

CHOICE HOTELS INTERNATIONAL INC /DE

Form 10-Q

May 08, 2013

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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 March 31, 2013

OR

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

COMMISSION FILE NO. 001-13393

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

DELAWARE

(State or other jurisdiction of
incorporation or organization)

1 CHOICE HOTELS CIRCLE, SUITE 400
ROCKVILLE, MD 20850

(Address of principal executive offices)

(Zip Code)

(301) 592-5000

(Registrant's telephone number, including area code)

52-1209792

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

10750 COLUMBIA PIKE

SILVER SPRING, MD. 20901

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

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CLASS	SHARES OUSTANDING AT MARCH 31, 2013
Common Stock, Par Value \$0.01 per share	58,491,263

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	Three Months Ended	
	March 31,	
	2013	2012
REVENUES:		
Royalty fees	\$49,736	\$47,853
Initial franchise and relicensing fees	3,777	2,528
Procurement services	3,950	3,315
Marketing and reservation	76,440	70,929
Hotel operations	956	978
Other	2,013	3,566
Total revenues	136,872	129,169
OPERATING EXPENSES:		
Selling, general and administrative	26,916	24,349
Depreciation and amortization	2,175	2,017
Marketing and reservation	76,440	70,929
Hotel operations	875	809
Total operating expenses	106,406	98,104
Operating income	30,466	31,065
OTHER INCOME AND EXPENSES, NET:		
Interest expense	10,770	3,117
Interest income	(644	) (337
Other gains	(710	) (2,003
Equity in net loss of affiliates	141	55
Total other income and expenses, net	9,557	832
Income before income taxes	20,909	30,233
Income taxes	5,386	10,236
Net income	\$15,523	\$19,997
Basic earnings per share	\$0.27	\$0.34
Diluted earnings per share	\$0.26	\$0.34

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED, IN THOUSANDS)

	Three Months Ended	
	March 31,	
	2013	2012
Net income	\$ 15,523	\$ 19,997
Other comprehensive income (loss), net of tax:		
Amortization of loss on cash flow hedge	215	215
Foreign currency translation adjustment, net	(232	) 412
Amortization of pension related costs, net of tax:		
Actuarial loss (net of income tax of \$12 for the three months ended March 31, 2012)	—	20
Other comprehensive income (loss), net of tax	(17	) 647
Comprehensive income	\$ 15,506	\$ 20,644

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

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

	March 31, 2013	December 31, 2012
ASSETS		
Current assets		
Cash and cash equivalents	\$ 140,225	\$ 134,177
Receivables (net of allowance for doubtful accounts of \$11,298 and \$10,820, respectively)	54,202	52,270
Income taxes receivable	—	2,732
Deferred income taxes	4,136	4,136
Investments, employee benefit plans, at fair value	378	3,486
Other current assets	40,832	36,669
Total current assets	239,773	233,470
Property and equipment, at cost, net	71,289	51,651
Goodwill	65,813	65,813
Franchise rights and other identifiable intangibles, net	12,550	13,473
Receivable – marketing and reservation fees	51,297	42,179
Investments, employee benefit plans, at fair value	13,933	12,755
Deferred income taxes	14,969	15,418
Other assets	76,349	76,013
Total assets	\$ 545,973	\$ 510,772
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities		
Accounts payable	\$ 59,429	\$ 38,714
Accrued expenses	35,134	55,552
Deferred revenue	76,316	71,154
Deferred compensation and retirement plan obligations	2,361	2,522
Current portion of long-term debt	8,201	8,195
Income taxes payable	1,550	—
Total current liabilities	182,991	176,137
Long-term debt	863,114	847,150
Deferred compensation and retirement plan obligations	19,940	20,399
Other liabilities	19,257	15,990
Total liabilities	1,085,302	1,059,676
Commitments and Contingencies		
SHAREHOLDERS' DEFICIT		
Common stock, \$0.01 par value, 160,000,000 shares authorized; 95,345,362 shares issued at March 31, 2013 and December 31, 2012 and 58,491,263 and 58,171,059 shares outstanding at March 31, 2013 and December 31, 2012, respectively	585	582
Additional paid-in-capital	108,995	110,246
Accumulated other comprehensive loss	(4,233	) (4,216)
Treasury stock (36,854,099 and 37,174,303 shares at March 31, 2013 and December 31, 2012, respectively), at cost	(921,421	) (927,776)
Retained earnings	276,745	272,260
Total shareholders' deficit	(539,329	) (548,904)
Total liabilities and shareholders' deficit	\$ 545,973	\$ 510,772

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

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

	Three Months Ended	
	March 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$15,523	\$19,997
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,175	2,017
Provision for bad debts, net	844	679
Non-cash stock compensation and other charges	2,549	2,543
Non-cash interest and other (income) loss	76	(1,593)
Deferred income taxes	446	(30)
Dividends received from equity method investments	146	—
Equity in net loss of affiliates	141	55
Changes in assets and liabilities:		
Receivables	(3,531)	(870)
Receivable – marketing and reservation fees, net	(4,101)	(6,187)
Accounts payable	10,471	6,712
Accrued expenses	(31,145)	(25,342)
Income taxes payable/receivable	4,367	8,180
Deferred revenue	5,160	1,997
Other assets	(3,869)	(2,611)
Other liabilities	2,622	(1,135)
Net cash provided by operating activities	1,874	4,412
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in property and equipment	(13,645)	(3,129)
Equity method investments	(1,000)	(2,600)
Issuance of notes receivable	(1,729)	(3,719)
Collections of notes receivable	19	151
Purchases of investments, employee benefit plans	(1,242)	(743)
Proceeds from sales of investments, employee benefit plans	3,882	8,652
Other items, net	(101)	(108)
Net cash used in investing activities	(13,816)	(1,496)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings pursuant to revolving credit facilities	18,000	5,900
Principal payments on long-term debt	(2,046)	(166)
Purchase of treasury stock	(3,634)	(14,854)
Dividends paid	(503)	(10,713)
Excess tax benefits from stock-based compensation	952	422
Proceeds from exercise of stock options	5,367	389
Net cash provided by (used) in financing activities	18,136	(19,022)
Net change in cash and cash equivalents	6,194	(16,106)
Effect of foreign exchange rate changes on cash and cash equivalents	(146)	361
Cash and cash equivalents at beginning of period	134,177	107,057
Cash and cash equivalents at end of period	\$140,225	\$91,312
Supplemental disclosure of cash flow information:		
Cash payments during the period for:		

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Income taxes, net of refunds	\$1,029	\$1,746
Interest	\$20,400	\$7,388
Non-cash investing and financing activities:		
Dividends declared but not paid	\$10,759	\$10,690
Issuance of restricted shares of common stock	\$7,151	\$8,497
Issuance of performance vested restricted stock units	\$1,298	\$—
Investment in property and equipment	\$10,356	\$—

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

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

1. Company Information and Significant Accounting Policies

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

Certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted. The year-end balance sheet information was derived from audited financial statements, but does not include all disclosures required by GAAP. The Company believes the disclosures made are adequate to make the information presented not misleading.

The consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2012 and notes thereto included in the Company's Form 10-K, filed with the SEC on February 28, 2013 (the "10-K"). Interim results are not necessarily indicative of the entire year results because of seasonal variations. All inter-company transactions and balances between Choice Hotels International, Inc. and its subsidiaries have been eliminated in consolidation.

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

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with a maturity of three months or less at the date of purchase to be cash equivalents. As of March 31, 2013 and December 31, 2012, \$3.1 million and \$5.0 million respectively, of book overdrafts representing outstanding checks in excess of funds on deposit are included in accounts payable in the accompanying consolidated balance sheets.

The Company maintains cash balances in domestic banks, which at times, may exceed the limits of amounts insured by the Federal Deposit Insurance Corporation. In addition, the Company also maintains cash balances in international banks which do not provide deposit insurance.

Recently Adopted Accounting Guidance

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") No. 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income" ("ASU 2013-02"). This update requires companies to present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. If a component is not required to be reclassified to net income in its entirety companies would instead cross reference to the related footnote for additional information. ASU 2013-02 became effective for interim and annual periods beginning after December 15, 2012 and the Company has adopted this ASU during the current quarter. The Company has elected to present the required disclosures in a single note rather than on the face of the financial statement. See Note 8 for additional information.

Future Adoption of Recently Announced Accounting Guidance

In February 2013, the FASB issued ASU No. 2013-04, "Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date" ("ASU 2013-04"). The ASU requires entities to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, as the sum of the following: (a) The amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and (b) any

additional amount the reporting entity expects to pay on behalf of its co-obligors. Required disclosures include a description of the joint-and-several arrangement and the total outstanding amount of the obligation for all joint parties. The ASU permits entities to aggregate disclosures (as opposed to providing separate disclosures for each joint-and-several obligation). ASU 2013-04 is effective for all interim and annual

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periods beginning after December 15, 2013. The ASU should be applied retrospectively to obligations with joint-and-several liabilities existing at the beginning of an entity's fiscal year of adoption. Early adoption is permitted. The Company is currently evaluating the impact the adoption of this statement will have on its financial statement presentation, if any, and will adopt the provision of this ASU on January 1, 2014.

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

2. Other Current Assets

Other current assets consist of the following:

	March 31, 2013	December 31, 2012
	(In thousands)	
Notes receivable (See Note 3)	\$ 14,923	\$ 14,415
Prepaid expenses	13,864	10,694
Land held for sale	8,798	8,541
Other current assets	3,247	3,019
Total	\$ 40,832	\$ 36,669

Land held for sale represents the Company's purchase of various parcels of real estate as part of its program to incent franchise development in strategic markets for certain brands. The Company has acquired this real estate with the intent to resell it to third-party developers for the construction of hotels operated under the Company's brands. The real estate is accounted for as assets held for sale and therefore is carried at the lower of its carrying value or its estimated fair value (based on comparable sales), less estimated costs to sell.

3. Notes Receivable and Allowance for Losses

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

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

Credit Quality Indicator	March 31, 2013 (\$ in thousands)			December 31, 2012 (\$ in thousands)		
	Forgivable Notes Receivable	Mezzanine & Other Notes Receivable	Total	Forgivable Notes Receivable	Mezzanine & Other Notes Receivable	Total
Senior	\$—	\$27,842	\$27,842	\$—	\$27,549	\$27,549
Subordinated	—	15,020	15,020	—	15,019	15,019
Unsecured	16,950	1,822	18,772	16,235	1,265	17,500
Total notes receivable	16,950	44,684	61,634	16,235	43,833	60,068
Allowance for losses on non-impaired loans	1,695	1,303	2,998	1,623	638	2,261
Allowance for losses on receivables specifically evaluated for impairment	—	8,288	8,288	—	8,289	8,289
Total loan reserves	1,695	9,591	11,286	1,623	8,927	10,550
Net carrying value	\$15,255	\$35,093	\$50,348	\$14,612	\$34,906	\$49,518
Current portion, net	\$561	\$14,362	\$14,923	\$420	\$13,995	\$14,415
Long-term portion, net	14,694	20,731	35,425	14,192	20,911	35,103
Total	\$15,255	\$35,093	\$50,348	\$14,612	\$34,906	\$49,518

The Company classifies notes receivable due within one year as other current assets and notes receivable with a maturity greater than one year as other assets in the Company's consolidated balance sheets.

The following table summarizes the activity related to the Company's Forgivable Notes Receivable and Mezzanine and Other Notes Receivable allowance for losses from December 31, 2012 through March 31, 2013:

	Forgivable Notes Receivable	Mezzanine & Other Notes Receivable
	(In thousands)	
Balance, December 31, 2012	\$1,623	\$8,927
Provisions	165	664
Recoveries	—	—
Write-offs	(6) —
Other ⁽¹⁾	(87) —
Balance, March 31, 2013	\$1,695	\$9,591

(1) Consists of default rate assumption changes

Forgivable Notes Receivable

As of March 31, 2013 and December 31, 2012, the unamortized balance of the Company's forgivable notes receivable totaled \$17.0 million and \$16.2 million, respectively. The Company recorded an allowance for credit losses on these

forgivable notes receivable of \$1.7 million and \$1.6 million at March 31, 2013 and December 31, 2012, respectively. At March 31, 2013 and December 31, 2012, the Company did not have any forgivable unsecured notes that were past due. Amortization expense included in the accompanying consolidated statements of income related to the notes for the three months ended March 31, 2013 and 2012 was \$0.9 million and \$0.6 million, respectively.

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Mezzanine and Other Notes Receivable

The Company has determined that approximately \$13.3 million of its mezzanine and other notes receivable were impaired at both March 31, 2013 and December 31, 2012, respectively. The Company has recorded allowance for credit losses on these impaired loans at both March 31, 2013 and December 31, 2012 totaling \$8.3 million resulting in a carrying value of impaired loans of \$5.0 million for both periods which we had no related allowance for credit losses. The Company recognized approximately \$66 thousand and \$31 thousand of interest income on impaired loans during the three months ended March 31, 2013 and 2012, respectively on the cash basis. The Company had provided loan reserves on non-impaired loans totaling \$1.3 million and \$0.6 million at March 31, 2013 and December 31, 2012, respectively.

