

DiamondRock Hospitality Co
Form 10-Q
August 08, 2017

Table of Contents

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-32514

DIAMONDROCK HOSPITALITY COMPANY

(Exact Name of Registrant as Specified in Its Charter)

Maryland

(State of Incorporation)

20-1180098

(I.R.S. Employer Identification No.)

3 Bethesda Metro Center, Suite 1500, Bethesda, Maryland 20814

(Address of Principal Executive Offices)

(Zip Code)

(240) 744-1150

(Registrant's telephone number, including area code)

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 (or for such shorter period that the registrant was required to file such reports), 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 (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Emerging growth company (Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards pursuant to Section 13(a) of the Exchange Act.

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

The registrant had 200,305,232 shares of its \$0.01 par value common stock outstanding as of August 8, 2017.

Table of Contents
INDEX

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (unaudited):</u>	
<u>Condensed Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016</u>	<u>1</u>
<u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2017 and 2016</u>	<u>2</u>
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2017 and 2016</u>	<u>3</u>
<u>Notes to the Condensed Consolidated Financial Statements</u>	<u>4</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>15</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>28</u>
<u>Item 4. Controls and Procedures</u>	<u>29</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>30</u>
<u>Item 1A. Risk Factors</u>	<u>30</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>30</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>30</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>30</u>
<u>Item 5. Other Information</u>	<u>30</u>
<u>Item 6. Exhibits</u>	<u>31</u>

Table of Contents

PART I. FINANCIAL INFORMATION

Item I. Financial Statements

DIAMONDROCK HOSPITALITY COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(unaudited)

	June 30, 2017	December 31, 2016
ASSETS		
Property and equipment, net	\$2,739,193	\$ 2,646,676
Restricted cash	41,481	46,069
Due from hotel managers	99,150	77,928
Favorable lease assets, net	26,902	18,013
Prepaid and other assets	40,640	37,682
Cash and cash equivalents	149,645	243,095
Total assets	\$3,097,011	\$ 3,069,463
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Mortgage debt, net of unamortized debt issuance costs	\$645,798	\$ 821,167
Term loans, net of unamortized debt issuance costs	297,922	99,372
Total debt	943,720	920,539
Deferred income related to key money, net	19,025	20,067
Unfavorable contract liabilities, net	71,690	72,646
Deferred ground rent	83,576	80,509
Due to hotel managers	63,774	58,294
Dividends declared and unpaid	25,548	25,567
Accounts payable and accrued expenses	54,936	55,054
Total liabilities	1,262,269	1,232,676
Stockholders' Equity:		
Preferred stock, \$0.01 par value; 10,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$0.01 par value; 400,000,000 shares authorized; 200,305,232 and 200,200,902 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	2,003	2,002
Additional paid-in capital	2,058,380	2,055,365
Accumulated deficit	(225,641)	(220,580)
Total stockholders' equity	1,834,742	1,836,787
Total liabilities and stockholders' equity	\$3,097,011	\$ 3,069,463

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

Table of Contents

DIAMONDROCK HOSPITALITY COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Revenues:				
Rooms	\$177,483	\$186,113	\$315,315	\$335,556
Food and beverage	52,762	57,407	97,540	107,781
Other	13,027	13,144	26,627	26,361
Total revenues	243,272	256,664	439,482	469,698
Operating Expenses:				
Rooms	41,565	43,257	78,466	81,971
Food and beverage	33,064	35,265	62,530	68,615
Management fees	6,949	8,772	12,961	15,381
Other hotel expenses	78,608	79,524	150,267	158,453
Depreciation and amortization	25,585	25,005	49,948	50,126
Hotel acquisition costs	22	—	2,273	—
Corporate expenses	6,828	6,736	13,090	12,736
Total operating expenses, net	192,621	198,559	369,535	387,282
Operating profit	50,651	58,105	69,947	82,416
Interest and other income, net	(192)	(68)	(551)	(118)
Interest expense	9,585	11,074	19,098	22,738
Loss on early extinguishment of debt	274	—	274	—
Gain on sale of hotel properties	—	(8,121)	—	(8,121)
Total other expenses, net	9,667	2,885	18,821	14,499
Income before income taxes	40,984	55,220	51,126	67,917
Income tax expense	(4,389)	(11,045)	(5,644)	(6,964)
Net income	\$36,595	\$44,175	\$45,482	\$60,953
Earnings per share:				
Basic earnings per share	\$0.18	\$0.22	\$0.23	\$0.30
Diluted earnings per share	\$0.18	\$0.22	\$0.23	\$0.30

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

- 2-

Table of Contents

DIAMONDROCK HOSPITALITY COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$45,482	\$60,953
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	49,948	50,126
Corporate asset depreciation as corporate expenses	32	34
Gain on sale of hotel properties	—	(8,121)
Loss on early extinguishment of debt	274	—
Non-cash ground rent	3,164	2,662
Amortization of debt issuance costs	1,028	1,215
Amortization of favorable and unfavorable contracts, net	(956)	(956)
Amortization of deferred income related to key money	(1,042)	(1,434)
Stock-based compensation	3,340	3,363
Changes in assets and liabilities:		
Prepaid expenses and other assets	(3,261)	(5,983)
Restricted cash	3,986	3,664
Due to/from hotel managers	(20,258)	(12,637)
Accounts payable and accrued expenses	5,623	1,720
Net cash provided by operating activities	87,360	94,606
Cash flows from investing activities:		
Hotel capital expenditures	(60,403)	(54,096)
Hotel acquisitions	(93,795)	—
Net proceeds from sale of hotel properties	—	118,309
Change in restricted cash	2,094	3,529
Net cash (used in) provided by investing activities	(152,104)	67,742
Cash flows from financing activities:		
Scheduled mortgage debt principal payments	(5,870)	(5,678)
Repayments of mortgage debt	(170,368)	(249,793)
Proceeds from senior unsecured term loan	200,000	100,000
Draws on senior unsecured credit facility	—	75,000
Repayments of senior unsecured credit facility	—	(75,000)
Payment of financing costs	(1,579)	(2,740)
Payment of cash dividends	(50,360)	(50,488)
Repurchase of common stock	(529)	(685)
Net cash used in financing activities	(28,706)	(209,384)
Net decrease in cash and cash equivalents	(93,450)	(47,036)
Cash and cash equivalents, beginning of period	243,095	213,584
Cash and cash equivalents, end of period	\$149,645	\$166,548

Supplemental Disclosure of Cash Flow Information:

Cash paid for interest	\$18,015	\$22,407
Cash paid for income taxes	\$1,770	\$1,203
Non-cash Investing and Financing Activities:		
Unpaid dividends	\$25,548	\$25,583

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

- 3-

Table of Contents

DIAMONDROCK HOSPITALITY COMPANY

Notes to the Condensed Consolidated Financial Statements
(Unaudited)

1. Organization

DiamondRock Hospitality Company (the “Company” or “we”) is a lodging-focused real estate company that owns a portfolio of premium hotels and resorts. Our hotels are concentrated in key gateway cities and in destination resort locations and the majority of our hotels are operated under a brand owned by one of the leading global lodging brand companies (Marriott International, Inc. or Hilton Worldwide). We are an owner, as opposed to an operator, of the hotels in our portfolio. As an owner, we receive all of the operating profits or losses generated by our hotels after we pay fees to the hotel managers, which are based on the revenues and profitability of the hotels.

As of June 30, 2017, we owned 28 hotels with 9,630 guest rooms, located in the following markets: Atlanta, Georgia; Boston, Massachusetts (2); Burlington, Vermont; Charleston, South Carolina; Chicago, Illinois (2); Denver, Colorado (2); Fort Lauderdale, Florida; Fort Worth, Texas; Huntington Beach, California; Key West, Florida (2); New York, New York (4); Salt Lake City, Utah; San Diego, California; San Francisco, California; Sedona, Arizona (2); Sonoma, California; Washington D.C. (2); St. Thomas, U.S. Virgin Islands; and Vail, Colorado.

We conduct our business through a traditional umbrella partnership real estate investment trust, or UPREIT, in which our hotel properties are owned by our operating partnership, DiamondRock Hospitality Limited Partnership, or subsidiaries of our operating partnership. The Company is the sole general partner of our operating partnership and currently owns, either directly or indirectly, all of the limited partnership units of our operating partnership.

2. Summary of Significant Accounting Policies

Basis of Presentation

We have condensed or omitted certain information and footnote disclosures normally included in financial statements presented in accordance with U.S. generally accepted accounting principles, or U.S. GAAP, in the accompanying unaudited condensed consolidated financial statements. We believe the disclosures made are adequate to prevent the information presented from being misleading. However, the unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2016, included in our Annual Report on Form 10-K filed on February 27, 2017.

In our opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly our financial position as of June 30, 2017, and the results of our operations for the three and six months ended June 30, 2017 and 2016, and cash flows for the six months ended June 30, 2017 and 2016. Interim results are not necessarily indicative of full-year performance because of the impact of seasonal and short-term variations.

Our financial statements include all of the accounts of the Company and its subsidiaries in accordance with U.S. GAAP. All intercompany accounts and transactions have been eliminated in consolidation. If the Company determines that it has an interest in a variable interest entity within the meaning of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 810, Consolidation, the Company will consolidate the entity when it is determined to be the primary beneficiary of the entity. Our operating partnership meets the criteria of a

variable interest entity. The Company is the primary beneficiary and, accordingly, we consolidate our operating partnership.

Property and Equipment

Investments in hotel properties, land, land improvements, building and furniture, fixtures and equipment and identifiable intangible assets are recorded at fair value upon acquisition. Property and equipment purchased after the hotel acquisition date is recorded at cost. Replacements and improvements are capitalized, while repairs and maintenance are expensed as incurred. Upon the sale or retirement of a fixed asset, the cost and related accumulated depreciation are removed from the Company's accounts and any resulting gain or loss is included in the statements of operations.

- 4-

Table of Contents

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 15 to 40 years for buildings, land improvements, and building improvements and 1 to 10 years for furniture, fixtures and equipment. Leasehold improvements are amortized over the shorter of the lease term or the useful lives of the related assets.

We review our investments in hotel properties for impairment whenever events or changes in circumstances indicate that the carrying value of the hotel properties may not be recoverable. Events or circumstances that may cause a review include, but are not limited to, adverse changes in the demand for lodging at the properties due to declining national or local economic conditions and/or new hotel construction in markets where the hotels are located. When such conditions exist, management performs an analysis to determine if the estimated undiscounted future cash flows from operations and the proceeds from the ultimate disposition of a hotel, less costs to sell, exceed its carrying value. If the estimated undiscounted future cash flows are less than the carrying amount of the asset, an adjustment to reduce the carrying amount to the related hotel's estimated fair market value is recorded and an impairment loss is recognized.

