )%	

Domestic hotels open and operating increased by 11 hotels during the three months ended June 30, 2015, compared to a net increase of 1 domestic hotel open and operating during the three months ended June 30, 2014. Gross domestic franchise additions increased from 67 for the three months ended June 30, 2014 to 74 for the same period of 2015.

New construction hotels represented 19 of the gross domestic additions during the three months ended June 30, 2015 as compared to 11 new construction hotel openings in the same period of the prior year. There were 55 gross domestic additions for conversion hotels during both the three months ended June 30, 2015 and 2014. The timing of conversion hotel openings are impacted by various factors including the complexity of the property improvement plans required to be completed prior to opening but typically open within three to four months after the execution of a franchise agreement.

Net domestic franchise terminations decreased from 66 in the three months ended June 30, 2014 to 63 for the three months ended June 30, 2015.

International royalties declined \$1.1 million from \$6.5 million for the three months ended June 30, 2014 to \$5.4 million for the three months ended June 30, 2015 despite a 1.0% increase in the number of rooms available primarily due to the negative impact of foreign currency fluctuations in the various countries that we operate. International rooms open and operating increased from 105,669 as of June 30, 2014 to 106,763 as of June 30, 2015, however, the total number of international hotels declined 1.2% from 1,160 as of June 30, 2014 to 1,146 as of June 30, 2015.

#### Initial Franchise and Relicensing Fees

Domestic initial franchise fee revenue, included in the initial franchise and relicensing fees caption on the Company's statements of income, generated from executed franchise agreements increased \$1.0 million to \$3.5 million for the three months ended June 30, 2015 from \$2.5 million for the three months ended June 30, 2014. Domestic initial fee revenue increased approximately 43% as there has been a 11% increase in executed franchise agreements from 125 franchise agreements, representing 9,964 rooms, executed in the second quarter of 2014 compared to 139 franchise agreements, representing 11,601 rooms executed in the second quarter of 2015. In addition, revenue increased due to an increase in deferred revenue recognized in 2015 related to franchise agreements containing developer incentives as well as a decline in the percentage of franchise agreements executed during the quarter containing developer incentives. Revenues associated with agreements including incentives are deferred and recognized when the incentive criteria are met or the agreement is terminated, whichever comes first.

During the second quarter of 2015, 30 of the executed agreements were for new construction hotel franchises representing 2,695 rooms compared to 29 contracts representing 2,080 rooms for the three months ended June 30, 2014. Conversion hotel executed franchise agreements totaled 109 representing 8,906 rooms for the three months ended June 30, 2015 compared to 96 agreements representing 7,884 rooms for the same period a year ago. The

increase in conversion deals primarily reflect the Company's continued focus on growing its Comfort brands as well as increased developer interest in the Quality brand particularly from owners who are unwilling or unable to meet the Company's increasing brand and property standards required to operate their hotel within in the Comfort family of brands.

45

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Table of Contents

A summary of executed domestic franchise agreements by brand for the three months ended June 30, 2015 and 2014 is as follows:

	Three Months Ended June 30, 2015			Three Months Ended June 30, 2014			% Change		
	New Construction	Conversion	Total	New Construction	Conversion	Total	New Construction	Conversion	Total
Comfort Inn	9	13	22	7	5	12	29%	160%	83%
Comfort Suites	8	—	8	6	—	6	33%	NM	33%
Sleep	4	—	4	10	1	11	(60)%	(100)%	(64)%
Quality	1	46	47	2	38	40	(50)%	21%	18%
Clarion	—	3	3	—	9	9	NM	(67)%	(67)%
Econo Lodge	—	19	19	—	21	21	NM	(10)%	(10)%
Rodeway	—	21	21	—	16	16	NM	31%	31%
MainStay	2	—	2	1	1	2	100%	(100)%	—%
Suburban	1	1	2	—	2	2	NM	(50)%	—%
Ascend Hotel Collection	—	6	6	3	3	6	(100)%	100%	—%
Cambria hotel & suites	5	—	5	—	—	—	NM	NM	NM
Total Domestic System	30	109	139	29	96	125	3%	14%	11%

Relicensing fees include fees charged to the new owners of a franchised property whenever an ownership change occurs and the property remains in the franchise system as well as fees required to renew expiring franchise contracts. Domestic relicensing and renewal revenues increased \$0.1 million or 7% from \$2.0 million for the three months ended June 30, 2014 to \$2.1 million for the three months ended June 30, 2015. The increase in revenues is due to a 13% increase in the execution of domestic relicensing and renewal contracts partially offset by a decline in the average fees per contract. Domestic relicensing and renewal contracts increased from 75 in the second quarter of 2014 to 85 for the three months ended June 30, 2015.

As of June 30, 2015, the Company had 518 franchised hotels with 40,297 rooms under construction, awaiting conversion or approved for development in its domestic system as compared to 423 hotels and 32,564 rooms at June 30, 2014. The number of new construction franchised hotels in the Company's domestic pipeline increased 30% to 321 at June 30, 2015 from 247 at June 30, 2014. The number of conversion franchised hotels in the Company's domestic pipeline increased by 21 hotels or 12% from 176 hotels at June 30, 2014 to 197 hotels at June 30, 2015. The Company had an additional 95 franchised hotels with 9,320 rooms under construction, awaiting conversion or approved for development in its international system as of June 30, 2015 compared to 93 hotels and 8,382 rooms at June 30, 2014. While the Company's hotel pipeline provides a strong platform for growth, a hotel in the pipeline does not always result in an open and operating hotel due to various factors.

Table of Contents

A summary of the domestic franchised hotels pipeline, which includes hotels under construction, awaiting conversion and approved for development, at June 30, 2015 and 2014 by brand is as follows:

	June 30, 2015			June 30, 2014			Variance		New Construction		Total				
	Conversion	New Construction	Total	Conversion	New Construction	Total	Units	%	Units	%	Units	%			
Comfort Inn	38	64	102	38	50	88	—	—	%	14	28	%	14	16	%
Comfort Suites	3	76	79	1	47	48	2	200	%	29	62	%	31	65	%
Sleep Quality	1	65	66	2	56	58	(1)	(50)	)%	9	16	%	8	14	%
Clarion	54	5	59	41	6	47	13	32	%	(1)	(17)	)%	12	26	%
Econo Lodge	11	2	13	12	2	14	(1)	(8)	)%	—	—	%	(1)	(7)	)%
Rodeway	24	4	28	33	2	35	(9)	(27)	)%	2	100	%	(7)	(20)	)%
MainStay	34	3	37	31	2	33	3	10	%	1	50	%	4	12	%
Suburban	1	47	48	2	35	37	(1)	(50)	)%	12	34	%	11	30	%
Ascend Hotel	6	12	18	7	14	21	(1)	(14)	)%	(2)	(14)	)%	(3)	(14)	)%
Collection Cambria hotel & suites	25	18	43	9	15	24	16	178	%	3	20	%	19	79	%
	—	25	25	—	18	18	—	NM		7	39	%	7	39	%
	197	321	518	176	247	423	21	12	%	74	30	%	95	22	%

**Selling, General and Administrative Expenses:** The cost to operate the business is reflected in SG&A on the consolidated statements of income. SG&A expenses were \$33.1 million for the three months ended June 30, 2015, an increase of \$1.7 million or 5% from the three months ended June 30, 2014.

