

DiamondRock Hospitality Co  
Form 10-Q/A  
December 07, 2009

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

**FORM 10-Q/A  
(Amendment No. 1)**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended June 19, 2009**  
**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.)**

**6903 Rockledge Drive, Suite 800, Bethesda,**  
**Maryland**  
**(Address of Principal Executive Offices)**

**20817**  
**(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, or a smaller reporting company. See definition 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

(Do not check if a 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

The registrant had 107,972,100 shares of its \$0.01 par value common stock outstanding as of July 28, 2009.



### EXPLANATORY NOTE

We are filing this Amendment No.1 (this Amendment ) to our Quarterly Report on Form 10-Q for the quarter ended June 19, 2009 (the Original Form 10-Q ), as filed with the Securities and Exchange Commission, or SEC, on July 28, 2009:

to amend the certifications of the Chief Executive Officer and Chief Financial Officer filed as Exhibits 31.1 and 31.2 to the Original 10-Q, which inadvertently omitted certain introductory language of paragraph 4 of Item 601(b)(31) of Regulation S-K, and

to file as exhibit 10.1 to this Amendment, the Sales Agreement, dated July 27, 2009 by and among DiamondRock Hospitality Company, DiamondRock Hospitality Limited Partnership and Cantor Fitzgerald & Co. (originally filed as an exhibit to the Company s Current Report on Form 8-K filed with the SEC on July 27, 2009), in its entirety, including all schedules and exhibits thereto.

This Amendment should be read in conjunction with the Original Form 10-Q, which continues to speak as of the date that the Original Form 10-Q was filed. Except as specifically noted above, this Amendment does not modify or update any disclosures in the Original Form 10-Q. Accordingly, this Amendment does not reflect events occurring after the filing of the Original Form 10-Q or modify or update any disclosures that may have been affected by subsequent events.

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**DIAMONDROCK HOSPITALITY COMPANY**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**As of June 19, 2009 and December 31, 2008**  
**(in thousands, except share amounts)**

|                                 | <b>June 19, 2009</b><br>(Unaudited) | <b>December 31,</b><br><b>2008</b> |
|---------------------------------|-------------------------------------|------------------------------------|
| <b>ASSETS</b>                   |                                     |                                    |
| Property and equipment, at cost | \$ 2,158,448                        | \$ 2,146,616                       |
| Less: accumulated depreciation  | (264,946)                           | (226,400)                          |
|                                 | 1,893,502                           | 1,920,216                          |
| Deferred financing costs, net   | 2,949                               | 3,335                              |
| Restricted cash                 | 30,176                              | 30,060                             |
| Due from hotel managers         | 53,297                              | 61,062                             |
| Favorable lease assets, net     | 38,983                              | 40,619                             |
| Prepaid and other assets        | 38,219                              | 33,414                             |
| Cash and cash equivalents       | 51,557                              | 13,830                             |
| <br>                            |                                     |                                    |
| Total assets                    | <b>\$ 2,108,683</b>                 | <b>\$ 2,102,536</b>                |

**LIABILITIES AND STOCKHOLDERS EQUITY****Liabilities:**

|                                           |            |            |
|-------------------------------------------|------------|------------|
| Mortgage debt                             | \$ 819,385 | \$ 821,353 |
| Senior unsecured credit facility          |            | 57,000     |
| Total debt                                | 819,385    | 878,353    |
| Deferred income related to key money, net | 20,067     | 20,328     |
| Unfavorable contract liabilities, net     | 83,610     | 84,403     |
| Due to hotel managers                     | 32,185     | 35,196     |
| Accounts payable and accrued expenses     | 54,189     | 66,624     |
| <br>                                      |            |            |
| Total other liabilities                   | 190,051    | 206,551    |

**Stockholders Equity:**

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|                                                                                                                                                                             |                     |                     |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| Preferred stock, \$.01 par value; 10,000,000 shares authorized; no shares issued and outstanding                                                                            |                     |                     |
| Common stock, \$.01 par value; 200,000,000 shares authorized; 107,972,100 and 90,050,264 shares issued and outstanding at June 19, 2009 and December 31, 2008, respectively | 1,080               | 901                 |
| Additional paid-in capital                                                                                                                                                  | 1,184,893           | 1,100,541           |
| Accumulated deficit                                                                                                                                                         | (86,726)            | (83,810)            |
| <br>                                                                                                                                                                        |                     |                     |
| Total stockholders' equity                                                                                                                                                  | 1,099,247           | 1,017,632           |
| <br>                                                                                                                                                                        |                     |                     |
| Total liabilities and stockholders' equity                                                                                                                                  | <b>\$ 2,108,683</b> | <b>\$ 2,102,536</b> |