We will classify a hotel as held for sale in the period that we have made the decision to dispose of the hotel, a binding agreement to purchase the property has been signed under which the buyer has committed a significant amount of nonrefundable cash and no significant financing or other contingencies exist which could cause the transaction to not be completed in a timely manner. If these criteria are met, we will record an impairment loss if the fair value less costs to sell is lower than the carrying amount of the hotel and related assets and will cease recording depreciation expense. We will classify the assets and related liabilities as held for sale on the balance sheet.

Revenue Recognition

Revenues from operations of the hotels are recognized when the goods or services are provided. Revenues consist of room sales, food and beverage sales, and other hotel department revenues, such as telephone, parking, gift shop sales and resort fees.

Earnings Per Share

Basic earnings per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period plus other potentially dilutive securities such as equity awards or shares issuable in the event of conversion of operating partnership units. No adjustment is made for shares that are anti-dilutive during a period.

Stock-based Compensation

We account for stock-based employee compensation using the fair value based method of accounting. We record the cost of stock-based awards based on the grant-date fair value of the award. The vesting of the awards issued to officers and employees is based on either continued employment (time-based) or based on continued employment and the relative total shareholder returns of the Company or improvement in market share of the Company's hotels (performance-based). The cost of time-based awards and performance-based awards is recognized over the period during which an employee is required to provide service in exchange for the award, adjusted for forfeitures.

Income Taxes

We account for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in earnings during the period in which the new rate is enacted.

We have elected to be treated as a real estate investment trust ("REIT") under the provisions of the Internal Revenue Code of 1986, as amended (the "Code"), which requires that we distribute at least 90% of our taxable income annually to our stockholders and comply with certain other requirements. In addition to paying federal and state taxes on any retained income, we may be subject to taxes on "built-in gains" on sales of certain assets. Our taxable REIT subsidiaries will generally be subject to federal, state, local, and/or foreign income taxes.

In order for the income from our hotel property investments to constitute "rents from real properties" for purposes of the gross income tests required for REIT qualification, the income we earn cannot be derived from the operation of any of our hotels. Therefore, we lease each of our hotel properties to a wholly owned subsidiary of Bloodstone TRS, Inc., our primary taxable REIT subsidiary, or TRS, except for the Frenchman's Reef & Morning Star Marriott Beach Resort, which is owned by a Virgin Islands

Table of Contents

corporation, which we have elected to be treated as a TRS, and the L'Auberge de Sedona and Orchards Inn Sedona, which are each leased to a wholly owned subsidiary of the Company, which we have elected to be treated as a TRS.

We had no accruals for tax uncertainties as of June 30, 2017 and December 31, 2016.

Fair Value Measurements

In evaluating fair value, U.S. GAAP outlines a valuation framework and creates a fair value hierarchy that distinguishes between market assumptions based on market data (observable inputs) and a reporting entity's own assumptions about market data (unobservable inputs). The hierarchy ranks the quality and reliability of inputs used to determine fair value, which are then classified and disclosed in one of the three categories. The three levels are as follows:

- Level 1 - Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 - Inputs include quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets in markets that are not active and model-derived valuations whose inputs are observable
- Level 3 - Model-derived valuations with unobservable inputs

Intangible Assets and Liabilities

Intangible assets and liabilities are recorded on non-market contracts assumed as part of the acquisition of certain hotels. We review the terms of agreements assumed in conjunction with the purchase of a hotel to determine if the terms are favorable or unfavorable compared to an estimated market agreement at the acquisition date. Favorable lease assets or unfavorable contract liabilities are recorded at the acquisition date and amortized using the straight-line method over the term of the agreement. We do not amortize intangible assets with indefinite useful lives, but we review these assets for impairment annually or at interim periods if events or circumstances indicate that the asset may be impaired.

Use of Estimates

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

Recently Issued Accounting Pronouncements

In January 2017, the FASB issued Accounting Standards Update ("ASU") No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which clarifies the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions of assets or business combinations. As a result of the standard, we anticipate that the majority of our hotel a will be considered asset purchases as opposed to business combinations. However, the determination will be made on a transaction-by-transaction basis and we do not expect the determination to materially change the recognition of the assets and liabilities acquired. This standard will be applied on a prospective basis and, therefore, it does not affect the accounting for any of our previous transactions. This standard will be effective for annual periods beginning after December 15, 2017, although early adoption is permitted.

Edgar Filing: DiamondRock Hospitality Co - Form 10-Q

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires that the statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. This standard will be effective for annual periods beginning after December 15, 2017, although early adoption is permitted. We do not anticipate that this guidance will have a material impact on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which clarifies and provides specific guidance on eight cash flow classification issues with an objective to reduce the current diversity in practice. This standard will be effective for annual periods beginning after December 15, 2017, although early adoption is permitted. We do not anticipate that this guidance will have a material impact on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which simplifies various aspects of how share-based payments are accounted for and presented in the financial statements. This standard requires companies to record all of the tax effects related to share-based

Table of Contents

payments through the income statement, allows companies to elect an accounting policy to either estimate the share based award forfeitures (and expense) or account for forfeitures (and expense) as they occur, and allows companies to withhold up to the maximum individual statutory tax rate the shares upon settlement of an award without causing the award to be classified as a liability. This guidance is effective for annual periods beginning after December 15, 2016. We adopted ASU No. 2016-09 effective January 1, 2017 and it did not have a material impact on our financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which primarily changes the lessee's accounting for operating leases by requiring recognition of lease right-of-use assets and lease liabilities. This standard is effective for annual reporting periods beginning after December 15, 2018, with early adoption permitted. The primary impact of the new standard will be to the treatment of our ground leases, which represent a majority of all of our operating lease payments. We are evaluating the effect of ASU 2016-02 on our consolidated financial statements and related disclosures.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which affects virtually all aspects of an entity's revenue recognition. The new standard sets forth five prescribed steps to determine the timing and amount of revenue to be recognized to appropriately depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which deferred the effectiveness of ASU No. 2014-09 to reporting periods beginning after December 15, 2017 and permitted early application for annual reporting periods beginning after December 15, 2016. While we have not completed our assessment of this standard, we do not expect it to materially affect the amount or timing of revenue recognition for revenues from room, food and beverage, and other hotel-level sales. Furthermore, we do not expect the standard to significantly impact the recognition of or accounting for real estate sales to third parties, since we primarily dispose of real estate in exchange for cash with few contingencies.

3. Property and Equipment

Property and equipment as of June 30, 2017 and December 31, 2016 consists of the following (in thousands):

	June 30, 2017	December 31, 2016
Land	\$602,879	\$553,769
Land improvements	7,994	7,994
Buildings and site improvements	2,438,245	2,355,871
Furniture, fixtures and equipment	468,078	428,991
Construction in progress	7,180	35,253
	3,524,376	3,381,878
Less: accumulated depreciation	(785,183)	(735,202)
	\$2,739,193	\$2,646,676

As of June 30, 2017 and December 31, 2016, we had accrued capital expenditures of \$5.1 million and \$10.8 million, respectively.

4. Favorable Lease Assets

Edgar Filing: DiamondRock Hospitality Co - Form 10-Q

In connection with the acquisition of certain hotels, we have recognized intangible assets for favorable leases. Our favorable lease assets, net of accumulated amortization of \$2.5 million and \$2.3 million as of June 30, 2017 and December 31, 2016, respectively, consist of the following (in thousands):

	June 30, December 31,	
	2017	2016
Westin Boston Waterfront Hotel Ground Lease	\$17,751	\$ 17,859
Orchards Inn Sedona Annex Sublease	9,013	—
Lexington Hotel New York Tenant Leases	138	154
	\$26,902	\$ 18,013

Favorable lease assets are recorded at the acquisition date and are generally amortized using the straight-line method over the remaining non-cancelable term of the lease agreement. We recorded \$0.1 million of amortization expense for each of the three months ended June 30, 2017 and 2016. We recorded \$0.2 million of amortization expense for each of the six months ended June 30, 2017 and 2016.

Table of Contents

In connection with our acquisition of the Orchards Inn Sedona on February 28, 2017, we recorded a \$9.1 million favorable lease asset. We determined the value using a discounted cash flow of the favorable difference between the contractual lease payments and estimated market rents. The market rents were estimated by a third-party valuation firm and the discount rate was estimated using a risk adjusted rate of return. See Note 9 for further discussion of this favorable lease asset.

5. Capital Stock

Common Shares

We are authorized to issue up to 400 million shares of common stock, \$0.01 par value per share. Each outstanding share of common stock entitles the holder to one vote on all matters submitted to a vote of stockholders. Holders of our common stock are entitled to receive dividends out of assets legally available for the payment of dividends when authorized by our board of directors.

We have an “at-the-market” equity offering program (the “ATM program”), pursuant to which we may issue and sell shares of our common stock from time to time, having an aggregate offering price of up to \$200 million. We have not sold any shares of our common stock during 2017 and there is \$128.3 million remaining under the ATM program.

Our board of directors has approved a share repurchase program authorizing us to repurchase up to \$150 million in shares of our common stock. Repurchases under this program are made in open market or privately negotiated transactions as permitted by federal securities laws and other legal requirements. This authority may be exercised from time to time and in such amounts as market conditions warrant, and subject to regulatory considerations. The timing, manner, price and actual number of shares repurchased depends on a variety of factors including stock price, corporate and regulatory requirements, market conditions, and other corporate liquidity requirements and priorities. The share repurchase program may be suspended or terminated at any time without prior notice. We have not repurchased any shares of our common stock during 2017 and we have \$143.5 million of capacity remaining under our share repurchase program.

Dividends

We have paid the following dividends to holders of our common stock during 2017 as follows:

Payment Date	Record Date	Dividend per Share
January 12, 2017	December 30, 2016	\$ 0.125
April 12, 2017	March 31, 2017	\$ 0.125
July 12, 2017	June 30, 2017	\$ 0.125

Preferred Shares

We are authorized to issue up to 10 million shares of preferred stock, \$0.01 par value per share. Our board of directors is required to set for each class or series of preferred stock the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications, and terms or conditions of redemption. As of June 30, 2017 and December 31, 2016, there were no shares of preferred stock outstanding.

Operating Partnership Units

Holders of operating partnership units have certain redemption rights, which would enable them to cause our operating partnership to redeem their units in exchange for cash per unit equal to the market price of our common stock, at the time of redemption, or, at our option for shares of our common stock on a one-for-one basis. The number of shares issuable upon exercise of the redemption rights will be adjusted upon the occurrence of stock splits, mergers, consolidations or similar pro-rata share transactions, which otherwise would have the effect of diluting the ownership interests of the limited partners or our stockholders. As of June 30, 2017 and December 31, 2016, there were no operating partnership units held by unaffiliated third parties.

6. Stock Incentive Plans

- 8-

Table of Contents

We are authorized to issue up to 6,082,664 shares of our common stock under our 2016 Equity Incentive Plan (the "2016 Plan"), of which we have issued or committed to issue 443,453 shares as of June 30, 2017. In addition to these shares, additional shares of common stock could be issued in connection with the performance stock unit awards as further described below. The 2016 Plan replaced the 2004 Stock Option and Incentive Plan, as amended (the "2004 Plan"). We no longer make share grants and issuances under the 2004 Plan, although awards previously made under the 2004 Plan that are outstanding will remain in effect in accordance with the terms of that plan and the applicable award agreements.