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

	30-89 days Past Due (\$ in thousands)	> 90 days Past Due	Total Past Due	Current	Total Receivables
As of March 31, 2013					
Senior	\$—	\$—	\$—	\$27,842	\$27,842
Subordinated	162	9,629	9,791	5,229	15,020
Unsecured	—	47	47	1,775	1,822
	\$162	\$9,676	\$9,838	\$34,846	\$44,684
As of December 31, 2012					
Senior	\$—	\$—	\$—	\$27,549	\$27,549
Subordinated	619	9,629	10,248	4,771	15,019
Unsecured	—	47	47	1,218	1,265
	\$619	\$9,676	\$10,295	\$33,538	\$43,833

Loans Acquired with Deteriorated Credit Quality

On December 2, 2011, the Company acquired an \$11.5 million mortgage, held on a franchisee hotel asset, from a financial institution for \$7.9 million. At the time of acquisition, the Company determined that it would be unable to collect all contractually required payments under the original mortgage terms. The contractually required payments receivable, including principal and interest, under the terms of the acquired mortgage totaled \$12.0 million. The Company expects to collect \$9.7 million of these contractually required payments. No prepayments were considered in the determination of contractual cash flows and cash flows expected to be collected. At both March 31, 2013 and December 31, 2012, the carrying amount of this loan, which is reported under senior mezzanine and other notes receivables, was \$7.9 million and there was no allowance for uncollectable amounts. The Company's accretable yield at acquisition was \$1.8 million or 7.36% and a reconciliation of the accretable yield for the three months ended March 31, 2013 is as follows:

	Accretable Yield (\$ in thousands)
Balance, December 31, 2012	\$ 1,161
Additions	—
Accretion	(141)
Disposals	—
Reclassifications from nonaccretable yield	—
Balance, March 31, 2013	\$ 1,020

4. Receivable – Marketing and Reservation Fees

The marketing fees receivable from cumulative marketing expenses incurred in excess of cumulative marketing fees earned at March 31, 2013 and December 31, 2012 was \$11.5 million and \$7.9 million, respectively. As of March 31, 2013 and December 31, 2012, the reservation fees receivable related to cumulative reservation expenses incurred in excess of cumulative reservation fees earned was \$39.8 million and \$34.2 million, respectively. Depreciation and

amortization expense attributable to marketing and reservation activities for the three months ended March 31, 2013 and 2012 was \$4.0 million and \$3.5 million, respectively. Interest expense attributable to marketing and reservation activities was \$0.9 million and \$1.2 million for the three months ended March 31, 2013 and 2012, respectively.

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The Company evaluates the receivable for marketing and reservation costs in excess of cumulative marketing and reservation system revenues earned on a periodic basis for collectibility. The Company will record an allowance when, based on current information and events, it is probable that it will be unable to collect all amounts due for marketing and reservation activities according to the contractual terms of the franchise agreements. The receivables are considered to be uncollectible if the expected net, undiscounted cash flows from marketing and reservation activities are less than the carrying amount of the asset. Based on the Company's analysis of projected net cash flows from marketing and reservation activities for all periods presented, the Company concluded that the receivable for marketing and reservation activities was fully collectible and as a result no allowance for possible losses was recorded.

5. Other Assets

Other assets consist of the following:

	March 31, 2013	December 31, 2012
	(In thousands)	
Notes receivable (see Note 3)	\$35,425	\$35,103
Equity method investments	28,140	27,453
Deferred financing fees	10,619	11,174
Land held for sale	1,300	1,300
Other assets	865	983
Total	\$76,349	\$76,013

Variable Interest Entities

Equity method investments include investments in joint ventures totaling \$24.2 million and \$24.3 million at March 31, 2013 and December 31, 2012, respectively that the Company has determined to be variable interest entities. These investments relate to the Company's program to offer equity support to qualified franchisees to develop and operate Cambria Suites hotels in strategic markets. Based on an analysis of who has the power to direct the activities that most significantly impact these entities performance and who has an obligation to absorb losses of these entities or a right to receive benefits from these entities that could potentially be significant to the entity, the Company has determined that it is not the primary beneficiary of any of its joint venture investments. We based our quantitative analysis on the forecasted cash flows of the entity and our qualitative analysis on our review of the design of the entity, its organizational structure including decision-making ability and the relevant development, operating management and financial agreements. As a result, the Company's investment in these entities is accounted for under the equity method. For the three months ended March 31, 2013, the Company recognized losses totaling \$0.1 million. No income or losses were recognized related to these investments during the three months ended March 31, 2012.

6. Deferred Revenue

Deferred revenue consists of the following:

	March 31, 2013	December 31, 2012
	(In thousands)	
Loyalty programs	\$63,101	\$64,636
Initial, relicensing and franchise fees	4,366	4,994
Procurement service fees	3,743	1,225
Other	5,106	299
Total	\$76,316	\$71,154

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7. Debt

Debt consists of the following at:

	March 31, 2013	December 31, 2012
	(In thousands)	
\$400 million senior unsecured notes with an effective interest rate of 5.94% at March 31, 2013 and December 31, 2012	\$400,000	\$400,000
\$250 million senior unsecured notes with an effective interest rate of 6.19% less discount of \$0.5 million at March 31, 2013 and December 31, 2012	249,524	249,508
\$350 million senior secured credit facility with an effective interest rate of 2.59% and 2.66% at March 31, 2013 and December 31, 2012, respectively	219,375	203,250
Capital lease obligations due 2016 with an effective interest rate of 3.18% at March 31, 2013 and December 31, 2012	2,352	2,519
Other notes payable	64	68
Total debt	\$871,315	\$855,345
Less current portion	8,201	8,195
Total long-term debt	\$863,114	\$847,150

Senior Unsecured Notes Due 2022

On June 27, 2012, the Company issued unsecured notes in the principal amount of \$400 million ("the 2012 Senior Notes") at par, bearing a coupon of 5.75% with an effective rate of 5.94%. The 2012 Senior Notes will mature on July 1, 2022, with interest to be paid semi-annually on January 1st and July 1st. The Company used the net proceeds of this offering, after deducting underwriting discounts and commissions and other offering expenses, together with a portion of the proceeds from a new credit facility, to pay a special cash dividend totaling approximately \$600.7 million paid to shareholders on August 23, 2012. The Company's 2012 Senior Notes are guaranteed jointly, severally, fully and unconditionally, subject to certain customary limitations by eight 100%-owned domestic subsidiaries.

Senior Unsecured Notes Due 2020

On August 25, 2010, the Company issued unsecured senior notes in the principal amount of \$250 million ("the 2010 Senior Notes") at a discount of \$0.6 million, bearing a coupon of 5.7% with an effective rate of 6.19%. The 2010 Senior Notes will mature on August 28, 2020, with interest to be paid semi-annually on February 28th and August 28th. The Company used the net proceeds from the offering, after deducting underwriting discounts and other offering expenses, to repay outstanding borrowings and for other general corporate purposes. The Company's 2010 Senior Notes are guaranteed jointly, severally, fully and unconditionally, subject to certain customary limitations by eight 100%-owned domestic subsidiaries.