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

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**DIAMONDROCK HOSPITALITY COMPANY**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Fiscal Quarters Ended June 19, 2009 and June 13, 2008 and**  
**the Periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008**  
**(in thousands, except per share amounts)**

|                                     | <b>Fiscal<br/>Quarter<br/><br/>Ended<br/>June 19,<br/>2009<br/>(Unaudited)</b> | <b>Fiscal<br/>Quarter<br/><br/>Ended<br/>June 13,<br/>2008<br/>(Unaudited)</b> | <b>Period from<br/>January 1, 2009<br/>to<br/>June 19, 2009<br/>(Unaudited)</b> | <b>Period from<br/>January 1, 2008<br/>to<br/>June 13, 2008<br/>(Unaudited)</b> |
|-------------------------------------|--------------------------------------------------------------------------------|--------------------------------------------------------------------------------|---------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| <b>Revenues:</b>                    |                                                                                |                                                                                |                                                                                 |                                                                                 |
| Rooms                               | \$ 90,228                                                                      | \$ 116,011                                                                     | \$ 165,343                                                                      | \$ 201,938                                                                      |
| Food and beverage                   | 44,697                                                                         | 55,532                                                                         | 81,587                                                                          | 95,614                                                                          |
| Other                               | 8,682                                                                          | 9,473                                                                          | 15,221                                                                          | 16,327                                                                          |
| <br>                                |                                                                                |                                                                                |                                                                                 |                                                                                 |
| Total revenues                      | 143,607                                                                        | 181,016                                                                        | 262,151                                                                         | 313,879                                                                         |
| <br>                                |                                                                                |                                                                                |                                                                                 |                                                                                 |
| <b>Operating Expenses:</b>          |                                                                                |                                                                                |                                                                                 |                                                                                 |
| Rooms                               | 22,974                                                                         | 26,249                                                                         | 42,956                                                                          | 47,408                                                                          |
| Food and beverage                   | 30,320                                                                         | 36,377                                                                         | 56,901                                                                          | 65,305                                                                          |
| Management fees                     | 5,008                                                                          | 8,048                                                                          | 8,336                                                                           | 13,013                                                                          |
| Other hotel expenses                | 50,516                                                                         | 55,189                                                                         | 96,540                                                                          | 101,641                                                                         |
| Impairment of favorable lease asset | 1,286                                                                          |                                                                                | 1,286                                                                           |                                                                                 |
| Depreciation and amortization       | 19,729                                                                         | 18,069                                                                         | 38,446                                                                          | 34,756                                                                          |
| Corporate expenses                  | 3,651                                                                          | 3,345                                                                          | 7,419                                                                           | 6,305                                                                           |
| <br>                                |                                                                                |                                                                                |                                                                                 |                                                                                 |
| Total operating expenses            | 133,484                                                                        | 147,277                                                                        | 251,884                                                                         | 268,428                                                                         |
| <br>                                |                                                                                |                                                                                |                                                                                 |                                                                                 |
| <b>Operating profit</b>             | <b>10,123</b>                                                                  | <b>33,739</b>                                                                  | <b>10,267</b>                                                                   | <b>45,451</b>                                                                   |
| <br>                                |                                                                                |                                                                                |                                                                                 |                                                                                 |
| <b>Other Expenses (Income):</b>     |                                                                                |                                                                                |                                                                                 |                                                                                 |
| Interest income                     | (101)                                                                          | (332)                                                                          | (183)                                                                           | (770)                                                                           |
| Interest expense                    | 11,086                                                                         | 11,430                                                                         | 22,584                                                                          | 22,125                                                                          |
| <br>                                |                                                                                |                                                                                |                                                                                 |                                                                                 |
| Total other expenses                | 10,985                                                                         | 11,098                                                                         | 22,401                                                                          | 21,355                                                                          |

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|                                          |          |           |            |           |
|------------------------------------------|----------|-----------|------------|-----------|
| <b>(Loss) income before income taxes</b> | (862)    | 22,641    | (12,134)   | 24,096    |
| Income tax benefit (expense)             | 3,319    | (886)     | 9,297      | 2,836     |
| <b>Net income (loss)</b>                 | \$ 2,457 | \$ 21,755 | \$ (2,837) | \$ 26,932 |

**Earnings (loss) per share:**

|                                             |         |         |           |         |
|---------------------------------------------|---------|---------|-----------|---------|
| Basic and diluted earnings (loss) per share | \$ 0.02 | \$ 0.23 | \$ (0.03) | \$ 0.28 |
|---------------------------------------------|---------|---------|-----------|---------|