Restricted Stock Awards

Restricted stock awards issued to our officers and employees generally vest over a three-year period from the date of the grant based on continued employment. We measure compensation expense for the restricted stock awards based upon the fair market value of our common stock at the date of grant. Compensation expense is recognized on a straight-line basis over the vesting period and is included in corporate expenses in the accompanying condensed consolidated statements of operations. A summary of our restricted stock awards from January 1, 2017 to June 30, 2017 is as follows:

	Number of Shares	Weighted- Average Grant Date Fair Value
Unvested balance at January 1, 2017	567,540	\$ 10.62
Granted	320,866	11.20
Vested	(244,411)	11.29
Forfeited	(16,669)	10.80
Unvested balance at June 30, 2017	627,326	\$ 10.65

The remaining share awards are expected to vest as follows: 285,936 shares during 2018, 226,487 shares during 2019, and 114,903 during 2020. As of June 30, 2017, the unrecognized compensation cost related to restricted stock awards was \$5.6 million and the weighted-average period over which the unrecognized compensation expense will be recorded is approximately 26 months. We recorded \$0.8 million of compensation expense related to restricted stock awards for each of the three months ended June 30, 2017 and 2016. We recorded \$1.5 million and \$1.6 million, respectively, of compensation expense related to restricted stock awards for the six months ended June 30, 2017 and 2016.

Performance Stock Units

Performance stock units ("PSUs") are restricted stock units that vest three years from the date of grant. Each executive officer is granted a target number of PSUs (the "PSU Target Award"). For the PSUs issued in 2014 and 2015 and vesting in 2017 and 2018, respectively, the actual number of shares of common stock issued to each executive officer is subject to the achievement of certain levels of total stockholder return relative to the total stockholder return of a peer group of publicly traded lodging REITs over a three-year performance period. There will be no payout of shares of our common stock if our total stockholder return falls below the 30th percentile of the total stockholder returns of the peer group. The maximum number of shares of common stock issued to an executive officer is equal to 150% of the PSU Target Award and is earned if our total stockholder return is equal to or greater than the 75th percentile of the total stockholder returns of the peer group. For the PSUs issued in 2016 and vesting in 2019, the calculation of total stockholder return relative to the total stockholder return of a peer group over a three-year performance period

remained in effect for 75% of the number of PSUs to be earned in the performance period. The remaining 25% is determined based on achieving improvement in market share for each of our hotels over the three-year performance period. For the PSUs issued in 2017 and vesting in 2020, the calculation of total stockholder return relative to the total stockholder return of a peer group over a three-year performance period applies to 50% of the number of PSUs to be earned in the performance period. The remaining 50% is determined based on achieving improvement in market share for each of our hotels over the three-year performance period.

We measure compensation expense for the PSUs based upon the fair market value of the award at the grant date. Compensation expense is recognized on a straight-line basis over the three-year performance period and is included in corporate expenses in the accompanying condensed consolidated statements of operations. The grant date fair value of the portion of the PSUs based on our relative total stockholder return is determined using a Monte Carlo simulation performed by a third-party valuation firm. The grant date fair value of the portion of the PSUs based on improvement in market share for each of our hotels is the closing price of our common stock on the grant date.

Table of Contents

On February 27, 2017, our board of directors granted 266,009 PSUs to our executive officers. The grant date fair value of the portion of the PSUs based on our relative total stockholder return was \$10.89 using the assumptions of volatility of 26.7% and a risk-free rate of 1.46%. The grant date fair value of the portion of the PSUs based on hotel market share was \$11.20, the closing stock price of our common stock on such date.

A summary of our PSUs from January 1, 2017 to June 30, 2017 is as follows:

	Number of Target Units	Weighted- Average Grant Date Fair Value
Unvested balance at January 1, 2017	686,684	\$ 10.65
Granted	266,009	11.04
Additional units from dividends	16,312	11.09
Vested (1)	(200,374)	12.15
Unvested balance at June 30, 2017	768,631	\$ 10.40

There was no payout of shares of our common stock for PSUs that vested on February 27, 2017, as our total (1) stockholder return fell below the 30th percentile of the total stockholder returns of the peer group over the three-year performance period.

The remaining target units are expected to vest as follows: 211,463 units during 2018, 288,112 units during 2019 and 269,056 units during 2020. The number of shares earned upon vesting is subject to the attainment of the performance goals described above. As of June 30, 2017, the unrecognized compensation cost related to the PSUs was \$4.4 million and is expected to be recognized on a straight-line basis over a weighted average period of 26 months. We recorded \$0.6 million of compensation expense related to the PSUs for each of the three months ended June 30, 2017 and 2016. We recorded \$1.2 million and \$1.3 million, respectively, of compensation expense related to the PSUs for the six months ended June 30, 2017 and 2016.

7. Earnings Per Share

Basic earnings per share is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings per share is calculated by dividing net income available to common stockholders that has been adjusted for dilutive securities, by the weighted-average number of common shares outstanding including dilutive securities.

The following is a reconciliation of the calculation of basic and diluted earnings per share (in thousands, except share and per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Numerator:				
Net income	\$36,595	\$44,175	\$45,482	\$60,953
Denominator:				
Weighted-average number of common shares outstanding—basic	200,810,321	201,273,767	200,732,629	201,133,321
Effect of dilutive securities:				
Unvested restricted common stock	99,677	—	165,483	81,513

Edgar Filing: DiamondRock Hospitality Co - Form 10-Q

Shares related to unvested PSUs	831,394	553,617	831,394	553,617
Weighted-average number of common shares outstanding—diluted	201,741,394	201,827,384	201,729,526	201,768,451
Earnings per share:				
Basic earnings per share	\$0.18	\$ 0.22	\$0.23	\$ 0.30
Diluted earnings per share	\$0.18	\$ 0.22	\$0.23	\$ 0.30

We did not include unexercised stock appreciation rights of 20,770 for the three and six months ended June 30, 2017 and 2016 as they would be anti-dilutive.

- 10-

Table of Contents

8. Debt

The following table sets forth information regarding the Company's debt as of June 30, 2017 (dollars in thousands):

Property	Principal Balance	Interest Rate	Maturity Date
Salt Lake City Marriott Downtown	\$57,523	4.25%	November 2020
Westin Washington D.C. City Center	65,847	3.99%	January 2023
The Lodge at Sonoma, a Renaissance Resort & Spa	28,585	3.96%	April 2023
Westin San Diego	65,571	3.94%	April 2023
Courtyard Manhattan / Midtown East	84,761	4.40%	August 2024
Renaissance Worthington	84,878	3.66%	May 2025
JW Marriott Denver at Cherry Creek	64,051	4.33%	July 2025
Boston Westin	199,765	4.36%	November 2025
Unamortized debt issuance costs	(5,183)		
Total mortgage debt, net of unamortized debt issuance costs	645,798		
Unsecured term loan	100,000	LIBOR + 1.45% (1)	May 2021
Unsecured term loan	200,000	LIBOR + 1.45% (2)	April 2022
Unamortized debt issuance costs	(2,078)		
Unsecured term loan, net of unamortized debt issuance costs	297,922		
Senior unsecured credit facility	—	LIBOR + 1.50%	May 2020 (3)
Total debt, net of unamortized debt issuance costs	\$943,720		
Weighted-Average Interest Rate		3.69%	

(1) The interest rate as of June 30, 2017 was 2.51%.

(2) The interest rate as of June 30, 2017 was 2.50%.

(3) The credit facility may be extended for an additional year upon the payment of applicable fees and the satisfaction of certain customary conditions.

Mortgage Debt

We have incurred limited recourse, property specific mortgage debt secured by certain of our hotels. In the event of default, the lender may only foreclose on the secured assets; however, in the event of fraud, misapplication of funds or other customary recourse provisions, the lender may seek payment from us. As of June 30, 2017, eight of our 28 hotels were secured by mortgage debt. Our mortgage debt contains certain property specific covenants and restrictions, including minimum debt service coverage ratios that trigger "cash trap" provisions as well as restrictions on incurring additional debt without lender consent. As of June 30, 2017, we were in compliance with the financial covenants of our mortgage debt.

On April 26, 2017, we repaid the mortgage loan secured by the Lexington Hotel New York with proceeds from a new unsecured term loan, which is discussed further below. The mortgage loan had an outstanding principal balance of \$170.4 million at repayment.

Senior Unsecured Credit Facility

We are party to a senior unsecured credit facility with a capacity up to \$300 million. The maturity date is May 2020 and may be extended for an additional year upon the payment of applicable fees and the satisfaction of certain customary conditions. The facility also includes an accordion feature to expand up to \$600 million, subject to lender consent. The interest rate on the facility is based upon LIBOR, plus an applicable margin based upon the Company's leverage ratio, as follows:

- 11-

Table of Contents

Leverage Ratio	Applicable Margin
Less than or equal to 35%	1.50 %
Greater than 35% but less than or equal to 45%	1.65 %
Greater than 45% but less than or equal to 50%	1.80 %
Greater than 50% but less than or equal to 55%	2.00 %
Greater than 55%	2.25 %

In addition to the interest payable on amounts outstanding under the facility, we were required to pay an amount equal to 0.20% of the unused portion of the facility if the average usage of the facility was greater than 50% or 0.30% of the unused portion of the facility if the average usage of the facility was less than or equal to 50%.

The facility also contains various corporate financial covenants. A summary of the most restrictive covenants is as follows:

	Covenant	Actual at June 30, 2017
Maximum leverage ratio (1)	60%	25.0%
Minimum fixed charge coverage ratio (2)	1.50x	4.62x
Minimum tangible net worth (3)	\$1.91 billion	\$2.59 billion
Secured recourse indebtedness	Less than 45% of Total Asset Value	21.1%

(1) Leverage ratio is net indebtedness, as defined in the credit agreement, divided by total asset value, defined in the credit agreement as the value of our owned hotels based on hotel net operating income divided by a defined capitalization rate.

(2) Fixed charge coverage ratio is Adjusted EBITDA, generally defined in the credit agreement as EBITDA less FF&E reserves, for the most recently ending 12 months, to fixed charges, which is defined in the credit agreement as interest expense, all regularly scheduled principal payments and payments on capitalized lease obligations, for the same most recently ending 12-month period.

(3) Tangible net worth, as defined in the credit agreement, is (i) total gross book value of all assets, exclusive of depreciation and amortization, less intangible assets, total indebtedness, and all other liabilities, plus (ii) 75% of net proceeds from future equity issuances.

As of June 30, 2017, we had no borrowings outstanding under the facility and the Company's leverage ratio was 25.0%. Accordingly, interest on our borrowings under the facility, if any, will be based on LIBOR plus 150 basis points for the following quarter. We incurred interest and unused credit facility fees on the facility of \$0.2 million and \$0.4 million for the three months ended June 30, 2017 and 2016, respectively. We incurred interest and unused credit facility fees on the facility of \$0.5 million and \$0.8 million for the six months ended June 30, 2017 and 2016, respectively.