SG&A expenses for the three months ended June 30, 2015 and 2014 include approximately \$4.3 million and \$4.2 million, respectively related to the Company's SkyTouch division.

Excluding the SG&A expenses for the SkyTouch division, SG&A for the three months ended June 30, 2015 increased \$1.6 million or 6% from the prior year. This increase in SG&A primarily reflects general inflationary cost increases as well as additional expenses related to an expansion of the Company's franchised hotel quality assurance program; increased variable franchise sales compensation due to an 11% increase in domestic executed franchise agreements; increased investment in franchise sales personnel and incremental advertising to support franchise sales and the launch of the Company's new brand identity. These cost increases were partially offset by a \$1.0 million decrease in compensation related to the fluctuation in the fair value of investments held in the Company's non-qualified benefit plans.

**Marketing and Reservations:** The Company's franchise agreements require the payment of franchise fees, which include marketing and reservation system fees. The fees, which are primarily based on a percentage of the franchisees' gross room revenues, are used exclusively by the Company for expenses associated with providing franchise services such as central reservation and property management systems, loyalty programs, national marketing and media advertising. The Company is contractually obligated to expend the marketing and reservation system fees it collects from franchisees in accordance with the franchise agreements; as such, no net income or loss to the Company is generated. Cumulative marketing and reservation fees not expended are deferred and recorded as a liability in the Company's financial statements and carried over to the next fiscal year and expended in accordance with the franchise agreements. Conversely, cumulative marketing and reservation expenditures incurred in excess of fees billed for marketing and reservation activities are deferred and recorded as an asset in the Company's financial statements and

recovered in future periods.

Total marketing and reservation system revenues increased 28% from \$103.8 million for the three months ended June 30, 2014 to \$133.1 million for the three months ended June 30, 2015. The increase in revenues was primarily due to improved system fees resulting from RevPAR increases and increasing revenues from the Choice Privileges loyalty program resulting from the growth in program membership and increased in average daily rate and the recognition of \$7.0 million of previously deferred revenues compared to a \$15.8 million deferral of revenues to future periods recorded in 2014.

Table of Contents

At June 30, 2015 and December 31, 2014, cumulative marketing and reservation system fees billed exceeded expenses by \$35.7 million and \$44.3 million, respectively, with the excess reflected as an other long-term liability in the accompanying consolidated balance sheets.

Other (Gains) and Losses: Other (gains) and losses increased from a gain of \$0.5 million for the three months ended June 30, 2014 to a gain of \$1.2 million in the same period of the current year primarily due to a \$1.3 million gain on the sale of an interest in an unconsolidated joint venture partially offset by fluctuations in the fair value of investments held in the Company's non-qualified employee benefit plans which declined \$0.6 million compared to the same period of the prior year.

Equity in Net Loss of Affiliates: Losses recognized from unconsolidated joint ventures increased \$0.4 million to \$0.4 million for the three months ended June 30, 2015. These losses are primarily attributable to the results of operations during the ramp up period of operations for several recently opened hotel projects owned by unconsolidated joint ventures. These investments relate to the Company's program to offer equity support to qualified franchisees to develop and operate Cambria hotel & suites in strategic markets.

Income Taxes: The Company's effective income tax rates from continuing operations were 32.3% and 29.8% for the three months ended June 30, 2015 and June 30, 2014, respectively. The effective income tax rates for the three months ended June 30, 2015 and 2014 were 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.

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 beginning in the first quarter of 2014. Net income from discontinued operations was \$0.1 million in the second quarter of 2014 and primarily reflected a \$0.3 million pre-tax gain on the sale of one of these hotels during the three months ended June 30, 2014.

## Operations Review

## Comparison of Operating Results for the Six-Month Periods Ended June 30, 2015 and 2014

Summarized financial results for the six months ended June 30, 2015 and 2014 are as follows:

(in thousands)	2015	2014
<b>REVENUES:</b>		
Royalty fees	\$143,614	\$136,210
Initial franchise and relicensing fees	11,533	8,462
Procurement services	13,396	12,798
Marketing and reservation	231,835	193,372
Other	7,023	6,558
Total revenues	407,401	357,400
<b>OPERATING EXPENSES:</b>		
Selling, general and administrative	65,560	58,093
Depreciation and amortization	5,685	4,610
Marketing and reservation	231,835	193,372
Total operating expenses	303,080	256,075
Operating income	104,321	101,325
<b>OTHER INCOME AND EXPENSES, NET:</b>		
Interest expense	21,236	20,881
Interest income	(623)	(850)
Other (gains) and losses	(1,641)	(533)
Equity in net loss of affiliates	1,436	65
Total other income and expenses, net	20,408	19,563
Income from continuing operations before income taxes	83,913	81,762
Income taxes	26,506	25,014

Income from continuing operations, net of income taxes	57,407	56,748
Income from discontinued operations, net of income taxes	—	1,762
Net income	\$57,407	\$58,510

#### Results of Operations

The Company recorded income from continuing operations of \$57.4 million for the six month period ended June 30, 2015, a \$0.7 million, or 1% increase from the same period of the prior year. The increase in income from continuing operations primarily reflects a \$3.0 million increase in operating income and a \$1.1 million increase in other gains and losses partially offset by an increase in the Company's effective income tax rate from continuing operations from 30.6% for the six month period ended June 30, 2014 to 31.6% for the six month period ended June 30, 2015 and a \$1.4 million increase in losses recognized from unconsolidated equity method investments.

Operating income increased \$3.0 million as the Company's franchising revenues increased by \$10.6 million or 6% partially offset by an increase in SG&A expenses of \$7.5 million or 13%. Adjusted EBITDA for the six months ended June 30, 2015 increased \$4.1 million or 4% to \$110 million. The key drivers of these fluctuations are described in more detail below.

**Franchising Revenues:** Franchising revenues were \$174.6 million for the six months ended June 30, 2015 compared to \$163.9 million for the six months ended June 30, 2014, an increase of 6%. The increase in franchising revenues is primarily due to a \$7.4 million or 5% increase in royalty revenues, a \$0.6 million or 5% increase in procurement services revenues and a \$3.1 million or 36% increase in initial franchising and relicensing revenues.

#### Royalty Fees

Domestic royalty fees for the six months ended June 30, 2015 increased \$9.2 million to \$133.6 million, an increase of 7.4% compared to the six months ended June 30, 2014. The increase in royalties is attributable to a combination of factors including a 8.1% increase in RevPAR partially offset by a 0.7% decrease in the number of domestic franchised hotel rooms open and

Table of Contents

operating and a 1 basis point decline in the effective royalty rate from 4.30% to 4.29%. System-wide RevPAR increased due to a combination of a 3.7% increase in average daily rates and a 240 basis point increase in occupancy rates.