Revolving Credit Facilities

On July 25, 2012, the Company entered into a \$350 million senior secured credit facility, comprised of a \$200 million revolving credit tranche (the "New Revolver") and a \$150 million term loan tranche (the "Term Loan") with Deutsche Bank AG New York Branch, as administrative agent, Wells Fargo Bank, National Association, as administrative agent and a syndication of lenders (the "New Credit Facility"). The New Credit Facility has a final maturity date of July 25, 2016, subject to an optional one-year extension provided certain conditions are met. Up to \$25 million of the borrowings under the New Revolver may be used for letters of credit, up to \$10 million of borrowings under the New Revolver may be used for swing-line loans and up to \$35 million of borrowings under the New Revolver may be used for alternative currency loans. The Term Loan requires quarterly amortization payments (a) during the first two years, in equal installments aggregating 5% of the original principal amount of the Term Loan per year, (b) during the second two years, in equal installments aggregating 7.5% of the original principal amount of the Term Loan per year, and (c) during the one-year extension period (if exercised), equal installments aggregating 10% of the original principal amount of the Term Loan.

The Company utilized the proceeds from the Term Loan and borrowings from the New Revolver, together with the net proceeds from the Company's 2012 Senior Notes, to pay a special cash dividend of approximately \$600.7 million in the aggregate to the Company's stockholders on August 23, 2012.

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

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

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

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

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

The Company may reduce the New Revolver commitment and/or prepay the Term Loan in whole or in part at any time without penalty, subject to reimbursement of customary breakage costs, if any. Any Term Loan prepayments made by the Company shall be applied to reduce the scheduled amortization payments in direct order of maturity. Additionally, the New Credit Facility requires that the Company and its restricted subsidiaries comply with various covenants, including with respect to restrictions on liens, incurring indebtedness, making investments, paying dividends or repurchasing stock, and effecting mergers and/or asset sales. With respect to dividends, the Company may not make any payment if there is an existing event of default or if the payment would create an event of default. In addition, if the Company's total leverage ratio exceeds 4.50 to 1.00, the Company is generally restricted from paying aggregate dividends in excess of \$50.0 million during any calendar year.

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

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

The New Credit Facility includes customary events of default, the occurrence of which, following any applicable cure period, would permit the lenders to, among other things, declare the principal, accrued interest and other obligations of the Company under the New Credit Facility to be immediately due and payable. At March 31, 2013, the Company was in compliance with all covenants under the New Credit Facility.

At March 31, 2013, the Company had \$144.4 million and \$75.0 million outstanding under the Term Loan and New Revolver, respectively. At December 31, 2012, the Company had \$146.3 million and \$57.0 million outstanding under the Term Loan and New Revolver, respectively.

In connection with the entering into the New Credit Facility, the Company's \$300 million senior unsecured revolving credit agreement, dated as of February 24, 2011, among the Company, Wells Fargo Bank, National Association, as administrative agent, and a syndicate of lenders (the "Old Credit Facility"), was terminated and replaced by the New Credit Facility. Borrowings under the Old Credit Facility bore interest at (i) a base rate plus a margin ranging from 5 to 80 basis points based on the Company's credit rating or (ii) LIBOR plus a margin ranging from 105 to 180 basis

points based on the Company's credit rating. In addition, the Old Credit Facility required the Company to pay a quarterly facility fee on the full amount of the commitments under the Old Credit Facility (regardless of usage) ranging from 20 to 45 basis points based upon the credit rating of the Company.

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8. Accumulated Other Comprehensive Income (Loss)

The following represents the changes in accumulated other comprehensive loss, net of tax by component for the three months ended March 31, 2013:

	Loss on Cash Flow Hedge	Foreign Currency Items	Total
	(\$ in thousands)		
Balance, December 31, 2012	\$ (6,607	) \$ 2,391	\$ (4,216)
Other comprehensive income (loss) before reclassification	—	(232	) (232)
Amounts reclassified from accumulated other comprehensive income (loss)	215	—	215
Net current period other comprehensive income (loss)	215	(232	) (17)
Balance, March 31, 2013	\$ (6,392	) \$ 2,159	\$ (4,233)

The amounts reclassified from other accumulated other comprehensive income (loss) during the three months ended March 31, 2013 were reclassified to the following line items in the Company's Consolidated Statement of Income.

Component	Amount Reclassified from Accumulated Other Comprehensive Income(Loss)	Affected Line Item in the Consolidated Statement of Net Income
Loss on cash flow hedge		
Interest rate contract	\$ 215	Interest expense
	—	Tax (expense) benefit
	\$ 215	Net of tax

9. Non-Qualified Retirement, Savings and Investment Plans

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

In 2002, the Company adopted the Choice Hotels International, Inc. Executive Deferred Compensation Plan ("EDCP") which became effective January 1, 2003. Under the EDCP, certain executive officers may defer a portion of their salary into an irrevocable trust. Prior to January 1, 2010, participants could elect an investment return of either the annual yield of the Moody's Average Corporate Bond Rate Yield Index plus 300 basis points, or a return based on a selection of available diversified investment options. Effective January 1, 2010, the Moody's Average Corporate Bond Rate Yield Index plus 300 basis points is no longer an investment option for salary deferrals made on compensation earned after December 31, 2009. The Company recorded current and long-term deferred compensation liabilities of \$10.1 million and \$11.7 million, as of March 31, 2013 and December 31, 2012, respectively, related to these deferrals and credited investment returns. Compensation expense is recorded in SG&A expense on the Company's consolidated

statements of income based on the change in the deferred compensation obligation related to earnings credited to participants as well as changes in the fair value of diversified investments. Compensation expense recorded in SG&A for the three months ended March 31, 2013 and 2012 was \$0.3 million and \$0.4 million, respectively. In addition, the EDCP Plan held shares of the Company's common stock with a market value of \$0.2 million and \$0.1 million at March 31, 2013 and December 31, 2012, respectively which were recorded as a component of shareholders' deficit. The Company has invested the employee salary deferrals in diversified long-term investments which are intended to provide investment returns that partially offset the earnings credited to the participants. The diversified investments held in the trusts

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totaled \$3.4 million and \$6.0 million as of March 31, 2013 and December 31, 2012, respectively, and are recorded at their fair value, based on quoted market prices. At March 31, 2013, the Company expects \$0.4 million of the assets held in the trusts to be distributed to participants during the next twelve months. These investments are considered trading securities and therefore the changes in the fair value of the diversified assets is included in other gains and losses in the accompanying consolidated statements of income. The Company recorded investment gains during the three months ended March 31, 2013 and 2012 of approximately \$0.1 million and \$1.1 million, respectively.