Unsecured Term Loans

We are party to a five-year \$100 million unsecured term loan. On April 26, 2017, we closed on a new five-year \$200 million unsecured term loan. A portion of the proceeds from the new term loan was used to repay the \$170.4 million mortgage loan secured by the Lexington Hotel New York.

The financial covenants of the term loans are consistent with the covenants on our senior unsecured credit facility, which are described above. The interest rate on each of the term loans is based on a pricing grid ranging from 145 to

220 basis points over LIBOR, as follows:

Leverage Ratio	Applicable Margin
Less than or equal to 35%	1.45 %
Greater than 35% but less than or equal to 45%	1.60 %
Greater than 45% but less than or equal to 50%	1.75 %
Greater than 50% but less than or equal to 55%	1.95 %
Greater than 55%	2.20 %

As of June 30, 2017, the Company's leverage ratio was 25.0%. Accordingly, interest on our borrowings under the term loans will be based on LIBOR plus 145 basis points for the following quarter. We incurred interest on the term loans of \$1.5 million

- 12-

Table of Contents

and \$0.3 million for the three months ended June 30, 2017 and 2016, respectively. We incurred interest on the term loans of \$2.1 million and \$0.3 million on the six months ended June 30, 2017 and 2016, respectively.

9. Acquisitions

On February 28, 2017, we acquired the 88-room L'Auberge de Sedona and the 70-room Orchards Inn Sedona, each located in Sedona, Arizona, for a total contractual purchase price of \$97 million. The acquisition was funded with corporate cash. The hotels are managed by IMH Financial Corporation pursuant to a new management agreement with an initial term of five years, which is terminable at our discretion beginning December 31, 2017. The management agreement provides for a base management fee of 2.45% of gross revenues in 2017, 2.70% of gross revenues in 2018, and 3.0% of gross revenues in 2019 and through the end of the term. The management agreement also provides for an incentive management fee of 12% of hotel operating profit above an owner's priority determined in accordance with the terms of the management agreement in 2017, increasing to 15% by 2020.

We lease the buildings and sublease the underlying land containing 28 of the 70 rooms at the Orchards Inn Sedona, which expires in 2070, including all extension options. We reviewed the terms of the annex sublease in conjunction with the hotel acquisition accounting and concluded that the terms are favorable to us compared with a typical current market lease. As a result, we recorded a \$9.1 million favorable lease asset that will be amortized through 2070.

We believe all material adjustments necessary to reflect the effects of the acquisitions have been made; however, the amounts recorded are based on a preliminary estimate of the fair value of the assets acquired and the liabilities assumed. We will finalize the recorded amounts upon the completion of our valuation analysis of the assets acquired and liabilities assumed, not to exceed one year from the date of acquisition. The following table summarizes the preliminary estimated fair value of the assets acquired and liabilities assumed in our acquisitions (in thousands):

	L'Auberge de Sedona	Orchards Inn Sedona
Land	\$ 39,384	\$ 9,726
Building and improvements	22,204	10,180
Furnitures, fixtures and equipment	4,376	1,982
Total fixed assets	65,964	21,888
Favorable lease asset	—	9,065
Other assets and liabilities, net	(2,710)	(412)
Total	\$ 63,254	\$ 30,541

Acquired properties are included in our results of operations from the date of acquisition. The following unaudited pro forma financial information presents our results of operations (in thousands, except per share data) as if the hotels were acquired on January 1, 2016. The comparable information is not necessarily indicative of the results that actually would have occurred nor does it indicate future operating results.

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Revenues	\$243,272	\$264,530	\$442,904	\$482,929
Net income	\$36,595	\$45,536	\$45,207	\$62,345
Earnings per share:				
Basic earnings per share	\$0.18	\$0.23	\$0.23	\$0.31
Diluted earnings per share	\$0.18	\$0.23	\$0.22	\$0.31

For the three and six months ended June 30, 2017, our condensed consolidated statements of operations include \$9.5 million and \$12.8 million of revenues, respectively, and \$2.3 million and \$3.2 million of net income, respectively, related to the operations of the L'Auberge de Sedona and Orchards Inn Sedona.

10. Fair Value of Financial Instruments

- 13-

Table of Contents

The fair value of certain financial assets and liabilities and other financial instruments as of June 30, 2017 and December 31, 2016, in thousands, is as follows:

June 30, 2017		December 31, 2016	
Carrying Amount (1)	Fair Value	Carrying Amount (1)	Fair Value
Debt	\$943,720	\$920,539	\$906,156

(1) The carrying amount of debt is net of unamortized debt issuance costs.

The fair value of our mortgage debt is a Level 2 measurement under the fair value hierarchy (see Note 2). We estimate the fair value of our mortgage debt by discounting the future cash flows of each instrument at estimated market rates. The carrying value of our other financial instruments approximate fair value due to the short-term nature of these financial instruments.

11. Commitments and Contingencies

Litigation

We are subject to various claims, lawsuits and legal proceedings, including routine litigation arising in the ordinary course of business, regarding the operation of our hotels and company matters. While it is not possible to ascertain the ultimate outcome of such matters, management believes that the aggregate amount of such liabilities, if any, in excess of amounts covered by insurance will not have a material adverse impact on our financial condition or results of operations. The outcome of claims, lawsuits and legal proceedings brought against the Company, however, is subject to significant uncertainties.

Other Matters

As previously reported, in February 2016, the Company was notified by the franchisor of one of its hotels that as a result of low guest satisfaction scores, the Company was in default under the franchise agreement for that hotel. The Company continues to proactively work with the franchisor and the manager of the hotel and has developed and executed a plan aimed to improve guest satisfaction scores. To date, the guest satisfaction scores have improved so that the Company is no longer in default under the franchise agreement. However, if the guest satisfaction scores were to decrease again, the franchisor may again notify the Company that it is in default under the franchise agreement and that the franchisor is reserving all of its rights under the franchise agreement, including the right to terminate the franchise agreement in the future.

While the Company continues to work diligently with the franchisor and manager to maintain the guest satisfaction scores at a level such that the Company does not fall back into default, no assurance can be given that the Company will be successful. If the Company is not successful, the franchisor may seek to terminate the franchise agreement and assert a claim it is owed a termination fee, including a payment for liquidated damages, which could result in a material adverse effect on the Company's business, financial condition or results of operation.

Table of Contents

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and includes this statement for purposes of complying with these safe harbor provisions. These forward-looking statements are generally identifiable by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project” or similar expressions, whether in the negative or affirmative. Forward-looking statements are based on management’s current expectations and assumptions and are not guarantees of future performance. Factors that may cause actual results to differ materially from current expectations include, but are not limited to, the risks discussed herein and the risk factors discussed from time to time in our periodic filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended December 31, 2016 as updated by our Quarterly Reports on Form 10-Q. Accordingly, there is no assurance that the Company’s expectations will be realized. Except as otherwise required by the federal securities laws, the Company disclaims any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained in this report to reflect events, circumstances or changes in expectations after the date of this report.

Overview

DiamondRock Hospitality Company is a lodging-focused Maryland corporation operating as a real estate investment trust (“REIT”). As of June 30, 2017, we owned a portfolio of 28 premium hotels and resorts that contain 9,630 guest rooms located in 18 different markets in North America and the U.S. Virgin Islands. As an owner, rather than an operator, of lodging properties, we receive all of the operating profits or losses generated by our hotels after the payment of fees due to hotel managers, which are calculated based on the revenues and profitability of each hotel.

Our vision is to be a highly professional public lodging REIT that delivers long-term returns for our stockholders which exceed long-term returns generated by our peers. Our goal is to deliver long-term stockholder returns through a combination of dividends and enduring capital appreciation. Our strategy is to utilize disciplined capital allocation, focus on high quality lodging properties in North American markets with superior growth prospects and high barriers-to-entry, aggressively asset manage those hotels, and employ conservative amounts of leverage.

Our primary business is to acquire, own, asset manage and renovate full-service hotel properties in the United States. Our portfolio is concentrated in key gateway cities and destination resort locations. Each of our hotels is managed by a third party and a substantial number of our hotels are operated under a brand owned by Marriott International, Inc. or Hilton Worldwide.

We critically evaluate each of our hotels to ensure that we own a portfolio of hotels that conforms to our vision, supports our mission and corresponds with our strategy. On a regular basis, we analyze our portfolio to identify opportunities to invest capital in certain projects or market non-core assets for sale in order to increase our portfolio quality. We are committed to a conservative capital structure with prudent leverage. We regularly assess the availability and affordability of capital in order to maximize stockholder value and minimize enterprise risk. In addition, we are committed to following sound corporate governance practices and to being open and transparent in our communications with our stockholders.

Key Indicators of Financial Condition and Operating Performance

We use a variety of operating and other information to evaluate the financial condition and operating performance of our business. These key indicators include financial information that is prepared in accordance with U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), as well as other financial information that is not prepared in accordance with U.S. GAAP. In addition, we use other information that may not be financial in nature, including statistical information and comparative data. We use this information to measure the performance of individual hotels, groups of hotels and/or our business as a whole. We periodically compare historical information to our internal budgets as well as industry-wide information. These key indicators include:

• Occupancy percentage;

• Average Daily Rate (or ADR);

• Revenue per Available Room (or RevPAR);

• Earnings Before Interest, Income Taxes, Depreciation and Amortization (or EBITDA) and Adjusted EBITDA; and

Table of Contents

Funds From Operations (or FFO) and Adjusted FFO.

Occupancy, ADR and RevPAR are commonly used measures within the hotel industry to evaluate operating performance. RevPAR, which is calculated as the product of ADR and occupancy percentage, is an important statistic for monitoring operating performance at the individual hotel level and across our business as a whole. We evaluate individual hotel RevPAR performance on an absolute basis with comparisons to budget and prior periods, as well as on a company-wide and regional basis. ADR and RevPAR include only room revenue. Room revenue comprised approximately 72% of our total revenues for the six months ended June 30, 2017 and is dictated by demand, as measured by occupancy percentage, pricing, as measured by ADR, and our available supply of hotel rooms.

Our ADR, occupancy percentage and RevPAR performance may be impacted by macroeconomic factors such as U.S. economic conditions generally, regional and local employment growth, personal income and corporate earnings, office vacancy rates and business relocation decisions, airport and other business and leisure travel, increased use of lodging alternatives, new hotel construction and the pricing strategies of our competitors. In addition, our ADR, occupancy percentage and RevPAR performance is dependent on the continued success of our hotels' global brands.

We also use EBITDA, Adjusted EBITDA, FFO and Adjusted FFO as measures of the financial performance of our business. See "Non-GAAP Financial Measures."

Our Hotels

The following table sets forth certain operating information for the six months ended June 30, 2017 for each of our hotels.