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

	For the Six Months Ended June 30, 2015*			For the Six Months Ended June 30, 2014*			Change				
	Average			Average			Average				
	Daily Rate	Occupancy	RevPAR	Daily Rate	Occupancy	RevPAR	Daily Rate	Occupancy	RevPAR		
Comfort Inn	\$87.35	63.5	% \$55.48	\$83.68	61.3	% \$51.31	4.4	% 220	bps	8.1	%
Comfort Suites	93.06	68.2	% 63.43	89.35	65.7	% 58.68	4.2	% 250	bps	8.1	%
Sleep	79.60	64.0	% 50.93	75.94	61.3	% 46.57	4.8	% 270	bps	9.4	%
Quality	73.16	57.5	% 42.05	70.37	54.8	% 38.57	4.0	% 270	bps	9.0	%
Clarion	78.25	56.3	% 44.07	75.01	53.0	% 39.75	4.3	% 330	bps	10.9	%
Econo Lodge	57.47	52.4	% 30.13	55.75	49.7	% 27.72	3.1	% 270	bps	8.7	%
Rodeway	57.22	55.8	% 31.90	54.19	53.2	% 28.85	5.6	% 260	bps	10.6	%
MainStay	76.24	68.5	% 52.23	73.80	70.6	% 52.11	3.3	% (210)	bps	0.2	%
Suburban	47.25	76.5	% 36.15	44.53	72.6	% 32.34	6.1	% 390	bps	11.8	%
Ascend Hotel Collection	122.78	59.8	% 73.45	117.13	59.2	% 69.30	4.8	% 60	bps	6.0	%
Total	\$78.08	60.4	% \$47.15	\$75.26	58.0	% \$43.63	3.7	% 240	bps	8.1	%

\*Operating statistics exclude Cambria hotel & suites since the operating statistics are not representative of a stabilized brand which the Company defines as having at least 25 units open and operating for a twelve month period.

Domestic hotels open and operating increased by 9 hotels during the six months ended June 30, 2015 compared to a net increase of 32 domestic hotels open and operating during the six months ended June 30, 2014. Gross domestic franchise additions declined from 134 for the six months ended June 30, 2014 to 130 for the same period of 2015. New construction hotels represented 33 of the gross domestic additions during the six months ended June 30, 2015 as compared to 19 new construction hotel openings in the same period of the prior year. Gross domestic additions for conversion hotels during the six months ended June 30, 2015 decreased by 18 units to 97 from 115 for the six months ended June 30, 2014. The decline reflects the variability in timing of hotel openings from period to period. The timing of conversion hotel openings are impacted by various factors including the complexity of the property improvement plans required to be completed prior to opening but typically open within three to four months after the execution of the franchise agreement. The Company expects the number of new franchise units that will open during 2015 to increase from 302 hotels in 2014 to 356 hotels. The projected increase in gross openings primarily reflects an additional 26 new construction openings as well as a 28 unit increase in conversion openings. The increase in new construction openings reflects the improving hotel development environment which has resulted in an increase in new construction executed franchise agreements since 2012. New construction hotels typically average 18 to 36 months to open after the franchise agreement is executed.

Net domestic franchise terminations increased from 102 in the six months ended June 30, 2014 to 121 for the six months ended June 30, 2015. The increase in net terminations primarily reflects an increase in the number of hotels removed from our franchise system for non-compliance with Company's rules and regulations. As industry supply growth continues to improve and return to historical average levels, the Company will continue to execute its strategy to replace or reposition franchised hotels that do not meet brand standards or are under-performing in their market. International royalties declined by \$1.8 million or 15% from the six months ended June 30, 2014 to \$10.0 million for the same period of 2015. International rooms open and operating increased 1.0% to 106,763 as of June 30, 2015 from 105,669 as of June 30, 2014. Despite the increase in international rooms available, royalties declined as a result of unfavorable foreign currency fluctuations in the countries in which we operate. The total number of international



hotels declined 1.2% from 1,160 as of June 30, 2014 to 1,146 as of June 30, 2015.

Table of Contents

## Initial Franchise and Relicensing Fees

Domestic initial fee revenue, included in the initial franchise and relicensing fees caption on the Company's statements of income, generated from executed franchise agreements increased \$2.3 million to \$6.5 million for the six months ended June 30, 2015 from \$4.3 million for the six months ended June 30, 2014. Domestic initial fee revenue increased approximately 53% primarily due to a 29% increase in the number of new domestic executed franchise agreements and a decline in the percentage of franchise agreements executed during the current period containing development incentives. Revenues associated with agreements including incentives are deferred and recognized when the incentive criteria are met or the agreement is terminated, whichever comes first.

New domestic franchise agreements executed in the six months ended June 30, 2015 totaled 238 representing 18,131 rooms compared to 184 agreements representing 14,654 rooms executed in the same period of 2014. During the six months ended June 30, 2015, 53 of the executed agreements were for new construction hotel franchises representing 4,182 rooms, compared to 48 contracts representing 3,493 rooms for the six months ended June 30, 2014. The increase in new construction franchise agreements primarily reflects a gradual improvement of the lending environment for hotel construction and improving lodging fundamentals including an increasing RevPAR environment and low industry supply growth which are typically a catalyst for increased construction of new hotels. Conversion hotel executed franchise agreements totaled 185 representing 13,949 rooms for the six months ended June 30, 2015 compared to 136 agreements representing 11,161 rooms for the same period a year ago. The increase in conversion deals primarily reflect the Company's continued focus on growing its Ascend Hotel Collection and Comfort brands as well as increased developer interest in the Quality brand particularly from owners who are unwilling or unable to meet the Company's increasing brand and property standards required to operate their hotel within in the Comfort family of brands.

A summary of executed domestic franchise agreements by brand for the six months ended June 30, 2015 and 2014 is as follows:

	Six Months Ended June 30, 2015			Six Months Ended June 30, 2014			% Change		
	New Construction	Conversion	Total	New Construction	Conversion	Total	New Construction	Conversion	Total
Comfort Inn	13	20	33	10	8	18	30%	150%	83%
Comfort Suites	13	2	15	7	—	7	86%	NM	114%
Sleep	9	—	9	14	1	15	(36)%	(100)%	(40)%
Quality	3	75	78	3	48	51	—%	56%	53%
Clarion	—	6	6	—	11	11	NM	(45)%	(45)%
Econo Lodge	—	28	28	—	27	27	NM	4%	4%
Rodeway	—	35	35	1	31	32	(100)%	13%	9%
MainStay	6	—	6	5	1	6	20%	(100)%	—%
Suburban	1	3	4	1	3	4	—%	—%	—%
Ascend Hotel Collection	1	16	17	6	6	12	(83)%	167%	42%
Cambria hotel & suites	7	—	7	1	—	1	600%	NM	600%
Total Domestic System	53	185	238	48	136	184	10%	36%	29%

Relicensing fees include fees charged to the new owners of a franchised property whenever an ownership change occurs and the property remains in the franchise system as well as fees required to renew expiring franchise contracts. Domestic relicensing revenues increased \$0.8 million or 22% from \$3.8 million for the six months ended June 30, 2014 to \$4.6 million for the six months ended June 30, 2015. The increase in revenues is due to a 17% increase in the execution of domestic relicensing and renewal contracts and an increase in the average fees per contract. Domestic relicensing and renewal contracts increased from 158 in the six months ended June 30, 2014 to 185 for the six months ended June 30, 2015.

Procurement Services: Revenues increased \$0.6 million or 5% from \$12.8 million for the six months ended June 30, 2014 to \$13.4 million for the six months ended June 30, 2015. The increase in revenues primarily reflects the implementation of new brand programs as well as an increased volume of business transacted with qualified vendors and strategic alliance partners.

Table of Contents

Other Income: Revenue increased \$0.5 million from the six months ended June 30, 2014 to \$7.0 million for the six months ended June 30, 2015. The increase in other income is primarily due to rental income earned from a commercial office building that was acquired on December 30, 2014 and support and consulting fees earned by the Company's SkyTouch division, offset by a decline in fees charged to franchisees for non-compliance with the Company's rules and regulations.