In 1997, the Company adopted the Choice Hotels International, Inc. Non-Qualified Retirement Savings and Investment Plan (“Non-Qualified Plan”). The Non-Qualified Plan allows certain employees who do not participate in the EDCP to defer a portion of their salary and invest these amounts in a selection of available diversified investment options. As of March 31, 2013 and December 31, 2012, the Company had recorded a deferred compensation liability of \$12.2 million and \$11.2 million, respectively, related to these deferrals. Compensation expense is recorded in SG&A expense on the Company's consolidated statements of income based on the change in the deferred compensation obligation related to earnings credited to participants as well as changes in the fair value of diversified investments. The net increase in compensation expense recorded in SG&A for the three months ended March 31, 2013 and 2012 was \$0.8 million and 0.9 million, respectively.

The diversified investments held in the trusts were \$10.9 million and \$10.2 million as of March 31, 2013 and December 31, 2012, respectively, and are recorded at their fair value, based on quoted market prices. These investments are considered trading securities and therefore the changes in the fair value of the diversified assets is included in other gains and losses in the accompanying consolidated statements of income. The Company recorded investment gains during the three months ended March 31, 2013 and 2012 of approximately \$0.6 million and \$0.9 million, respectively. In addition, the Non-Qualified Plan held shares of the Company's common stock with a market value of \$1.2 million and \$1.0 million at March 31, 2013 and December 31, 2012, respectively, which are recorded as a component of shareholders' deficit.

10. Fair Value Measurements

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

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

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

Level 3: Unobservable inputs, supported by little or no market data available, where the reporting entity is required to develop its own assumptions to determine the fair value of the instrument. The Company does not currently have any assets whose fair value was determined using Level 3 inputs.

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As of March 31, 2013 and December 31, 2012, the Company had the following assets measured at fair value on a recurring basis:

	Fair Value Measurements at			
	Total	Level 1	Level 2	Level 3
Assets (in thousands)				
As of March 31, 2013				
Money market funds, included in cash and cash equivalents	\$50,001	\$—	\$50,001	\$—
Mutual funds ⁽¹⁾	13,260	13,260	—	—
Money market funds ⁽¹⁾	1,051	—	1,051	—
	\$64,312	\$13,260	\$51,052	\$—
As of December 31, 2012				
Money market funds, included in cash and cash equivalents	\$20,001	\$—	\$20,001	\$—
Mutual funds ⁽¹⁾	11,884	11,884	—	—
Money market funds ⁽¹⁾	4,357	—	4,357	—
	\$36,242	\$11,884	\$24,358	\$—

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

The Company's policy is to recognize transfers in and transfers out of the three levels of the fair value hierarchy as of the end of each quarterly reporting period. There were no transfers between Level 1 and 2 assets during the three months ended March 31, 2013.

Other Financial Instruments

The Company believes that the fair value of its current assets and current liabilities approximate their reported carrying amounts due to the short-term nature of these items. In addition, the interest rates of the Company's New Credit Facility adjust frequently based on current market rates; accordingly its carrying amount approximates fair value.

The Company estimates the fair value of notes receivable which approximate their carrying value, utilizing an analysis of future cash flows and credit worthiness for similar types of arrangements. Based upon the availability of market data, we have classified these notes receivables as Level 3 inputs. The primary sensitivity in these calculations is based on the selection of appropriate interest and discount rates. For further information on the notes receivables see Note 3.

The Company estimates the fair value of the Company's \$250 million and \$400 million senior notes using quoted market prices, which are directly observable Level 1 inputs. At March 31, 2013 and December 31, 2012, the \$250 million senior notes had an approximate fair value of \$276.9 million and \$271.6 million, respectively. At March 31, 2013 and December 31, 2012, the \$400 million senior notes had an approximate fair value of \$444.0 million and \$442.0 million, respectively.

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

11. Income Taxes

The effective income tax rates were 25.8% and 33.9% for the three months ended March 31, 2013 and 2012, respectively.

The effective income tax rate for the three months ended March 31, 2013 and 2012 were lower than the U.S federal income tax rate of 35% due to the impact of foreign operations, partially offset by state taxes. The effective income tax rate for the three months ended March 31, 2013 was further reduced by settlements of unrecognized tax positions

and by legislation retroactively extending the U.S. controlled foreign corporation look-through rule.

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12. Share-Based Compensation and Capital Stock

Stock Options

The Company granted 0.2 million and 0.2 million options to certain employees of the Company at a fair value of \$1.7 million and \$1.6 million for the three months ended March 31, 2013 and 2012, respectively. The stock options granted by the Company had an exercise price equal to the market price of the Company's common stock on the date of grant. The fair value of the options granted was estimated on the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2013 Grants	2012 Grants	
Risk-free interest rate	0.73	% 0.78	%
Expected volatility	38.14	% 40.15	%
Expected life of stock option	4.5 years	4.4 years	
Dividend yield	2.01	% 2.08	%
Requisite service period	4 years	4 years	
Contractual life	7 years	7 years	
Weighted average fair value of options granted	\$9.89	\$9.98	

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

The aggregate intrinsic value of the stock options outstanding and exercisable at March 31, 2013 was \$29.2 million and \$23.3 million, respectively. The total intrinsic value of options exercised during the three months ended March 31, 2013 and 2012 was approximately \$2.3 million and \$0.4 million, respectively.

The Company received approximately \$5.4 million and \$0.4 million in proceeds from the exercise of 204,323 and 20,216 employee stock options during the three month periods ended March 31, 2013 and 2012, respectively.

Restricted Stock

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

	Three Months Ended	
	March 31,	
	2013	2012
Restricted share grants	194,541	238,019
Weighted average grant date fair value per share	\$36.76	\$35.70
Aggregate grant date fair value (\$000)	\$7,151	\$8,497
Restricted shares forfeited	21,499	4,328
Vesting service period of shares granted	3 - 4 years	36 - 68 months
Grant date fair value of shares vested (\$000)	\$6,999	\$5,013

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

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Performance Vested Restricted Stock Units

The Company has granted performance vested restricted stock units (“PVRSU”) to certain employees. The fair value is measured by the market price of the Company's common stock on the date of the grant. The vesting of these stock awards is contingent upon the Company achieving performance targets at the end of specified performance periods and the employees' continued employment. The performance conditions affect the number of shares that will ultimately vest. The range of possible stock-based award vesting is generally between 0% and 200% of the initial target. If minimum performance targets are not attained then no awards will vest under the terms of the various PVRSU agreements. Compensation expense related to these awards is recognized over the requisite service period based on the Company's estimate of the achievement of the various performance targets. The Company has currently estimated that between 100% and 160% of the various award targets will be achieved. Compensation expense is recognized ratably over the requisite service period only on those PVRSUs that ultimately vest.