Table of Contents

Property	Location	Number of Rooms	Occupancy (%)	ADR(\$)	RevPAR(\$)	% Change from 2016 RevPAR (1)
Chicago Marriott Downtown	Chicago, Illinois	1,200	65.9 %	\$ 213.45	\$ 140.71	4.9 %
Westin Boston Waterfront Hotel	Boston, Massachusetts	793	77.8 %	250.32	194.85	4.2 %
Lexington Hotel New York	New York, New York	725	91.2 %	218.18	198.91	2.8 %
Salt Lake City Marriott Downtown	Salt Lake City, Utah	510	78.9 %	165.26	130.31	17.6 %
Renaissance Worthington	Fort Worth, Texas	504	78.1 %	184.07	143.73	9.8 %
Frenchman's Reef & Morning Star Marriott Beach Resort	St. Thomas, U.S. Virgin Islands	502	88.2 %	306.95	270.82	6.5 %
Westin San Diego	San Diego, California	436	85.0 %	197.50	167.87	6.4 %
Westin Fort Lauderdale Beach Resort	Fort Lauderdale, Florida	432	90.3 %	213.57	192.82	(9.1) %
Westin Washington, D.C. City Center	Washington, D.C.	410	86.6 %	241.03	208.68	3.6 %
Hilton Boston Downtown	Boston, Massachusetts	403	83.2 %	273.08	227.24	1.4 %
Vail Marriott Mountain Resort & Spa	Vail, Colorado	344	73.2 %	326.95	239.43	5.4 %
Marriott Atlanta Alpharetta	Atlanta, Georgia	318	76.4 %	171.24	130.82	0.6 %
Courtyard Manhattan/Midtown East	New York, New York	321	87.7 %	235.75	206.80	(4.8) %
The Gwen Chicago	Chicago, Illinois	311	64.7 %	216.58	140.14	(0.8) %
Hilton Garden Inn Times Square Central	New York, New York	282	96.6 %	216.35	209.01	(1.3) %
Bethesda Marriott Suites	Bethesda, Maryland	272	76.7 %	178.58	137.04	8.8 %
Hilton Burlington	Burlington, Vermont	258	75.9 %	152.25	115.56	(2.9) %
JW Marriott Denver at Cherry Creek	Denver, Colorado	196	78.8 %	257.69	203.12	(4.0) %
Courtyard Manhattan/Fifth Avenue	New York, New York	189	87.1 %	239.82	208.99	1.8 %
Sheraton Suites Key West	Key West, Florida	184	93.0 %	270.15	251.11	(3.1) %
The Lodge at Sonoma, a Renaissance Resort & Spa	Sonoma, California	182	57.4 %	295.91	169.74	(19.8) %
Courtyard Denver Downtown	Denver, Colorado	177	77.4 %	202.48	156.81	(1.8) %
Renaissance Charleston	Charleston, South Carolina	166	74.9 %	256.02	191.71	(7.5) %
Shorebreak Hotel	Huntington Beach, California	157	72.5 %	222.24	161.05	(6.9) %
Inn at Key West	Key West, Florida	106	78.8 %	213.30	168.15	(18.7) %
Hotel Rex	San Francisco, California	94	79.4 %	224.58	178.34	(10.6) %
L'Auberge de Sedona (2)	Sedona, Arizona	88	77.0 %	544.87	419.70	34.2 %
Orchards Inn Sedona (2)	Sedona, Arizona	70	80.7 %	230.52	186.11	17.4 %
TOTAL/WEIGHTED AVERAGE		9,630	79.6 %	\$ 229.55	\$ 182.66	2.0 %

(1) The percentage change from 2016 RevPAR reflects the comparable period in 2016 to our 2017 ownership period for our 2017 acquisitions.

(2) The hotel was acquired on February 28, 2017. The operating statistics reflect the period from February 28, 2017 to June 30, 2017.

Highlights

Hotel Acquisitions. In February 2017, we acquired the 88-room L'Auberge de Sedona and the 70-room Orchards Inn Sedona for a total contractual purchase price of \$97 million.

New Term Loan. On April 26, 2017, we closed on a new five-year \$200 million unsecured term loan.

Mortgage Loan Repayment. On April 26, 2017, we repaid the \$170.4 million mortgage loan secured by the Lexington Hotel New York using proceeds from the new \$200 million unsecured term loan.

Results of Operations

Comparison of the Three Months Ended June 30, 2017 to the Three Months Ended June 30, 2016

Revenue. Revenue consists primarily of the room, food and beverage and other operating revenues from our hotels, as follows (dollars in millions):

- 17-

Table of Contents

	Three Months Ended June 30,		
	2017	2016	% Change
Rooms	\$177.5	\$186.1	(4.6)%
Food and beverage	52.8	57.4	(8.0)%
Other	13.0	13.2	(1.5)%
Total revenues	\$243.3	\$256.7	(5.2)%

Our total revenues decreased \$13.4 million from \$256.7 million for the three months ended June 30, 2016 to \$243.3 million for the three months ended June 30, 2017. This decrease includes amounts that are not comparable quarter-over-quarter as follows:

- \$5.0 million decrease from the Orlando Airport Marriott, which was sold on June 8, 2016.
- \$15.4 million decrease from the Minneapolis Hilton, which was sold on June 30, 2016.
- \$3.7 million decrease from the Hilton Garden Inn Chelsea/New York City, which was sold on July 7, 2016.
- \$7.0 million increase from the L'Auberge de Sedona, which was acquired on February 28, 2017.
- \$2.4 million increase from the Orchards Inn Sedona, which was acquired on February 28, 2017.

Excluding these non-comparable amounts our total revenues increased \$1.3 million, or 0.6%.

The following are key hotel operating statistics for the three months ended June 30, 2017 and 2016. The 2016 amounts reflect the period in 2016 comparable to our ownership period in 2017 for the L'Auberge de Sedona and Orchards Inn Sedona and exclude the hotels sold in 2016.

	Three Months Ended June 30,		
	2017	2016	% Change
Occupancy %	85.0	% 85.4	% (0.4) percentage points
ADR	\$239.00	\$233.36	2.4 %
RevPAR	\$203.21	\$199.22	2.0 %

Excluding non-comparable amounts from our acquisitions and dispositions, the increase in room revenue is a result of a 5.6% increase in the business transient segment, a 0.9% increase in the leisure transient segment, and a 0.2% increase in the group segment, partially offset by an 8.8% decrease in the contract segment.

Food and beverage revenues decreased \$4.6 million from the three months ended June 30, 2016, which includes amounts that are not comparable quarter-over-quarter as follows:

- \$1.7 million decrease from the Orlando Airport Marriott, which was sold on June 8, 2016.
- \$5.4 million decrease from the Minneapolis Hilton, which was sold on June 30, 2016.
- \$0.1 million decrease from the Hilton Garden Inn Chelsea/New York City, which was sold on July 7, 2016.
- \$2.3 million increase from the L'Auberge de Sedona, which was acquired on February 28, 2017.
- \$1.1 million increase from the Orchards Inn Sedona, which was acquired on February 28, 2017.

Excluding these non-comparable amounts, food and beverage revenues decreased \$0.8 million, or 1.6%, primarily due to a decrease in banquet revenues.

Excluding non-comparable amounts from our acquisitions and dispositions, other revenues, which primarily represent spa, parking, resort fees and attrition and cancellation fees, decreased by \$0.6 million, primarily due to a decrease in tenant lease income and parking revenue.

Hotel operating expenses. The operating expenses consisted of the following (dollars in millions):

- 18-

Table of Contents

	Three Months Ended June 30,		
	2017	2016	% Change (B)/W
Rooms departmental expenses	\$41.6	\$43.3	(3.9)%
Food and beverage departmental expenses	33.1	35.3	(6.2)
Other departmental expenses	3.1	3.1	—
General and administrative	19.5	20.6	(5.3)
Utilities	6.1	6.5	(6.2)
Repairs and maintenance	8.9	9.2	(3.3)
Sales and marketing	15.6	16.9	(7.7)
Franchise fees	6.0	5.7	5.3
Base management fees	5.8	6.3	(7.9)
Incentive management fees	1.1	2.5	(56.0)
Property taxes	13.9	10.7	29.9
Other fixed charges	2.8	3.0	(6.7)
Ground rent—Contractual	1.1	2.4	(54.2)
Ground rent—Non-cash	1.6	1.3	23.1
Total hotel operating expenses	\$160.2	\$166.8	(4.0)%

Our hotel operating expenses decreased \$6.6 million from \$166.8 million for the three months ended June 30, 2016 to \$160.2 million for the three months ended June 30, 2017. The decrease in hotel operating expenses includes amounts that are not comparable quarter-over-quarter as follows:

- \$3.8 million decrease from the Orlando Airport Marriott, which was sold on June 8, 2016.
- \$10.4 million decrease from the Minneapolis Hilton, which was sold on June 30, 2016.
- \$2.4 million decrease from the Hilton Garden Inn Chelsea/New York City, which was sold on July 7, 2016.
- \$4.9 million increase from the L'Auberge de Sedona, which was acquired on February 28, 2017.
- \$1.5 million increase from the Orchards Inn Sedona, which was acquired on February 28, 2017.

Excluding the non-comparable amounts, hotel operating expenses increased \$3.6 million, or 2.4%, from the three months ended June 30, 2016. The decrease in contractual ground rent quarter over quarter is due to the sale of the Hilton Minneapolis, which was sold on June 30, 2016. The increase in property taxes is primarily due to successful appeals for our two Chicago hotels during the three months ended June 30, 2016, as well as increased assessments at our two Chicago hotels and our three Colorado hotels during the three months ended June 30, 2017.

The decrease in incentive management fees is primarily due to our contribution to the renovation at the Chicago Marriott Downtown. There is no owner's priority; however, our accumulated contribution to the hotel's renovation is treated as a deduction spread over a period of time in calculating net operating income. As our accumulated contribution has increased, the incentive management fees have decreased.

Depreciation and amortization. Depreciation and amortization is recorded on our hotel buildings over 40 years for the periods subsequent to acquisition. Depreciable lives of hotel furniture, fixtures and equipment are estimated as the time period between the acquisition date and the date that the hotel furniture, fixtures and equipment will be replaced. Our depreciation and amortization expense increased \$0.6 million, or 2.3%, from the three months ended June 30, 2016.

Corporate expenses. Corporate expenses principally consist of employee-related costs, including base payroll, bonus and restricted stock. Corporate expenses also include corporate operating costs, professional fees and directors' fees. Our corporate expenses increased \$0.1 million, from \$6.7 million for the three months ended June 30, 2016 to \$6.8 million for the three months ended June 30, 2017.