Selling, General and Administrative Expenses: The cost to operate the business is reflected in SG&A on the consolidated statements of income. SG&A expenses were \$65.6 million for the six months ended June 30, 2015, an increase of \$7.5 million or 13% from the six months ended June 30, 2014.

SG&A expenses for the six months ended June 30, 2015 and 2014 include approximately \$9.7 million and \$7.5 million, respectively, related to the Company's SkyTouch division. The increase in expenses related to SkyTouch primarily reflects increased investment in the division's sales and marketing efforts and product development.

Excluding the SG&A expenses for the SkyTouch division, SG&A for the six months ended June 30, 2015 increased \$5.3 million from the prior year. This increase in SG&A primarily reflects general inflationary cost increases as well as additional expenses related to an expansion of the Company's franchised hotel quality assurance program; increased variable franchise sales compensation due to a 29% increase in domestic executed franchise agreements; increased investment in franchise sales personnel; realized foreign currency exchange rate losses and incremental advertising to support franchise sales and the launch of the Company's new brand identity. These cost increases were partially offset by a \$0.5 million decrease in compensation related to the fluctuation in the fair value of investments held in the Company's non-qualified benefit plans.

Marketing and Reservations: The Company's franchise agreements require the payment of franchise fees, which include marketing and reservation system fees. The fees, which are primarily based on a percentage of the franchisees' gross room revenues, are used exclusively by the Company for expenses associated with providing franchise services such as central reservation and property management systems, loyalty programs, national marketing and media advertising. The Company is contractually obligated to expend the marketing and reservation system fees it collects from franchisees in accordance with the franchise agreements; as such, no net income or loss to the Company is generated. Cumulative marketing and reservation fees not expended are deferred and recorded as a liability in the Company's financial statements and carried over to the next fiscal year and expended in accordance with the franchise agreements. Conversely, cumulative marketing and reservation expenditures incurred in excess of fees billed for marketing and reservation activities are deferred and recorded as an asset in the Company's financial statements and recovered in future periods.

Total marketing and reservation system revenues increased 20% from \$193.4 million for the six months ended June 30, 2014 to \$231.8 million for the six months ended June 30, 2015. The increase in revenues was primarily due to improved system fees resulting from RevPAR increases and increasing revenues from the Choice Privileges loyalty program resulting from the growth in program membership and increase in average daily rate and the recognition of \$8.6 million of previously deferred revenues in 2015 compared to a \$10.1 million deferral of revenues to future periods recorded in 2014.

At June 30, 2015 and December 31, 2014, cumulative marketing and reservation system fees billed exceeded expenses by \$35.7 million and \$44.3 million, respectively, with the excess reflected as an other long-term liability in the accompanying consolidated balance sheets.

Other (Gains) and Losses: Other (gains) and losses increased from a gain of \$0.5 million for the six months ended June 30, 2014 to a gain of \$1.6 million in the same period of the current year primarily due to a \$1.3 million gain on the sale of an interest in an unconsolidated joint venture, offset by fluctuations in the fair value of investments held in the Company's non-qualified employee benefit plans.

Equity in Net Loss of Affiliates: Losses recognized from unconsolidated joint ventures increased \$1.4 million to \$1.4 million for the six months ended June 30, 2015. These losses are primarily attributable to the results of operations during the ramp up period of operations for several recently opened hotel projects owned by unconsolidated joint ventures. These investments relate to the Company's program to offer equity support to qualified franchisees to develop and operate Cambria hotel & suites in strategic markets.

Income Taxes: The Company's effective income tax rates for income from continuing operations were 31.6% and 30.6% for the six months ended June 30, 2015 and 2014, respectively. The effective income tax rates for the six months ended June 30, 2015 and 2014 were 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 rate for the six months ended June 30, 2015 was further reduced due to the settlement of uncertain tax positions.

## Table of Contents

**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 beginning in the first quarter of 2014. Net income from discontinued operations was \$1.8 million in the first six months of 2014 and primarily reflected a \$2.8 million pre-tax gain on the sale of the three hotels.

### Liquidity and Capital Resources

#### Operating Activities

During the six months ended June 30, 2015 and 2014, net cash provided by operating activities totaled \$37.9 million and \$65.8 million, respectively. Operating cash flows declined \$27.9 million primarily due to a \$27.8 million decrease in cash flows from marketing and reservation activities and a \$12.5 million increase in net disbursements to franchisees for property improvements and other purposes utilizing forgivable notes receivable partially offset by the improvement in receivable collections and the timing of payable disbursements.

Net cash provided by marketing and reservation activities totaled \$3.7 million during the six months ended June 30, 2015 compared to \$31.5 million during the six months ended June 30, 2014. The decline in cash provided by marketing and reservation activities primarily reflects an increase in advertising and promotional costs to support various brand programs as well as an expansion of the Company's information technology workforce to support improvements to the Company's various property management and central reservation technologies that are designed to deliver guests to our franchised hotels.

In conjunction with brand and development programs, the Company provides financing to franchisees for property improvements and other purposes in the form of forgivable notes receivable. If the franchisee remains in the system in good standing over the term of the promissory note, the Company forgives the outstanding principal balance and related interest. Since these forgivable notes are predominantly forgiven ratably over the term of the promissory note rather than repaid, the Company classifies the related issuance and collections of these notes as operating activities. During the six months ended June 30, 2015 and 2014, the Company's net advances for these purposes totaled \$19.2 million and \$6.7 million, respectively. The timing and amount of these cash flows is dependent on various factors including the implementation of various development and brand incentive programs, the level of franchise sales as well as the timing of hotel openings. At June 30, 2015, the Company had commitments to extend an additional \$49.2 million for these purposes provided certain conditions are met by its franchisees, of which \$9.5 million is expected to be advanced in the next twelve months.

#### Investing Activities

Cash utilized for investing activities totaled \$9.3 million for the six months ended June 30, 2015 compared to net cash provided of \$4.6 million for the same period of 2014. The increase in cash utilized for investing activities for the six months ended June 30, 2015 primarily reflects the following items:

During the six months ended June 30, 2015 and 2014, capital expenditures totaled \$14.6 million and \$7.3 million, respectively. The increase in capital expenditures from 2014 primarily reflect increased spending on upgrades of our central reservation and yield management systems as well as purchases of technology hardware.

During the six months ended June 30, 2015, the Company realized proceeds from the sales of assets totaling \$6.3 million related to the sale of a parcel of land and an interest in an unconsolidated joint venture that developed and operated a Cambria hotel & suites. During the six months ended June 30, 2014, the Company realized proceeds from the sale of assets totaling \$12.2 million related to the sale of three company-owned Mainstay hotels and a facility previously utilized as a call center.

During the six months ended June 30, 2015 and 2014, the Company invested \$2.4 million and \$6.9 million, respectively, in joint ventures accounted for under the equity method of accounting. The Company's investment in these joint ventures primarily relate to ventures that either support the Company's efforts to increase business delivery to its franchisees or promote growth of our emerging brands.

During the six months ended June 30, 2015 and 2014, the Company sold investments totaling \$1.1 million and \$0.6 million, respectively, and utilized the proceeds to distribute participant deferred compensation balances from the

Company's non-qualified retirement plans. The increase in proceeds from the sale of investments primarily reflects the timing of employee terminations and their deferred compensation distribution elections.