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

	Three Months Ended	
	March 31,	
	2013	2012
Performance vested restricted stock units granted at target	58,902	38,476
Weighted average grant date fair value per share	\$36.76	\$35.60
Aggregate grant date fair value (\$000)	\$2,165	\$1,370
Stock units forfeited	—	—
Requisite service period	22-36 months	3 years

During the three months ended March 31, 2013, 39,816 PVRSU grants vested at a fair value of \$1.3 million. These PVRSU grants were initially granted at a target of 30,624 units. However, since the Company exceeded targeted performance conditions contained in the stock awards granted in prior periods by 130%, an additional 9,192 shares were earned and issued. No PVRSU grants vested during the three months ended March 31, 2012. In addition, no stock units were forfeited in the three months ended March 31, 2013 and 2012.

A summary of stock-based award activity as of March 31, 2013 and changes during the three months ended are presented below:

	Stock Options		Weighted Average Remaining Contractual Term	Restricted Stock		Performance Vested Restricted Stock Units	
	Options	Weighted Average Exercise Price		Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2013	1,934,034	\$25.80		606,547	\$35.17	170,116	\$35.56
Granted	173,413	36.76		194,541	36.76	58,902	36.76
Performance based leveraging ⁽¹⁾	—	—		—	—	9,192	32.60
Exercised/Vested	(204,323)	26.27		(207,622)	33.71	(39,816)	32.60
Expired	(75,473)	36.99		—	—	—	—
Forfeited	—	—		(21,499)	34.74	—	—
Outstanding at March 31, 2013	1,827,651	\$26.32	4.3 years	571,967	\$36.25	198,394	\$36.37
Options exercisable at March 31, 2013	1,317,396	\$24.61	3.0 years				

⁽¹⁾PVRSU shares have been increased by 9,192 units due to the Company exceeding the targeted performance conditions contained in PVRSUs granted in prior periods during the three months ended March 31, 2013.

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The components of the Company's pretax stock-based compensation expense and associated income tax benefits are as follows for the three months ended March 31, 2013 and 2012:

(in millions)	Three Months Ended	
	March 31,	
	2013	2012
Stock options	\$0.5	\$0.6
Restricted stock	1.8	2.0
Performance vested restricted stock units	0.6	0.2
Total	\$2.9	\$2.8
Income tax benefits	\$1.1	\$1.0
Dividends		

The Company currently maintains the payment of a quarterly dividend on its common shares outstanding of \$0.185 per share, however the declaration of future dividends are subject to the discretion of the board of directors. In the fourth quarter of 2012, the Company's board of directors elected to pay prior to December 31, 2012 the regular quarterly dividend initially scheduled to be paid in the first quarter of 2013.

During the three months ended March 31, 2013, the Company paid previously declared dividends totaling \$0.5 million that were contingent upon the vesting of performance vested restricted units. No dividends on performance vested restricted units were paid during the three months ended March 31, 2012.

On February 8, 2013, the Company's board of directors declared a quarterly cash dividend of \$0.185 per share (or approximately \$10.8 million in the aggregate), which was paid on April 16, 2013 to shareholders of record as of April 2, 2013.

Share Repurchases and Redemptions

No shares of common stock were purchased by the Company under the share repurchase program during the three months ended March 31, 2013. During the three months ended March 31, 2012, the Company purchased 0.3 million shares of common stock under the share repurchase program at a total cost of \$12.9 million.

During the three months ended March 31, 2013, the Company redeemed 96,977 shares of common stock at a total cost of approximately \$3.6 million from employees to satisfy statutory minimum tax requirements from the vesting of restricted stock and performance vested restricted stock unit grants. During the three months ended March 31, 2012, the Company redeemed 55,162 shares of common stock at a total cost of approximately \$2.0 million from employees to satisfy statutory minimum tax requirements from the vesting of restricted stock grants. These redemptions were outside the share repurchase program initiated in June 1998.

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13. Earnings Per Share

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

(In thousands, except per share amounts)	Three Months Ended	
	March 31,	
	2013	2012
Computation of Basic Earnings Per Share:		
Net income	\$ 15,523	\$ 19,997
Income allocated to participating securities	(163	) (204
Net income available to common shareholders	\$ 15,360	\$ 19,793
Weighted average common shares outstanding – basic	57,720	57,622
Basic earnings per share	\$0.27	\$0.34
Computation of Diluted Earnings Per Share:		
Net income	\$ 15,523	\$ 19,997
Income allocated to participating securities	(162	) (204
Net income available to common shareholders	\$ 15,361	\$ 19,793
Weighted average common shares outstanding – basic	57,720	57,622
Diluted effect of stock options and PVRsUs	361	100
Weighted average shares outstanding – diluted	58,081	57,722
Diluted earnings per share	\$0.26	\$0.34

The Company's unvested restricted shares contain rights to receive non-forfeitable dividends, and thus are participating securities requiring the two-class method of computing earnings per share (“EPS”). The calculation of EPS for common stock shown above excludes the income attributable to the unvested restricted share awards from the numerator and excludes the dilutive impact of those awards from the denominator.

At March 31, 2013 and 2012, the Company had 1.8 million and 1.7 million outstanding stock options, respectively. Stock options are included in the diluted earnings per share calculation using the treasury stock method and average market prices during the period, unless the stock options would be anti-dilutive. For the three month period ended March 31, 2013, the Company did not exclude any anti-dilutive stock options from the diluted earnings per share calculation. For the three month period ended March 31, 2012, the Company excluded 0.4 million of anti-dilutive stock options from the diluted earnings per share calculation.

PVRsUs are also included in the diluted earnings per share calculation assuming the performance conditions have been met at the reporting date. However, at March 31, 2013 and 2012, PVRsUs totaling 198,394 and 148,245, respectively, were excluded from the computation since the performance conditions had not been met.

14. Condensed Consolidating Financial Statements

The Company’s Senior Notes due 2020 and 2022 are guaranteed jointly, severally, fully and unconditionally, subject to certain customary limitations, by eight 100%-owned domestic subsidiaries. There are no legal or regulatory restrictions on the payment of dividends to Choice Hotels International, Inc. from subsidiaries that do not guarantee the Senior Notes. As a result of the guarantee arrangements, the following condensed consolidating financial statements are presented. Investments in subsidiaries are accounted for under the equity method of accounting.

Certain revisions have been made to correct immaterial errors in the condensed consolidating statement of income and condensed consolidating statement of cash flows for the three months ended March 31, 2012. The revisions to the condensed consolidating statement of income decreased the Guarantor's marketing and reservation expense and total operating expenses by \$1.1 million and increased the Guarantor's interest expense and total other income and expenses, net by \$1.1 million for the three months ended March 31, 2012, with corresponding offsetting adjustments to the same items in the Eliminations column.