Interest expense. Our interest expense was \$9.6 million and \$11.1 million for the three months ended June 30, 2017 and 2016, respectively, and comprises the following (in millions):

- 19-

Table of Contents

	Three Months Ended June 30,	
	2017	2016
Mortgage debt interest	\$7.4	\$9.7
Term loan interest	1.5	0.3
Credit facility interest and unused fees	0.2	0.4
Amortization of deferred financing costs and debt premium	0.5	0.6
Interest rate cap fair value adjustment	—	0.1
	\$9.6	\$11.1

The decrease in mortgage debt interest expense is primarily related to the repayment of the mortgage loans secured by the Courtyard Manhattan Fifth Avenue and the Lexington Hotel New York, which were prepaid on May 11, 2016 and April 26, 2017, respectively. The decrease is also attributed to the sale of the Hilton Minneapolis on June 30, 2016, in which the buyer assumed \$89.5 million of mortgage debt secured by the hotel. The decrease in interest expense is partially offset by the increase in interest expense from our two unsecured term loans, entered into in May 2016 and April 2017.

Loss on early extinguishment of debt. We prepaid the \$170.4 million mortgage loan previously secured by the Lexington Hotel New York on April 26, 2017 and recognized a loss on early extinguishment of debt of approximately \$0.3 million resulting from the write-off of unamortized debt issuance costs.

Income taxes. We recorded income tax expense of \$4.4 million for the three months ended June 30, 2017 and an income tax expense of \$11.0 million for the three months ended June 30, 2016. The income tax expense for the three months ended June 30, 2017 includes \$4.2 million of income tax expense on the \$10.3 million pre-tax income of our taxable REIT subsidiaries ("TRS"), \$0.1 million of state franchise taxes, and \$0.1 million of income tax expense incurred on the \$2.0 million pre-tax income of the TRS that owns Frenchman's Reef. The income tax expense for the three months ended June 30, 2016 includes \$10.8 million of income tax expense incurred on the \$26.3 million pre-tax income of our TRS, \$0.1 million of income tax expense incurred on the \$2.0 million pre-tax income of the TRS that owns Frenchman's Reef, and \$0.1 million of state franchise taxes.

Comparison of the Six Months Ended June 30, 2017 to the Six Months Ended June 30, 2016

Revenue. Revenue consists primarily of the room, food and beverage and other operating revenues from our hotels, as follows (dollars in millions):

	Six Months Ended June 30,		
	2017	2016	% Change
Rooms	\$315.4	\$335.5	(6.0)%
Food and beverage	97.5	107.8	(9.6)%
Other	26.6	26.4	0.8%
Total revenues	\$439.5	\$469.7	(6.4)%

Our total revenues decreased \$30.2 million from \$469.7 million for the six months ended June 30, 2016 to \$439.5 million for the six months ended June 30, 2017. This decrease includes amounts that are not comparable

period-over-period as follows:

- \$14.1 million decrease from the Orlando Airport Marriott, which was sold on June 8, 2016.
- \$24.8 million decrease from the Minneapolis Hilton, which was sold on June 30, 2016.
- \$6.3 million decrease from the Hilton Garden Inn Chelsea/New York City, which was sold on July 7, 2016.
- \$9.4 million increase from the L'Auberge de Sedona, which was acquired on February 28, 2017.
- \$3.5 million increase from the Orchards Inn Sedona, which was acquired on February 28, 2017.

Excluding these non-comparable amounts our total revenues increased \$2.1 million, or 0.5%.

The following are key hotel operating statistics for the six months ended June 30, 2017 and 2016. The 2016 amounts reflect the period in 2016 comparable to our ownership period in 2017 for the L'Auberge de Sedona and Orchards Inn Sedona and exclude the hotels sold in 2016.

- 20-

Table of Contents

	Six Months Ended June 30,			
	2017	2016	% Change	
Occupancy %	79.6	79.4	0.2	percentage points
ADR	\$229.16	\$225.89	1.4	%
RevPAR	\$182.48	\$179.27	1.8	%

Excluding non-comparable amounts from our acquisitions and dispositions, the increase in room revenue is a result of a 5.4% increase in the business transient segment, a 1.4% increase in the contract segment, and a 0.6% increase in the group segment, partially offset by a 1.2% decrease in the leisure transient segment.

Food and beverage revenues decreased \$10.3 million from the six months ended June 30, 2016, which includes amounts that are not comparable period-over-period as follows:

- \$4.7 million decrease from the Orlando Airport Marriott, which was sold on June 8, 2016.
- \$9.1 million decrease from the Minneapolis Hilton, which was sold on June 30, 2016.
- \$0.1 million decrease from the Hilton Garden Inn Chelsea/New York City, which was sold on July 7, 2016.
- \$2.9 million increase from the L'Auberge de Sedona, which was acquired on February 28, 2017.
- \$1.5 million increase from the Orchards Inn Sedona, which was acquired on February 28, 2017.

Excluding these non-comparable amounts, food and beverage revenues decreased \$0.8 million, or 0.9%, primarily due to a decrease in banquet revenues.

Excluding non-comparable amounts from our acquisitions and dispositions, other revenues, which primarily represent spa, parking, resort fees and attrition and cancellation fees, decreased by less than \$0.1 million.

Hotel operating expenses. The operating expenses consisted of the following (dollars in millions):

	Six Months Ended June 30,			
	2017	2016	% Change	
			(B)/W	
Rooms departmental expenses	\$78.5	\$82.0	(4.3)	%
Food and beverage departmental expenses	62.5	68.6	(8.9))
Other departmental expenses	6.1	6.2	(1.6))
General and administrative	37.5	40.3	(6.9))
Utilities	12.1	13.3	(9.0))
Repairs and maintenance	17.6	18.5	(4.9))
Sales and marketing	29.4	32.6	(9.8))
Franchise fees	11.0	11.0	—	
Base management fees	10.4	11.6	(10.3))
Incentive management fees	2.6	3.8	(31.6))
Property taxes	26.1	22.9	14.0)
Other fixed charges	5.3	6.1	(13.1))
Ground rent—Contractual	2.0	4.9	(59.2))
Ground rent—Non-cash	3.1	2.6	19.2)
Total hotel operating expenses	\$304.2	\$324.4	(6.2)	%

Our hotel operating expenses decreased \$20.2 million from \$324.4 million for the six months ended June 30, 2016 to \$304.2 million for the six months ended June 30, 2017. The decrease in hotel operating expenses includes amounts that are not comparable period-over-period as follows:

- \$9.1 million decrease from the Orlando Airport Marriott, which was sold on June 8, 2016.
- \$19.4 million decrease from the Minneapolis Hilton, which was sold on June 30, 2016.
- \$4.6 million decrease from the Hilton Garden Inn Chelsea/New York City, which was sold on July 7, 2016.
- \$6.5 million increase from the L'Auberge de Sedona, which was acquired on February 28, 2017.
- \$2.1 million increase from the Orchards Inn Sedona, which was acquired on February 28, 2017.

- 21-

Table of Contents

Excluding the non-comparable amounts, hotel operating expenses increased \$4.3 million, or 1.5%, from the six months ended June 30, 2016. The decrease in contractual ground rent period-over-period is due to the sale of the Hilton Minneapolis, which was sold on June 30, 2016. The increase in property taxes is primarily due to successful appeals for our two Chicago hotels during the six months ended June 30, 2016, as well as increased assessments at our two Chicago hotels and our three Colorado hotels during the six months ended June 30, 2017.

The decrease in incentive management fees is primarily due to our contribution to the renovation at the Chicago Marriott Downtown. There is no owner's priority; however, our accumulated contribution to the hotel's renovation is treated as a deduction spread over a period of time in calculating net operating income. As our accumulated contribution has increased, the incentive management fees have decreased.

Depreciation and amortization. Depreciation and amortization is recorded on our hotel buildings over 40 years for the periods subsequent to acquisition. Depreciable lives of hotel furniture, fixtures and equipment are estimated as the time period between the acquisition date and the date that the hotel furniture, fixtures and equipment will be replaced. Our depreciation and amortization expense decreased \$0.2 million, or 0.4%, from the six months ended June 30, 2016.

Hotel acquisition costs. We incurred \$2.3 million of hotel acquisition costs during the six months ended June 30, 2017 associated with the acquisitions of L'Auberge de Sedona and Orchards Inn Sedona.

Corporate expenses. Corporate expenses principally consist of employee-related costs, including base payroll, bonus and restricted stock. Corporate expenses also include corporate operating costs, professional fees and directors' fees. Our corporate expenses increased \$0.4 million, from \$12.7 million for the six months ended June 30, 2016 to \$13.1 million for the six months ended June 30, 2017. The increase is partially due to the fee paid for the recruitment of our new Executive Vice President and Chief Operating Officer in January 2017.

Interest expense. Our interest expense was \$19.1 million and \$22.7 million for the six months ended June 30, 2017 and 2016, respectively, and comprises the following (in millions):

	Six Months Ended June 30,	
	2017	2016
Mortgage debt interest	\$15.5	\$20.3
Term loan interest	2.1	0.3
Credit facility interest and unused fees	0.5	0.8
Amortization of deferred financing costs and debt premium	1.0	1.2
Interest rate cap fair value adjustment	—	0.1
	\$19.1	\$22.7

The decrease in mortgage debt interest expense is primarily related to the repayment of the mortgage loans secured by the Chicago Marriott Downtown, the Courtyard Manhattan Fifth Avenue, and the Lexington Hotel New York. The decrease is also attributed to the sale of the Hilton Minneapolis on June 30, 2016, in which the buyer assumed \$89.5 million of mortgage debt secured by the hotel. The decrease in interest expense is partially offset by the increase in interest expense from our two unsecured term loans, entered into in May 2016 and April 2017.

Loss on early extinguishment of debt. We prepaid the \$170.4 million mortgage loan previously secured by the Lexington Hotel New York on April 26, 2017 and recognized a loss on early extinguishment of debt of approximately

\$0.3 million.

Income taxes. We recorded income tax expense of \$5.6 million for the six months ended June 30, 2017 and an income tax expense of \$7.0 million for the six months ended June 30, 2016. The income tax expense for the six months ended June 30, 2017 includes \$4.9 million of income tax expense on the \$12.2 million pre-tax income of our TRSs, \$0.1 million of state franchise taxes, and \$0.6 million of income tax expense incurred on the \$7.9 million pre-tax income of the TRS that owns Frenchman's Reef. The income tax expense for the six months ended June 30, 2016 includes \$6.3 million of income tax expense incurred on the \$15.3 million pre-tax income of our TRS, \$0.6 million of foreign income tax expense incurred on the \$8.0 million pre-tax income of the TRS that owns Frenchman's Reef, and \$0.1 million of state franchise taxes.

- 22-

Table of Contents

Liquidity and Capital Resources

Our short-term liquidity requirements consist primarily of funds necessary to fund distributions to our stockholders to maintain our REIT status as well as to pay for operating expenses and capital expenditures directly associated with our hotels, funding of share repurchases under our share repurchase program, debt repayments upon maturity and scheduled debt payments of interest and principal. We currently expect that our available cash flows, which are generally provided through net cash from hotel operations, existing cash balances, equity issuances, proceeds from new financings and refinancings of maturing debt, proceeds from property dispositions, and, if necessary, short-term borrowings under our senior unsecured credit facility, will be sufficient to meet our short-term liquidity requirements.