From time to time, our board of directors authorizes specific transactions and general programs which permit us to provide financing, investment and guarantees and similar credit support to qualified franchisees, as well as to acquire and resell real estate to incent franchise development. Since 2006, we have engaged in these financial support activities to encourage acceleration of the growth of our Cambria hotel & suites brand, primarily in strategic markets and locations. Over the next

## Table of Contents

three to five years, depending on market and other conditions, we expect to continue to deploy capital in support of this brand and expect our investment to range between \$250 million to \$350 million over that time period. The annual pace of future financial support activities will depend upon market and other conditions including among others, our franchise sales results, the environment for new construction hotel development and the hotel lending environment. Our support of the Cambria brand's growth is expected to be primarily in the form of joint venture investments, forgivable key money loans, senior mortgage loans, including development loans, mezzanine lending, and through the operation of a land-banking program. With respect to our lending and joint venture investments, we generally expect to recycle these loans and investments within a five year period. At June 30, 2015, the Company had approximately \$60 million outstanding pursuant to these financial support activities.

### Financing Activities

Financing cash flows relate primarily to the Company's borrowings, open market treasury stock repurchases, acquisition of shares in connection with the exercise or vesting of equity awards, and dividends.

### Debt

#### Senior Unsecured Notes due 2022

On June 27, 2012, the Company issued unsecured senior notes with a principal amount of \$400 million (the "2012 Senior Notes") at par, bearing a coupon of 5.75% with an effective rate of 6%. 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 utilized the net proceeds of this offering, after deducting underwriting discounts and commissions and other offering expenses, together with borrowings under the Company's senior 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.

The Company may redeem the 2012 Senior Notes at its option at a redemption price equal to the greater of (a) 100% of the principal amount of the notes to be redeemed and (b) the sum of the present values of the remaining scheduled principal and interest payments from the redemption date to the date of maturity discounted to the redemption date on a semi-annual basis at the Treasury rate, plus 50 basis points.

#### Senior Unsecured Notes due 2020

On August 25, 2010, the Company issued unsecured senior notes with a principal amount of \$250 million (the "2010 Senior Notes") at a discount of \$0.6 million, bearing a coupon of 5.70% with an effective rate of 6.19%. The 2010 Senior Notes will mature on August 28, 2020, with interest on the 2010 Senior Notes 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 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.

The Company may redeem the 2010 Senior Notes at its option at a redemption price equal to the greater of (a) 100% of the principal amount of the notes to be redeemed and (b) the sum of the present values of the remaining scheduled principal and interest payments from the redemption date to the date of maturity discounted to the redemption date on a semi-annual basis at the Treasury rate, plus 45 basis points.

#### Old Senior Secured 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 lenders (the "Old Credit Facility"). The Old Credit Facility had a final maturity date of July 25, 2016, subject to an optional one-year extension, provided certain conditions were met. Up to \$25 million of the borrowings under the Revolver were available to be used for letters of credit, up to \$10 million of borrowings under the Revolver were available for swing line loans and up to \$35 million of borrowings under the Revolver were available to be used for alternative currency loans. The Term Loan required 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.

Table of Contents

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

The Old Credit Facility was 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 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.

The Company could 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.

Additionally, the Old Credit Facility required that the Company and its restricted subsidiaries comply with various financial maintenance covenants, as well as covenants with respect to restrictions on liens, incurring indebtedness, making investments, paying dividends or repurchasing stock, and effecting mergers and/or asset sales.

At June 30, 2015, the Company was in compliance with all covenants under the Old Credit Facility.

At June 30, 2015, the Company had \$123.8 million outstanding under the Term Loan and \$13.0 million outstanding under the Revolver. At December 31, 2014, the Company had \$129.4 million outstanding under the Term Loan and no amounts outstanding under the Revolver.

**New Unsecured Credit Agreement**

On July 21, 2015, the Company refinanced the Old Credit Facility by entering into a \$450 million senior unsecured revolving credit agreement among the Company and Deutsche Bank AG New York Branch, as administrative agent, Wells Fargo Bank, National Association as syndication agent and swing line lender, and a syndication of lenders (the "New Credit Agreement").

The New Credit Agreement provides for a \$450 million unsecured revolving credit facility (the "New Revolver") with a final maturity date of July 21, 2020, subject to optional one-year extensions that can be requested by the Company prior to each of the first, second and third anniversaries of the closing date of the New Revolver. The effectiveness of any such extensions is subject to the consent of the lenders under the New Credit Agreement and certain customary conditions. Up to \$35 million of borrowings under the New Revolver may be used for alternative currency loans and up to \$15 million of borrowings under the New Revolver may be used for swing line loans.

The New Revolver is unconditionally guaranteed, jointly and severally, by certain of the Company's domestic subsidiaries, which are considered restricted subsidiaries under the New Credit Agreement. The subsidiary guarantors currently include all subsidiaries that guarantee the obligations under the Company's Indenture governing the terms of its 5.75% senior notes due 2022 and its 5.70% senior notes due 2020. If the Company achieves and maintains an Investment Grade Rating, as defined in the New Credit Agreement, then the subsidiary guarantees will at the election of the Company be released and the New Revolver will not be guaranteed.

The Company may at any time prior to the final maturity date increase the amount of the New Revolver by up to an additional \$150 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.

The Company currently may elect to have borrowings under the New Revolver bear interest at a rate equal to (i) LIBOR plus a margin ranging from 135 to 175 basis points based on the Company's total leverage ratio or (ii) a base rate plus a margin ranging from 35 to 75 basis points based on the Company's total leverage ratio. If the Company achieves an Investment Grade Rating, then the Company may elect to use a different, ratings-based, pricing grid set forth in the New Credit Agreement.

The New Credit Agreement requires the Company to pay a fee on the undrawn portion of the New Revolver, calculated on the basis of the average daily unused amount of the New Revolver multiplied by 0.20% per annum. If the Company achieves an Investment Grade Rating and it elects to use the ratings-based pricing grid set forth in the New Credit Agreement, then the Company will be required to pay a fee on the total commitments under the New

Revolver, calculated on the basis of the actual daily amount of the commitments under the New Revolver (regardless of usage) times a percentage per annum ranging from 0.10% to 0.25% (depending on the Company's senior unsecured long-term debt rating).

## Table of Contents

The New Credit Agreement requires that the Company and its restricted subsidiaries comply with various covenants, including with respect to restrictions on liens, incurring indebtedness, making investments and effecting mergers and/or asset sales. With respect to dividends, the Company may not declare or 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 4.0 to 1.0, the Company is generally restricted from paying aggregate dividends in excess of \$50 million in any calendar year.

The New Credit Agreement imposes financial maintenance covenants requiring the Company to maintain a total leverage ratio of not more than 4.5 to 1.0 and a consolidated fixed charge coverage ratio of at least 2.5 to 1.0. If the Company achieves and maintains an Investment Grade Rating, then the Company will not need to comply with the consolidated fixed charge coverage ratio covenant.

The New Credit Agreement 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 New Credit Agreement to be immediately due and payable.

The proceeds of the New Revolver are expected to be used for general corporate purposes, including working capital, debt repayment, stock repurchases, dividends, investments and other permitted uses set forth in the New Credit Agreement.