The condensed consolidating statement of cash flows for the three months ended March 31, 2012 has been revised from prior filings to reflect the reclassification of certain operating, investing and financing cash flows related to inter-company investment transactions between wholly-owned subsidiaries. The revisions to the condensed consolidating statement of cash

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flows increased the Guarantors net cash provided (used) by operating activities and increased investment in affiliates and net cash used in investing activities by \$2.6 million and decreased the Non-Guarantor's net cash provided (used) by operating activities and increased proceeds from contributions from affiliates and net cash provided (used) by financing activities by \$2.6 million for the three months ended March 31, 2012, with corresponding offsetting adjustments to the same items in the Eliminations column.

These revisions are not material to our financial statements taken as a whole.

Choice Hotels International, Inc.
Condensed Consolidating Statement of Income
For the Three Months Ended March 31, 2013
(Unaudited, in Thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUES:					
Royalty fees	\$44,236	\$24,205	\$9,195	\$(27,900)	\$49,736
Initial franchise and relicensing fees	3,568	—	209	—	3,777
Procurement services	3,800	—	150	—	3,950
Marketing and reservation	65,159	76,131	4,582	(69,432)	76,440
Other items, net	1,788	956	225	—	2,969
Total revenues	118,551	101,292	14,361	(97,332)	136,872
OPERATING EXPENSES:					
Selling, general and administrative	29,082	22,438	3,296	(27,900)	26,916
Marketing and reservation	67,698	73,136	5,038	(69,432)	76,440
Other items, net	714	2,136	200	—	3,050
Total operating expenses	97,494	97,710	8,534	(97,332)	106,406
Operating income (loss)	21,057	3,582	5,827	—	30,466
OTHER INCOME AND EXPENSES, NET:					
Interest expense	10,736	33	1	—	10,770
Equity in earnings of consolidated subsidiaries	(7,967)	—	—	7,967	—
Other items, net	(548)	(711)	46	—	(1,213)
Total other income and expenses, net	2,221	(678)	47	7,967	9,557
Income (loss) before income taxes	18,836	4,260	5,780	(7,967)	20,909
Income taxes (benefit)	3,313	1,891	182	—	5,386
Net income (loss)	\$15,523	\$2,369	\$5,598	\$(7,967)	\$15,523

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Choice Hotels International, Inc.
Condensed Consolidating Statement of Income
For the Three Months Ended March 31, 2012
(Unaudited, in Thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUES:					
Royalty fees	\$42,126	\$26,220	\$7,058	\$(27,551)	\$47,853
Initial franchise and relicensing fees	2,433	—	95	—	2,528
Procurement services	3,148	—	167	—	3,315
Marketing and reservation	59,653	72,684	4,387	(65,795)	70,929
Other items, net	3,441	978	125	—	4,544
Total revenues	110,801	99,882	11,832	(93,346)	129,169
OPERATING EXPENSES:					
Selling, general and administrative	24,487	22,828	4,585	(27,551)	24,349
Marketing and reservation	61,554	69,797	4,270	(64,692)	70,929
Other items, net	706	1,901	219	—	2,826
Total operating expenses	86,747	94,526	9,074	(92,243)	98,104
Operating income	24,054	5,356	2,758	(1,103)	31,065
OTHER INCOME AND EXPENSES, NET:					
Interest expense	4,216	—	4	(1,103)	3,117
Equity in earnings of consolidated subsidiaries	(6,881)	—	—	6,881	—
Other items, net	(202)	(2,003)	(80)	—	(2,285)
Total other income and expenses, net	(2,867)	(2,003)	(76)	5,778	832
Income before income taxes	26,921	7,359	2,834	(6,881)	30,233
Income taxes	6,924	3,058	254	—	10,236
Net income	\$19,997	\$4,301	\$2,580	\$(6,881)	\$19,997

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Choice Hotels International, Inc.
 Condensed Consolidating Statement of Comprehensive Income
 For the Three Months Ended March 31, 2013
 (Unaudited, in Thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income	\$15,523	\$2,369	\$5,598	\$(7,967)	\$15,523
Other comprehensive income (loss), net of tax:					
Amortization of loss on cash flow hedge	215	—	—	—	215
Foreign currency translation adjustment, net	(232)	—	(232)	232	(232)
Other comprehensive income (loss), net of tax	(17)	—	(232)	232	(17)
Comprehensive income	\$15,506	\$2,369	\$5,366	\$(7,735)	\$15,506

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Choice Hotels International, Inc.
Condensed Consolidating Statement of Comprehensive Income
For the Three Months Ended March 31, 2012
(Unaudited, in Thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income	\$19,997	\$4,301	\$2,580	\$(6,881)	) \$19,997
Other comprehensive income (loss), net of tax:					
Amortization of loss on cash flow hedge	215	—	—	—	) 215
Foreign currency translation adjustment, net	412	6	391	(397)	) 412
Amortization of pension related costs, net of tax:					
Actuarial loss	20	20	—	(20)	) 20
Other comprehensive income, net of tax	647	26	391	(417)) 647
Comprehensive income	\$20,644	\$4,327	\$2,971	\$(7,298)) \$20,644

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Choice Hotels International, Inc.
Condensed Consolidating Balance Sheet
As of March 31, 2013
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Cash and cash equivalents	\$5,185	\$328	\$134,712	\$—	\$140,225
Receivables, net	47,025	1,244	5,933	—	54,202
Other current assets	39,257	20,628	3,609	(18,148)	45,346
Total current assets	91,467	22,200	144,254	(18,148)	239,773
Property and equipment, at cost, net	13,445	56,844	1,000	—	71,289
Goodwill	60,620	5,193	—	—	65,813
Franchise rights and other identifiable intangibles, net	8,064	2,561	1,925	—	12,550
Receivable – marketing and reservation fees	51,297	—	—	—	51,297
Investments, employee benefit plans, at fair value	—	13,933	—	—	13,933
Investment in affiliates	338,267	26,027	—	(364,294)	—
Advances to affiliates	13,840	193,247	9,649	(216,736)	—
Deferred income taxes	—	28,538	637	(14,206)	14,969
Other assets	31,349	19,034	25,966	—	76,349
Total assets	\$608,349	\$367,577	\$183,431	\$(613,384)	\$545,973
LIABILITIES AND SHAREHOLDERS' DEFICIT					
Accounts payable	\$11,351	\$43,176	\$4,902	\$—	\$59,429
Accrued expenses	19,116	14,255	1,763	—	35,134
Deferred revenue	19,536	55,912	868	—	76,316
Current portion of long-term debt	7,500	680	21	—	8,201
Deferred compensation & retirement plan obligations	—	2,361	—	—	2,361
Other current liabilities	—	19,097	601	(18,148)	1,550
Total current liabilities	57,503	135,481	8,155	(18,148)	182,991
Long-term debt	861,398	1,674	42	—	863,114
Deferred compensation & retirement plan obligations	—	19,933	7	—	19,940
Advances from affiliates	208,942	249	7,545	(216,736)	—
Other liabilities	19,835	13,418	210	(14,206)	19,257
Total liabilities	1,147,678	170,755	15,959	(249,090)	1,085,302
Total shareholders' (deficit) equity	(539,329)	196,822	167,472	(364,294)	(539,329)
Total liabilities and shareholders' deficit	\$608,349	\$367,577	\$183,431	\$(613,384)	\$545,973