Some of our mortgage debt agreements contain “cash trap” provisions that are triggered when the hotel’s operating results fall below a certain debt service coverage ratio. When these provisions are triggered, all of the excess cash flow generated by the hotel is deposited directly into cash management accounts for the benefit of our lenders until a specified debt service coverage ratio is reached and maintained for a certain period of time. Such provisions do not allow the lender the right to accelerate repayment of the underlying debt. During 2016, the cash trap provision was triggered on the mortgage loan secured by the Lexington Hotel New York. This provision remained in effect until the repayment of the loan on April 26, 2017.

Our long-term liquidity requirements consist primarily of funds necessary to pay for the costs of acquiring additional hotels, renovations, and other capital expenditures that need to be made periodically to our hotels, scheduled debt payments, debt maturities and making distributions to our stockholders. We expect to meet our long-term liquidity requirements through various sources of capital, including cash provided by operations, borrowings, issuances of additional equity and/or debt securities and proceeds from property dispositions. Our ability to incur additional debt is dependent upon a number of factors, including the state of the credit markets, our degree of leverage, the value of our unencumbered assets and borrowing restrictions imposed by existing lenders. Our ability to raise capital through the issuance of additional equity and/or debt securities is also dependent on a number of factors including the current state of the capital markets, investor sentiment and intended use of proceeds. We may need to raise additional capital if we identify acquisition opportunities that meet our investment objectives and require liquidity in excess of existing cash balances. Our ability to raise funds through the issuance of equity securities depends on, among other things, general market conditions for hotel companies and REITs and market perceptions about us.

Our Financing Strategy

Since our formation in 2004, we have been committed to a conservative capital structure with prudent leverage. The majority of our outstanding debt is fixed interest rate mortgage debt. We have a preference to maintain a significant portion of our portfolio as unencumbered assets in order to provide balance sheet flexibility. We expect that our strategy will enable us to maintain a balance sheet with an appropriate amount of debt throughout all phases of the lodging cycle. We believe that it is not prudent to increase the inherent risk of highly cyclical lodging fundamentals through the use of a highly leveraged capital structure.

We prefer a relatively simple but efficient capital structure. We have not invested in joint ventures and have not issued any operating partnership units or preferred stock. We structure our hotel acquisitions to be straightforward and to fit within our capital structure; however, we will consider a more complex transaction if we believe that the projected returns to our stockholders will significantly exceed the returns that would otherwise be available.

We believe that we maintain a reasonable amount of debt. As of June 30, 2017, we had \$943.7 million of debt outstanding with a weighted average interest rate of 3.7% and a weighted average maturity date of approximately 6.2 years. We maintain one of the most durable and lowest levered balance sheets among our lodging REIT peers. We maintain balance sheet flexibility with no near-term debt maturities, capacity under our senior unsecured credit facility and 20 of our 28 hotels unencumbered by mortgage debt. We remain committed to our core strategy of maintaining a simple capital structure with conservative leverage.

Information about our financing activities is available in Note 8 to the accompanying condensed consolidated financial statements.

Share Repurchase Program

Our board of directors has approved a \$150 million share repurchase program authorizing us to repurchase shares of our common stock. Information about our share repurchase program is found in Note 5 to the accompanying condensed consolidated financial statements. During the three months ended June 30, 2017, we did not repurchase any shares of our common stock. As of August 8, 2017, we have \$143.5 million of authorized capacity remaining under our share repurchase program.

Short-Term Borrowings

- 23-

Table of Contents

Other than borrowings under our senior unsecured credit facility, discussed below, we do not utilize short-term borrowings to meet liquidity requirements.

Senior Unsecured Credit Facility

We are party to a \$300 million senior unsecured credit facility expiring in May 2020. Information about our senior unsecured credit facility is found in Note 8 to the accompanying condensed consolidated financial statements. As of June 30, 2017, we had no borrowings outstanding under our senior unsecured credit facility.

Unsecured Term Loans

We are party to a \$100 million unsecured term loan expiring in May 2021 and a \$200 million unsecured term loan expiring in April 2022. Information about our unsecured term loans is found in Note 8 to the accompanying condensed consolidated financial statements.

Sources and Uses of Cash

Our principal sources of cash are net cash flow from hotel operations and borrowings under mortgage debt, term loans, our senior unsecured credit facility and proceeds from hotel dispositions. Our principal uses of cash are acquisitions of hotel properties, debt service, debt maturities, capital expenditures, operating costs, corporate expenses and dividends. As of June 30, 2017, we had \$149.6 million of unrestricted corporate cash and \$41.5 million of restricted cash, as well as full borrowing capacity under our senior unsecured credit facility.

Our net cash provided by operations was \$87.4 million for the six months ended June 30, 2017. Our cash from operations generally consists of the net cash flow from hotel operations offset by cash paid for corporate expenses and other working capital changes.

Our net cash used in investing activities was \$152.1 million for the six months ended June 30, 2017, which consisted of \$93.8 million paid for the acquisitions of L'Auberge de Sedona and Orchards Inn Sedona, capital expenditures at our hotels of \$60.4 million, offset by the net return of \$2.1 million from property improvement reserves included within restricted cash to fund capital expenditures.

Our net cash used in financing activities was \$28.7 million for the six months ended June 30, 2017, which consisted of our \$170.4 million repayment of the mortgage debt secured by the Lexington Hotel New York, \$50.4 million of dividend payments, \$5.9 million of scheduled mortgage debt principal payments, \$0.5 million paid to repurchase shares upon the vesting of restricted stock for the payment of tax withholding obligations, and \$1.6 million of financing costs related to our unsecured term loan, partially offset by \$200.0 million of proceeds from our new \$200 million unsecured term loan.

We currently anticipate our significant source of cash for the remainder of the year ending December 31, 2017 will be the net cash flow from hotel operations. We expect our estimated uses of cash for the remainder of the year ending December 31, 2017 will be regularly scheduled debt service payments, capital expenditures, dividends, corporate expenses, potential hotel acquisitions, and potential share repurchases.

Dividend Policy

Edgar Filing: DiamondRock Hospitality Co - Form 10-Q

We intend to distribute to our stockholders dividends at least equal to our REIT taxable income to avoid paying corporate income tax and excise tax on our earnings (other than the earnings of our TRS, which are all subject to tax at regular corporate rates) and to qualify for the tax benefits afforded to REITs under the Code. In order to qualify as a REIT under the Code, we generally must make distributions to our stockholders each year in an amount equal to at least:

• 90% of our REIT taxable income determined without regard to the dividends paid deduction and excluding net capital gains, plus

• 90% of the excess of our net income from foreclosure property over the tax imposed on such income by the Code, minus

• any excess non-cash income.

- 24-

Table of Contents

The timing and frequency of distributions will be authorized by our board of directors and declared by us based upon a variety of factors, including our financial performance, restrictions under applicable law and our current and future loan agreements, our debt service requirements, our capital expenditure requirements, the requirements for qualification as a REIT under the Code and other factors that our board of directors may deem relevant from time to time.

We have paid the following dividends to holders of our common stock during 2017:

Payment Date	Record Date	Dividend per Share
January 12, 2017	December 30, 2016	\$ 0.125
April 12, 2017	March 31, 2017	\$ 0.125
July 12, 2017	June 30, 2017	\$ 0.125

Capital Expenditures

The management and franchise agreements for each of our hotels provide for the establishment of separate property improvement funds to cover, among other things, the cost of replacing and repairing furniture, fixtures and equipment at our hotels and other routine capital expenditures. Contributions to the property improvement fund are calculated as a percentage of hotel revenues. In addition, we may be required to pay for the cost of certain additional improvements that are not permitted to be funded from the property improvement fund under the applicable management or franchise agreement. As of June 30, 2017, we have set aside \$37.7 million for capital projects in property improvement funds, which are included in restricted cash.

We spent approximately \$60.4 million on capital improvements during the six months ended June 30, 2017, primarily related to the third phase of the Chicago Marriott Downtown renovation and the guest room renovations at the Gwen Chicago, Worthington Renaissance, Charleston Renaissance, and The Lodge at Sonoma. We expect to spend between \$110 million and \$120 million on capital improvements at our hotels in 2017. Significant projects in 2017 include:

- Chicago Marriott Downtown: We completed the third phase of the multi-year renovation, which included the upgrade renovation of 340 guest rooms. We expect to commence the final phase of the multi-year renovation, which will include renovating the remaining 258 of 1,200 guest rooms during late 2017 with completion in early 2018.
- The Gwen: We completed the renovation of the hotel's 311 guest rooms in April 2017.
- Worthington Renaissance: We completed the renovation of the hotel's 504 guest rooms in January 2017.
- Charleston Renaissance: We completed the renovation of the hotel's 166 guest rooms in February 2017.
- The Lodge at Sonoma: We completed the renovation of the hotel's 182 guest rooms in April 2017.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Non-GAAP Financial Measures

We use the following non-GAAP financial measures that we believe are useful to investors as key measures of our operating performance: EBITDA, Adjusted EBITDA, FFO and Adjusted FFO. These measures should not be considered in isolation or as a substitute for measures of performance in accordance with U.S. GAAP. EBITDA,

Adjusted EBITDA, FFO and Adjusted FFO, as calculated by us, may not be comparable to other companies that do not define such terms exactly as the Company.

Use and Limitations of Non-GAAP Financial Measures

Our management and Board of Directors use EBITDA, Adjusted EBITDA, FFO and Adjusted FFO to evaluate the performance of our hotels and to facilitate comparisons between us and other lodging REITs, hotel owners who are not REITs and other capital intensive companies. The use of these non-GAAP financial measures has certain limitations. These non-GAAP financial measures as presented by us, may not be comparable to non-GAAP financial measures as calculated by other real estate companies. These measures do not reflect certain expenses or expenditures that we incurred and will incur, such as depreciation, interest and capital expenditures. We compensate for these limitations by separately considering the impact of these excluded items to the extent they are material to operating decisions or assessments of our operating performance. Our reconciliations to the most comparable GAAP financial measures, and our consolidated statements of operations and cash flows, include interest

- 25-

Table of Contents

expense, capital expenditures, and other excluded items, all of which should be considered when evaluating our performance, as well as the usefulness of our non-GAAP financial measures.

These non-GAAP financial measures are used in addition to and in conjunction with results presented in accordance with GAAP. They should not be considered as alternatives to operating profit, cash flow from operations, or any other operating performance measure prescribed by GAAP. These non-GAAP financial measures reflect additional ways of viewing our operations that we believe, when viewed with our GAAP results and the reconciliations to the corresponding GAAP financial measures, provide a more complete understanding of factors and trends affecting our business than could be obtained absent this disclosure. We strongly encourage investors to review our financial information in its entirety and not to rely on a single financial measure.