### Fixed Rate Collateralized Mortgage

On December 30, 2014, a court awarded the Company title to an office building as settlement for a portion of an outstanding loan receivable for which the building was pledged as collateral. In conjunction with the court award, the Company also assumed the \$9.5 million mortgage on the property with a fixed interest rate of 7.26%. The mortgage which is collateralized by the office building requires monthly payments of principal and interest and matures in December 2020 with a balloon payment due of \$6.9 million. At the time of acquisition, the Company determined that the fixed interest rate of 7.26% exceeded market interest rates and therefore the Company increased the carrying value of the debt by \$1.2 million to record the debt at fair value. The fair value adjustment will be amortized over the remaining term of the mortgage utilizing the effective interest method.

### 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 headquarters relocation and tenant improvement costs in consideration of the employment of permanent, full-time employees within the jurisdictions. At June 30, 2015, the Company had been advanced approximately \$3.5 million pursuant to these agreements and expects to receive the remaining \$0.9 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, 2015.

### Dividends

The Company currently maintains the payment of a quarterly dividend on its common stock outstanding of \$0.195 per share, however, the declaration of future dividends are subject to the discretion of our board of directors. In December 2014, the Company's board of directors increased the quarterly dividend rate to \$0.195 per share, beginning with the dividend payable in January 2015, representing a 5% increase from previous quarterly declarations. The Company's quarterly dividend rate declared during the six months ended June 30, 2015 remained unchanged from the previous

quarterly declaration.

During the six months ended June 30, 2015, the Company paid cash dividends totaling \$22.9 million. We expect to continue to pay dividends in the future, subject to the declaration of our board of directors as well as to future business performance,

55

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## Table of Contents

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 2015 would be approximately \$45.4 million.

### Share Repurchases

The Company did not repurchase any shares of its common stock under the share repurchase program during the six months ended June 30, 2015. Since the program's inception through June 30, 2015, we have repurchased 46.7 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 \$1.2 billion. Considering the effect of the two-for-one stock split, the Company has repurchased 79.7 million shares at an average price of \$14.55 per share. As of June 30, 2015, the Company had approximately 3.0 million shares remaining under the current share repurchase authorization.

During the six months ended June 30, 2015, the Company redeemed 102,753 shares of common stock at a total cost of approximately \$6.2 million 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 items

Approximately \$205 million of the Company's cash and cash equivalents at June 30, 2015 pertains to undistributed earnings of the Company's consolidated foreign subsidiaries. Since the Company's intent is for such earnings to be reinvested by the foreign subsidiaries, the Company has not provided additional U.S. income taxes on these amounts. While the Company has no intention to utilize these cash and cash equivalents in its domestic operations, any change to this policy would result in the Company incurring additional U.S. income taxes on any amounts utilized domestically.

The Company believes that cash flows from operations and available financing capacity are adequate to meet the expected future operating, investing and financing needs of the business.

### Off Balance Sheet Arrangements

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 June 30, 2015, the VIE refinanced the construction loan into a mini-permanent loan with the same lender. In connection with the refinancing, the Company entered into a limited payment guaranty on substantially the same terms as the original limited payment guaranty and reaffirmed its obligations under the environmental indemnity agreement. In addition, the completion guaranty was terminated.

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.

The Company believes the likelihood of having to perform under the aforementioned limited payment guarantees was remote at June 30, 2015 and December 31, 2014.



## Table of Contents

### Critical Accounting Policies

Our accounting policies comply with principles generally accepted in the United States. We have described below those policies that we believe are critical and require the use of complex judgment or significant estimates in their application. Additional discussion of these policies is included in Note 1 to our consolidated financial statements as of and for the year ended December 31, 2014 included in our Annual Report on Form 10-K.

### Revenue Recognition

We recognize continuing franchise fees, including royalty, marketing and reservations system fees, when earned and realizable from our franchisees. Franchise fees are typically based on a percentage of gross room revenues or the number of hotel rooms of each franchisee. Franchise fees based on a percentage of gross room revenues are recognized in the same period that the underlying gross room revenues are earned by our franchisees. Our estimate of the allowance for uncollectible royalty fees is charged to SG&A expense and our estimate of the allowance for uncollectible marketing and reservation system fees is charged to marketing and reservation expenses.

Initial franchise and relicensing fees are recognized, in most instances, in the period the related franchise agreement is executed because the initial franchise and relicensing fees are non-refundable and the Company is not required to provide initial services to the franchisee prior to hotel opening. We defer the initial franchise and relicensing fee revenue related to franchise agreements which include incentives until the incentive criteria are met or the agreement is terminated, whichever occurs first.

The Company recognizes procurement services revenues from qualified vendors when the services are performed or the product delivered, evidence of an arrangement exists, the fee is fixed or determinable and collectability is reasonably assured. We defer the recognition of procurement services revenues related to certain upfront fees and recognize them over a period corresponding to the Company's estimate of the life of the arrangement.

### Marketing and Reservation Revenues and Expenses

The Company's franchise agreements require the payment of certain marketing and reservation system fees, which are used exclusively by the Company for expenses associated with providing franchise services such as national marketing, media advertising, central reservation systems and technology services. The Company is contractually obligated to expend the marketing and reservation system fees it collects from franchisees in accordance with the franchise agreements; as such, no net income or loss to the Company is generated. In accordance with our contracts, we include in marketing and reservation expenses an allocation of costs for certain activities, such as human resources, facilities, legal and accounting, required to carry out marketing and reservation activities.

The Company records marketing and reservation system revenues and expenses on a gross basis since the Company is the primary obligor in the arrangement, maintains the credit risk, establishes the price and nature of the marketing or reservation services and retains discretion in supplier selection. In addition, net advances to and recoveries from the franchise system for marketing and reservation activities are presented as cash flows from operating activities.

Marketing and reservation system fees not expended in the current year are recorded as a liability in the Company's balance sheet and are carried over to the next fiscal year and expended in accordance with the franchise agreements or utilized to repay previous advances. Marketing and reservation expenses incurred in excess of revenues are recorded as an asset in the Company's balance sheet, with a corresponding reduction in costs, and are similarly recovered in subsequent years. Under the terms of the franchise agreements, the Company may advance capital and incur costs as necessary for marketing and reservation activities and recover such advances through future fees. The Company believes that any credit risk associated with cost advances for marketing and reservation system activities is mitigated due to our contractual right to recover these amounts from a large geographically dispersed group of franchisees. However, our ability to recover advances may be adversely impacted by certain factors, including, among others, declines in the ability of our franchisees to generate revenues at properties they franchise from us, lower than expected franchise system growth, an extended period of occupancy or room rate declines or a decline in the number of hotel rooms in our franchise system. If these factors exist it could result in the generation of insufficient funds to recover marketing and reservation advances as well as meet the ongoing marketing and reservation needs of the overall system.



The Company evaluates the recoverability of marketing and reservation costs incurred in excess of cumulative marketing and reservation system revenues earned on a periodic basis. The Company will record a reserve when, based on current information and events, it is probable that it will be unable to recover the cumulative amounts advanced for marketing and reservation activities according to the contractual terms of the franchise agreements. These advances are considered to be unrecoverable if

57

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## Table of Contents

the expected net, undiscounted cash flows from marketing and reservation activities are less than the carrying amount of the asset.