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Choice Hotels International, Inc.
Condensed Consolidating Balance Sheet
As of December 31, 2012
(In Thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Cash and cash equivalents	\$8,420	\$407	\$125,350	\$—	\$134,177
Receivables, net	44,344	1,797	6,129	—	52,270
Other current assets	41,897	20,110	3,528	(18,512)	47,023
Total current assets	94,661	22,314	135,007	(18,512)	233,470
Property and equipment, at cost, net	11,307	39,298	1,046	—	51,651
Goodwill	60,620	5,193	—	—	65,813
Franchise rights and other identifiable intangibles, net	8,669	2,715	2,089	—	13,473
Receivable - marketing and reservation fees	42,179	—	—	—	42,179
Investments, employee benefit plans, at fair value	—	12,755	—	—	12,755
Investment in affiliates	329,038	26,194	—	(355,232)	—
Advances to affiliates	14,252	206,770	13,479	(234,501)	—
Deferred income taxes	—	28,539	640	(13,761)	15,418
Other assets	32,085	18,925	25,003	—	76,013
Total assets	\$592,811	\$362,703	\$177,264	\$(622,006)	\$510,772
LIABILITIES AND SHAREHOLDERS' DEFICIT					
Accounts payable	\$5,930	\$28,525	\$4,259	\$—	\$38,714
Accrued expenses	18,582	34,576	2,394	—	55,552
Deferred revenue	17,239	53,081	834	—	71,154
Current portion of long-term debt	7,500	675	20	—	8,195
Deferred compensation and retirement plan obligations	—	2,522	—	—	2,522
Other current liabilities	—	17,722	790	(18,512)	—
Total current liabilities	49,251	137,101	8,297	(18,512)	176,137
Long-term debt	845,257	1,845	48	—	847,150
Deferred compensation & retirement plan obligations	—	20,390	9	—	20,399
Advances from affiliates	226,917	189	7,395	(234,501)	—
Other liabilities	20,290	9,216	245	(13,761)	15,990
Total liabilities	1,141,715	168,741	15,994	(266,774)	1,059,676
Total shareholders' (deficit) equity	(548,904)	193,962	161,270	(355,232)	(548,904)
Total liabilities and shareholders' deficit	\$592,811	\$362,703	\$177,264	\$(622,006)	\$510,772

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Choice Hotels International, Inc.
Condensed Consolidating Statement of Cash Flows
For the Three Months Ended March 31, 2013
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided (used) by operating activities	\$(17,180)	\$9,216	\$ 9,838	\$—	\$1,874
CASH FLOWS FROM INVESTING ACTIVITIES:					
Investment in property and equipment	(2,328)	(11,237)	(80)	—	(13,645)
Equity method investments	—	—	(1,000)	—	(1,000)
Issuance of notes receivable	—	(1,484)	(245)	—	(1,729)
Collections of notes receivable	19	—	—	—	19
Purchases of investments, employee benefit plans	—	(1,242)	—	—	(1,242)
Proceeds from sales of investments, employee benefit plans	—	3,882	—	—	3,882
Advances to and investments in affiliates	(1,000)	—	—	1,000	—
Other items, net	(101)	—	—	—	(101)
Net cash provided (used) by investing activities	(3,410)	(10,081)	(1,325)	1,000	(13,816)
CASH FLOWS FROM FINANCING ACTIVITIES:					
Net borrowings pursuant to revolving credit facilities	18,000	—	—	—	18,000
Repayments of long-term debt	(1,875)	(166)	(5)	—	(2,046)
Purchase of treasury stock	(3,634)	—	—	—	(3,634)
Dividends paid	(503)	—	—	—	(503)
Excess tax benefits from stock-based compensation	—	952	—	—	952
Proceeds from contributions from affiliates	—	—	1,000	(1,000)	—
Proceeds from exercise of stock options	5,367	—	—	—	5,367
Net cash provided (used) by financing activities	17,355	786	995	(1,000)	18,136
Net change in cash and cash equivalents	(3,235)	(79)	9,508	—	6,194
Effect of foreign exchange rate changes on cash and cash equivalents	—	—	(146)	—	(146)
Cash and cash equivalents at beginning of period	8,420	407	125,350	—	134,177
Cash and cash equivalents at end of period	\$5,185	\$328	\$ 134,712	\$—	\$140,225

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Choice Hotels International, Inc.
Condensed Consolidating Statement of Cash Flows
For the Three Months Ended March 31, 2012
(Unaudited, in Thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided (used) by operating activities	\$5,388	\$(3,265)	\$ 2,289	\$—	\$4,412
CASH FLOWS FROM INVESTING ACTIVITIES:					
Investment in property and equipment	(1,354)	(1,688)	(87)	—	(3,129)
Equity method investments	—	—	(2,600)	—	(2,600)
Issuance of notes receivable	(3,136)	(583)	—	—	(3,719)
Collections of notes receivable	44	107	—	—	151
Purchases of investments, employee benefit plans	—	(743)	—	—	(743)
Proceeds from sales of investments, employee benefit plans	—	8,652	—	—	8,652
Advances to and investments in affiliates	—	(2,623)	—	2,623	—
Other items, net	(108)	—	—	—	(108)
Net cash provided (used) in investing activities	(4,554)	3,122	(2,687)	2,623	(1,496)
CASH FLOWS FROM FINANCING ACTIVITIES:					
Net borrowings pursuant to revolving credit facility	5,900	—	—	—	5,900
Repayments of long-term debt	—	(161)	(5)	—	(166)
Purchase of treasury stock	(14,854)	—	—	—	(14,854)
Dividends paid	(10,713)	—	—	—	(10,713)
Excess tax benefits from stock-based compensation	—	422	—	—	422
Proceeds from contributions from affiliates	—	—	2,623	(2,623)	—
Proceeds from exercise of stock options	389	—	—	—	389
Net cash provided (used) by financing activities	(19,278)	261	2,618	(2,623)	(19,022)
Net change in cash and cash equivalents	(18,444)				