EBITDA and FFO

EBITDA represents net income excluding: (1) interest expense; (2) provision for income taxes, including income taxes applicable to sale of assets; and (3) depreciation and amortization. We believe EBITDA is useful to an investor in evaluating our operating performance because it helps investors evaluate and compare the results of our operations from period to period by removing the impact of our capital structure (primarily interest expense) and our asset base (primarily depreciation and amortization) from our operating results. In addition, covenants included in our debt agreements use EBITDA as a measure of financial compliance. We also use EBITDA as one measure in determining the value of hotel acquisitions and dispositions.

The Company computes FFO in accordance with standards established by the National Association of Real Estate Investment Trusts ("NAREIT"), which defines FFO as net income determined in accordance with U.S. GAAP, excluding gains or losses from sales of properties and impairment losses, plus depreciation and amortization. The Company believes that the presentation of FFO provides useful information to investors regarding its operating performance because it is a measure of the Company's operations without regard to specified non-cash items, such as real estate depreciation and amortization and gains or losses on the sale of assets. The Company also uses FFO as one measure in assessing its operating results.

Adjustments to EBITDA and FFO

We adjust EBITDA and FFO when evaluating our performance because we believe that the exclusion of certain additional items described below provides useful supplemental information to investors regarding our ongoing operating performance and that the presentation of Adjusted EBITDA and Adjusted FFO, when combined with U.S. GAAP net income, EBITDA and FFO, is beneficial to an investor's complete understanding of our consolidated operating performance. We adjust EBITDA and FFO for the following items:

Non-Cash Ground Rent: We exclude the non-cash expense incurred from the straight line recognition of rent from our ground lease obligations and the non-cash amortization of our favorable lease assets. We exclude these non-cash items because they do not reflect the actual rent amounts due to the respective lessors in the current period and they are of lesser significance in evaluating our actual performance for that period.

Non-Cash Amortization of Favorable and Unfavorable Contracts: We exclude the non-cash amortization of the favorable and unfavorable contracts recorded in conjunction with certain acquisitions because the non-cash amortization is based on historical cost accounting and is of lesser significance in evaluating our actual performance for that period.

Cumulative Effect of a Change in Accounting Principle: Infrequently, the Financial Accounting Standards Board (FASB) promulgates new accounting standards that require the consolidated statement of operations to reflect the

cumulative effect of a change in accounting principle. We exclude the effect of these adjustments, which include the accounting impact from prior periods, because they do not reflect the Company's actual underlying performance for the current period.

Gains or Losses from Early Extinguishment of Debt: We exclude the effect of gains or losses recorded on the early extinguishment of debt because these gains or losses result from transaction activity related to the Company's capital structure that we believe are not indicative of the ongoing operating performance of the Company or our hotels.

Hotel Acquisition Costs: We exclude hotel acquisition costs expensed during the period because we believe these transaction costs are not reflective of the ongoing performance of the Company or our hotels.

Severance Costs: We exclude corporate severance costs incurred with the termination of corporate-level employees and severance costs incurred at our hotels related to lease terminations or structured severance programs because we believe these costs do not reflect the ongoing performance of the Company or our hotels.

Hotel Manager Transition Costs: We exclude the transition costs associated with a change in hotel manager because we believe these costs do not reflect the ongoing performance of the Company or our hotels.

Other Items: From time to time we incur costs or realize gains that we consider outside the ordinary course of business and that we do not believe reflect the ongoing performance of the Company or our hotels. Such items may include, but are not limited to, the following: pre-opening costs incurred with newly developed hotels; lease preparation costs incurred

Table of Contents

to prepare vacant space for marketing; management or franchise contract termination fees; gains or losses from legal settlements; bargain purchase gains incurred upon acquisition of a hotel; and gains from insurance proceeds.

In addition, to derive Adjusted EBITDA we exclude gains or losses on dispositions and impairment losses because we believe that including them in EBITDA does not reflect the ongoing performance of our hotels. Additionally, the gain or loss on dispositions and impairment losses are based on historical cost accounting and represent either accelerated depreciation or excess depreciation in previous periods, and depreciation is excluded from EBITDA.

In addition, to derive Adjusted FFO we exclude any fair value adjustments to debt instruments. We exclude these non-cash amounts because they do not reflect the underlying performance of the Company.

The following table is a reconciliation of our U.S. GAAP net income to EBITDA and Adjusted EBITDA (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$36,595	\$44,175	\$45,482	\$60,953
Interest expense	9,585	11,074	19,098	22,738
Income tax expense	4,389	11,045	5,644	6,964
Real estate related depreciation and amortization	25,585	25,005	49,948	50,126
EBITDA	76,154	91,299	120,172	140,781
Non-cash ground rent	1,614	1,328	3,164	2,662
Non-cash amortization of favorable and unfavorable contracts, net	(478)	(478)	(956)	(956)
Hotel acquisition costs	22	—	2,273	—
Loss on early extinguishment of debt	274	—	274	—
Gain on sale of hotel properties	—	(8,121)	—	(8,121)
Severance costs ⁽¹⁾	—	119	—	119
Adjusted EBITDA	\$77,586	\$84,147	\$124,927	\$134,485

⁽¹⁾ Classified within corporate expense on the condensed consolidated statements of operations.

Table of Contents

The following table is a reconciliation of our U.S. GAAP net income to FFO and Adjusted FFO (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$36,595	\$44,175	\$45,482	\$60,953
Real estate related depreciation and amortization	25,585	25,005	49,948	50,126
Gain on sale of hotel properties, net of income tax	—	(7,010)	—	(7,010)
FFO	62,180	62,170	95,430	104,069
Non-cash ground rent	1,614	1,328	3,164	2,662
Non-cash amortization of favorable and unfavorable contracts, net	(478)	(478)	(956)	(956)
Hotel acquisition costs	22	—	2,273	—
Loss on early extinguishment of debt	274	—	274	—
Severance costs ⁽¹⁾	—	119	—	119
Fair value adjustments to debt instruments	—	4	—	18
Adjusted FFO	\$63,612	\$63,143	\$100,185	\$105,912

⁽¹⁾ Classified within corporate expense on the condensed consolidated statements of operations.

Critical Accounting Policies

Our unaudited condensed consolidated financial statements have been prepared in conformity with U.S. GAAP, which requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of our financial statements and the reported amounts of revenues and expenses during the reporting period. While we do not believe that the reported amounts would be materially different, application of these policies involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. We evaluate our estimates and judgments on an ongoing basis. We base our estimates on experience and on various other assumptions that we believe to be reasonable under the circumstances. All of our significant accounting policies, including certain critical accounting policies, are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016.

Inflation

Operators of hotels, in general, possess the ability to adjust room rates daily to reflect the effects of inflation. However, competitive pressures may limit the ability of our management companies to raise room rates.

Seasonality

The operations of hotels historically have been seasonal depending on location, and accordingly, we expect some seasonality in our business. Volatility in our financial performance from the seasonality of the lodging industry could adversely affect our financial condition and results of operations.

New Accounting Pronouncements Not Yet Implemented

See Note 2 to the accompanying condensed consolidated financial statements for additional information relating to recently issued accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk includes risks that arise from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market sensitive instruments. In pursuing our business strategies, the primary market risk to which we are currently exposed, and, to which we expect to be exposed in the future, is interest rate risk. The face amount of our outstanding debt as of June 30, 2017 was \$951.0 million, of which \$300 million was variable rate. If market rates

- 28-

Table of Contents

of interest on our variable rate debt fluctuate by 25 basis points, interest expense would increase or decrease, depending on rate movement, future earnings and cash flows, by \$0.8 million annually.

Item 4. Controls and Procedures

The Company's management has evaluated, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as required by paragraph (b) of Rules 13a-15 and 15d-15 under the Exchange Act, and has concluded that as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective to give reasonable assurances that information we disclose in reports filed with the Securities and Exchange Commission is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There was no change in the Company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act during the Company's most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to various claims, lawsuits and legal proceedings, including routine litigation arising in the ordinary course of business, regarding the operation of our hotels and company matters. While it is not possible to ascertain the ultimate outcome of such matters, management believes that the aggregate amount of such liabilities, if any, in excess of amounts covered by insurance will not have a material adverse impact on our financial condition or results of operations. The outcome of claims, lawsuits and legal proceedings brought against the Company, however, is subject to significant uncertainties.

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs (in thousands) (1)
April 1 - April 30, 2017	—	\$ —	—	\$ 143,503
May 1 - May 31, 2017	—	\$ —	—	\$ 143,503
June 1 - June 30, 2017	—	\$ —	—	\$ 143,503

Represents amounts available under the Company's \$150 million share repurchase program. To facilitate repurchases, we make purchases pursuant to a trading plan under Rule 10b5-1 of the Exchange Act, which allows (1) us to repurchase shares during periods when we otherwise may be prevented from doing so under insider trading laws or because of self-imposed trading blackout periods. The share repurchase program may be suspended or terminated at any time without prior notice.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

- 30-

Table of Contents

Item 6. Exhibits

(a) Exhibits

The following exhibits are filed as part of this Form 10-Q:

Exhibit

- 3.1.1 Articles of Amendment and Restatement of the Articles of Incorporation of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Registration Statement on Form S-11 filed with the Securities and Exchange Commission (File No. 333-123065))
- 3.1.2 Amendment to the Articles of Amendment and Restatement of the Articles of Incorporation of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 10, 2007)
- 3.1.3 Amendment to the Articles of Amendment and Restatement of the Articles of Incorporation of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2012)
- 3.1.4 Articles Supplementary of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 26, 2014)
- 3.1.5 Amendment to the Articles of Amendment and Restatement of the Articles of Incorporation of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 5, 2016)
- 3.2.1 Fourth Amended and Restated Bylaws of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 5, 2016)
- 4.1 Form of Certificate for Common Stock for DiamondRock Hospitality Company (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 5, 2010)
- 10.1 Term Loan Agreement, dated as of April 26, 2017, by and among DiamondRock Hospitality Company, DiamondRock Hospitality Limited Partnership, Regions Bank, as administrative agent, Regions Capital Markets, KeyBanc Capital Markets, PNC Capital Markets, LLC and U.S. Bank National Association, as joint lead arrangers, and KeyBank National Association, PNC Bank, National Association and U.S. Bank National Association, as co-syndication agents, and the lenders party thereto (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 1, 2017)
- 31.1* Certification of Chief Executive Officer Required by Rule 13a-14(a) and Rule 15d-14(a) of the Exchange Act
- 31.2* Certification of Chief Financial Officer Required by Rule 13a-14(a) and Rule 15d-14(a) of the Exchange Act
- 32.1* Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Attached as Exhibit 101 to this report are the following materials from DiamondRock Hospitality Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2017 formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows, and (iv) the related notes to these condensed consolidated financial statements.

* Filed herewith

- 31-

Table of Contents

SIGNATURES

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.

DiamondRock Hospitality Company

August 8, 2017

/s/ Sean M. Mahoney

Sean M. Mahoney
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

/s/ Briony R. Quinn
Briony R. Quinn
Chief Accounting Officer and Corporate Controller
(Principal Accounting Officer)

- 32-