Choice Privileges is our frequent guest incentive marketing program. Choice Privileges enables members to earn points based on their spending levels with our franchisees and, to a lesser degree, through participation in affiliated partners' programs, such as those offered by credit card companies. The points, which we accumulate and track on the members' behalf, may be redeemed for free accommodations or other benefits.

We provide Choice Privileges as a marketing program to franchised hotels and collect a percentage of program members' room revenue from franchises to operate the program. Revenues are deferred in an amount equal to the estimated fair value of the future redemption obligation. The Company develops an estimate of the eventual redemption rates and point values using various actuarial methods. These judgmental factors determine the required liability attributable to outstanding points. Upon redemption of points, the Company recognizes the previously deferred revenue as well as the corresponding expense relating to the cost of the awards redeemed. Revenues in excess of the estimated future redemption obligation are recognized when earned to reimburse the Company for costs incurred to operate the program, including administrative costs, marketing, promotion and performing member services.

### Valuation of Intangibles and Long-Lived Assets

The Company evaluates the potential impairment of property and equipment and other long-lived assets, including franchise rights and other definite-lived intangibles, whenever an event or other circumstances indicates that the Company may not be able to recover the carrying value of the asset. When indicators of impairment are present, recoverability is assessed based on net, undiscounted expected cash flows. If the net, undiscounted expected cash flows are less than the carrying amount of the assets, an impairment charge is recorded for the excess of the carrying value over the fair value of the asset. We estimate the fair value of intangibles and long lived assets primarily using undiscounted cash flow analysis. Significant management judgment is involved in evaluating indicators of impairment and developing any required projections to test for recoverability or estimate the fair value of an asset. Furthermore, if management uses different projections or if different conditions occur in future periods, future-operating results could be materially impacted.

The Company evaluates the impairment of goodwill and trademarks with indefinite lives on an annual basis, or during the year if an event or other circumstance indicates that the Company may not be able to recover the carrying amount of the asset. In evaluating these assets for impairment, the Company may elect to first assess qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit or the indefinite lived intangible asset is less than its carrying amount. If the conclusion is that it is not more likely than not that the fair value of the asset is less than its carrying value, then no further testing is required. If the conclusion is that it is more likely than not that the fair value of the asset is less than its carrying value, then a two-step impairment test is performed for goodwill. The Company may elect to forego the qualitative assessment and move directly to the two-step impairment test for goodwill and the fair value determination for indefinite-lived intangibles. The Company determines the fair value of its reporting units and indefinite-lived intangibles using income and market methods.

### Valuation of Investments in Ventures

The Company evaluates an investment in a venture for impairment when circumstances indicate that the carrying value may not be recoverable, for example due to loan defaults, significant under performance relative to historical or projected operating performance, and significant negative industry or economic trends. When there is indication that a loss in value has occurred, the Company evaluates the carrying value compared to the estimated fair value of the investment. Fair value is based upon internally developed discounted cash flow models, third-party appraisals, and if appropriate, current estimated net sales proceeds from pending offers. If the estimated fair value is less than carrying value, management uses its judgment to determine if the decline in value is other-than-temporary. In determining this, the Company considers factors including, but not limited to, the length of time and extent of the decline, loss of values as a percentage of the cost, financial condition and near-term financial projections, the Company's intent and ability to recover the lost value and current economic conditions. For declines in value that are deemed other-than-temporary, impairments are charged to earnings.

Loan Loss Reserves

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.

58

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## Table of Contents

### Mezzanine and Other Notes Receivables

The Company has provided financing to franchisees in support of the development of properties in strategic markets. The Company expects the owners to repay the loans in accordance with the loan agreements, or earlier as the hotels mature and capital markets permit. The Company estimates the collectability and records an allowance for loss on its mezzanine and other notes receivable when recording the receivables in the Company's financial statements. These estimates are updated quarterly based on available information.

The Company considers a loan to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement. The Company measures loan impairment based on the present value of expected future cash flows discounted at the loan's original effective interest rate or the estimated fair value of the collateral. For impaired loans, the Company establishes a specific impairment reserve for the difference between the recorded investment in the loan and the present value of the expected future cash flows or the estimated fair value of the collateral. The Company applies its loan impairment policy individually to all mezzanine and other notes receivable in the portfolio and does not aggregate loans for the purpose of applying such policy. For impaired loans, the Company recognizes interest income on a cash basis. If it is likely that a loan will not be collected based on financial or other business indicators it is the Company's policy to charge off these loans to SG&A expenses in the accompanying consolidated statements of income in the quarter when it is deemed uncollectible. Recoveries of impaired loans are recorded as a reduction of SG&A expenses in the quarter received. The Company assesses the collectability of its senior notes receivable by comparing the market value of the underlying assets to the carrying value of the outstanding notes. In addition, the Company evaluates the property's operating performance, the borrower's compliance with the terms of the loan and franchise agreements, and all related personal guarantees that have been provided by the borrower. For subordinated or unsecured receivables, the Company assesses the property's operating performance, the subordinated equity available to the Company, the borrower's compliance with the terms of the loan and franchise agreements, and the related personal guarantees that have been provided by the borrower.

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.

### Forgivable Notes Receivable

In conjunction with brand and development programs, the Company may provide financing to franchisees for property improvements and other purposes in the form of forgivable promissory notes which bear interest at market rates. Under these promissory notes, the franchisee promises to repay the principal balance together with interest upon maturity unless certain conditions are met throughout the term of the promissory note. The principal balance and related interest are forgiven ratably over the term of the promissory note if the franchisee remains in the system in good standing. If during the term of the promissory note, the franchisee exits our franchise system or is not operating their franchise in accordance with our quality or credit standards, the Company may declare a default under the promissory note and commence collection efforts with respect to the full amount of the then-current outstanding principal and interest.

In accordance with the terms of the promissory notes, the initial principal balance and related interest are ratably reduced over the term of the loan on each anniversary date until the outstanding amounts are reduced to zero as long as the franchisee remains within the franchise system and operates in accordance with our quality and brand standards. As a result, the amounts recorded as an asset on the Company's consolidated balance sheet are also ratably reduced since the amounts forgiven no longer represent probable future economic benefits to the Company. The Company records the reduction of its recorded assets through amortization and marketing and reservation expense on its consolidated statements of income. Since these forgivable promissory notes receivable are predominately forgiven ratably over the term of the promissory note rather than repaid, the Company classifies the issuance and collection of

these notes receivable as operating activities in its consolidated statement of cash flows.

The Company fully reserves all defaulted notes in addition to recording a reserve on the estimated uncollectible portion of the remaining notes. For those notes not in default, the Company calculates an allowance for losses and determines the ultimate collectibility on these forgivable notes based on the historical default rates for those unsecured notes that are not forgiven but are required to be repaid. The Company records bad debt expense in SG&A and marketing and reservation system expenses in the accompanying consolidated statements of income in the quarter when the note is deemed uncollectible.

## Table of Contents

### Stock Compensation.

The Company's policy is to recognize compensation cost related to share-based payment transactions in the financial statements based on the fair value of the equity or liability instruments issued. Compensation expense related to the fair value of share-based awards is recognized over the requisite service period based on an estimate of those awards that will ultimately vest. The Company estimates the share-based compensation expense for awards that will ultimately vest upon inception of the grant and adjusts the estimate of share-based compensation for those awards with performance and/or service requirements that will not be satisfied so that compensation cost is recognized only for awards that ultimately vest.

### Income Taxes.

Income taxes are recorded using the asset and liability method of accounting for income taxes. Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not such assets will be unrealized. Deferred U.S. income taxes have not been recorded for temporary differences related to investments in certain foreign subsidiaries and corporate affiliates. The temporary differences consist primarily of undistributed earnings that are considered permanently reinvested in operations outside the U.S. If management's intentions change in the future, deferred taxes may need to be provided. With respect to uncertain income tax positions, a tax liability is recorded in full when management determines that the position does not meet the more likely than not threshold of being sustained on examination. A tax liability may also be recognized for a position that meets the more likely than not threshold, based upon management's assessment of the position's probable settlement value. The Company records interest and penalties on unrecognized tax benefits in the provision for income taxes.

### New Accounting Standards

See Footnote No. 1 of the Notes to our Financial Statements for information related to our adoption of new accounting standards in 2015 and for information on our anticipated adoption of recently issued accounting standards.

### FORWARD-LOOKING STATEMENTS

Certain matters discussed in this quarterly report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Generally, our use of words such as "expect," "estimate," "believe," "anticipate," "should", "will," "forecast," "plan", "project," "assume" or similar words of futurity identify such forward-looking statements. These forward-looking statements are based on management's current beliefs, assumptions and expectations regarding future events, which in turn are based on information currently available to management. Such statements may relate to projections of the Company's revenue, earnings and other financial and operational measures, Company debt levels, ability to repay outstanding indebtedness, payment of dividends, and future operations, among other matters. We caution you not to place undue reliance on any such forward-looking statements. Forward-looking statements do not guarantee future performance and involve known and unknown risks, uncertainties and other factors.

Several factors could cause actual results, performance or achievements of the Company to differ materially from those expressed in or contemplated by the forward-looking statements. Such risks include, but are not limited to, changes to general, domestic and foreign economic conditions; foreign currency fluctuations; operating risks common in the lodging and franchising industries; changes to the desirability of our brands as viewed by hotel operators and customers; changes to the terms or termination of our contracts with franchisees and our relationships with our franchisees; our ability to keep pace with improvements in technology utilized for marketing and reservations systems and other operating systems; our ability to grow our franchise system; exposures to risks relating to development activities; fluctuations in the supply and demand for hotels rooms; our ability to realize anticipated benefits of acquired businesses; the level of acceptance of alternative growth strategies we may implement; cyber security and data breach risks; operating risks associated with international operations; the outcome of litigation; and our ability to effectively manage our indebtedness. These and other risk factors are discussed in detail in the Risk Factors section of the Company's Form 10-K for the year ended December 31, 2014, filed with the Securities and Exchange Commission

on March 2, 2015. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by law.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk from changes in interest rates and the impact of fluctuations in foreign currencies on the Company's foreign investments and operations. The Company manages its exposure to these market risks through the monitoring of its available financing alternatives including in certain circumstances the use of derivative financial instruments. We are also subject to risk from changes in debt and equity prices from our non-qualified retirement savings plan investments in debt securities and common stock, which have a carrying value of \$18.4 million and \$17.8 million at June 30, 2015 and December 31, 2014, respectively which we account for as trading securities. The Company will continue to monitor the exposure in these areas and make the appropriate adjustments as market conditions dictate.

At June 30, 2015, the Company had \$136.8 million of variable interest rate debt instruments outstanding at an effective rate of 2.2%. A hypothetical change of 10% in the Company's effective interest rate from June 30, 2015 levels would increase or decrease annual interest expense by \$0.3 million. The Company expects to refinance its fixed and variable long-term debt obligations prior to their scheduled maturities.

The Company does not presently have any derivative financial instruments.

### ITEM 4. CONTROLS AND PROCEDURES

#### Management's Evaluation of Disclosure Controls and Procedures

The Company has a disclosure review committee whose membership includes the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), among others. The disclosure review committee's procedures are considered by the CEO and CFO in performing their evaluations of the Company's disclosure controls and procedures and in assessing the accuracy and completeness of the Company's disclosures.

Our management, with the participation of our CEO and CFO have evaluated the effectiveness of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"), as of the end of the period covered by this quarterly report as required by Rules 13a-15(b) or 15d-15(b) under the Exchange Act. Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met.

Table of Contents

An evaluation was performed under the supervision and with the participation of the Company's CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of June 30, 2015.

**Changes in internal control over financial reporting**

There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2015, that materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting.

**PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

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

**ITEM 1A. RISK FACTORS**

There have been no material changes in our risk factors from those disclosed in Part I, Item 1A to our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 filed on March 2, 2015. In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2014, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****Issuer Purchases of Equity Securities**

The following table sets forth purchases and redemptions of Choice Hotels International, Inc. common stock made by the Company during the six months ended June 30, 2015:

Month Ending	Total Number of Shares Purchased or Redeemed	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(1),(2)</sup>	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs, End of Period
January 31, 2015	19,246	\$54.75	—	3,000,000
February 28, 2015	69,937	62.13	—	3,000,000
March 31, 2015	13,274	62.38	—	3,000,000
April 30, 2015	296	62.68	—	3,000,000
May 31, 2015	—	—	—	3,000,000
June 30, 2015	—	—	—	3,000,000
Total	102,753	\$60.78	—	3,000,000

(1) The Company's share repurchase program was initially approved by the board of directors on June 25, 1998. The program has no fixed dollar amount or expiration date.

(2) During the six months ended June 30, 2015, the Company redeemed 102,753 shares of common stock from employees to satisfy the option price and minimum tax-withholding requirements related to the exercising of options and vesting of restricted stock and performance vested restricted stock unit grants. These redemptions were not part of the board repurchase authorization.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**



None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

61

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Table of Contents

ITEM 6. EXHIBITS

Exhibit Number and Description

Exhibit Number	Description
3.01(a)	Restated Certificate of Incorporation of Choice Hotels Franchising, Inc. (renamed Choice Hotels International, Inc.)
3.02(b)	Amendment to the Restated Certificate of Incorporation of Choice Hotels International, Inc.
3.03(c)	Amended and Restated Bylaws of Choice Hotels International, Inc.
3.04(d)	Amendment to the Amended and Restated Bylaws of Choice Hotels International, Inc.
10.01(d)	Amendment to the Choice Hotels International, Inc. 2006 Long-Term Incentive Plan.
31.1*	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a)
31.2*	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a)
32*	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Label Linkbase Document
101.PRE*	XBRL Taxonomy Presentation Linkbase Document

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\* Filed herewith

- (a) Incorporated by reference to the identical document filed as an exhibit to Choice Hotels International, Inc.'s Registration Statement on Form S-4, filed August 31, 1998 (Reg. No. 333-62543).
- (b) Incorporated by reference to the identical document filed as an exhibit to Choice Hotels International, Inc.'s Current Report on Form 8-K filed May 1, 2013.
- (c) Incorporated by reference to the identical document filed as an exhibit to Choice Hotels International, Inc.'s Current Report on Form 8-K filed February 16, 2010.
- (d) Incorporated by reference to the identical document filed as an exhibit to Choice Hotels International, Inc.'s Current Report on Form 8-K filed April 29, 2015.



Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CHOICE HOTELS INTERNATIONAL, INC.

August 5, 2015

By: /S/ DAVID L. WHITE  
David L. White  
Senior Vice President, Chief Financial Officer &  
Treasurer