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

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**DIAMONDROCK HOSPITALITY COMPANY**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Periods from January 1, 2009 to June 18, 2009 and January 1, 2008 to June 13, 2008**  
**(in thousands)**

|                                                                                          | <b>Period from<br/>January 1, 2009<br/>to<br/>June 19, 2009<br/>(Unaudited)</b> | <b>Period from<br/>January 1, 2008<br/>to<br/>June 13, 2008<br/>(Unaudited)</b> |
|------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| <b>Cash flows from operating activities:</b>                                             |                                                                                 |                                                                                 |
| Net (loss) income                                                                        | \$ (2,837)                                                                      | \$ 26,932                                                                       |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: |                                                                                 |                                                                                 |
| Real estate depreciation                                                                 | 38,446                                                                          | 34,756                                                                          |
| Corporate asset depreciation as corporate expenses                                       | 67                                                                              | 75                                                                              |
| Non-cash ground rent                                                                     | 3,570                                                                           | 3,550                                                                           |
| Non-cash financing costs as interest                                                     | 386                                                                             | 372                                                                             |
| Impairment of favorable lease asset                                                      | 1,286                                                                           |                                                                                 |
| Amortization of unfavorable contract liabilities                                         | (794)                                                                           | (794)                                                                           |
| Amortization of deferred income                                                          | (260)                                                                           | (253)                                                                           |
| Stock-based compensation                                                                 | 2,532                                                                           | 1,567                                                                           |
| Yield support received                                                                   |                                                                                 | 797                                                                             |
| Changes in assets and liabilities:                                                       |                                                                                 |                                                                                 |
| Prepaid expenses and other assets                                                        | (3,565)                                                                         | (4,022)                                                                         |
| Restricted cash                                                                          | 123                                                                             | (582)                                                                           |
| Due to/from hotel managers                                                               | 4,754                                                                           | (5,966)                                                                         |
| Accounts payable and accrued expenses                                                    | (13,457)                                                                        | (8,455)                                                                         |
| <b>Net cash provided by operating activities</b>                                         | <b>30,251</b>                                                                   | <b>47,977</b>                                                                   |
| <b>Cash flows from investing activities:</b>                                             |                                                                                 |                                                                                 |
| Hotel capital expenditures                                                               | (13,265)                                                                        | (36,766)                                                                        |
| Receipt of deferred key money                                                            |                                                                                 | 5,000                                                                           |
| Change in restricted cash                                                                | (970)                                                                           | (1,820)                                                                         |
| <b>Net cash used in investing activities</b>                                             | <b>(14,235)</b>                                                                 | <b>(33,586)</b>                                                                 |
| <b>Cash flows from financing activities:</b>                                             |                                                                                 |                                                                                 |
| Repayments of credit facility                                                            | (57,000)                                                                        | (15,000)                                                                        |
| Draws on credit facility                                                                 |                                                                                 | 47,000                                                                          |
| Scheduled mortgage debt principal payments                                               | (1,968)                                                                         | (1,413)                                                                         |
| Repurchase of shares                                                                     | (159)                                                                           | (3,184)                                                                         |
| Proceeds from sale of common stock                                                       | 82,562                                                                          |                                                                                 |
| Payment of costs related to sale of common stock                                         | (404)                                                                           |                                                                                 |

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|                                                            |               |    |                 |
|------------------------------------------------------------|---------------|----|-----------------|
| Payment of financing deposits                              | (1,240)       |    |                 |
| Payment of dividends                                       | (80)          |    | (46,630)        |
| <b>Net cash provided by (used in) financing activities</b> | <b>21,711</b> |    | <b>(19,227)</b> |
| Net increase (decrease) in cash and cash equivalents       | 37,727        |    | (4,836)         |
| Cash and cash equivalents, beginning of period             | 13,830        |    | 29,773          |
| Cash and cash equivalents, end of period                   | \$ 51,557     | \$ | 24,937          |
| <b>Supplemental Disclosure of Cash Flow Information:</b>   |               |    |                 |
| Cash paid for interest                                     | \$ 23,819     | \$ | 24,176          |
| Cash paid for income taxes                                 | \$ 868        | \$ | 861             |
| Capitalized interest                                       | \$ 19         | \$ | 183             |
| <b>Non-Cash Financing Activities:</b>                      |               |    |                 |
| Unpaid dividends                                           | \$            | \$ | 23,923          |

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

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**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, as of July 28, 2009, 20 premium hotels and resorts that contain approximately 9,600 guestrooms. We are committed to maximizing stockholder value through investing in premium full-service hotels and, to a lesser extent, premium urban limited-service hotels located throughout the United States. Our hotels are concentrated in key gateway cities and in destination resort locations and are all operated under a brand owned by one of the top three lodging national brand companies (Marriott International, Inc. ( Marriott ), Starwood Hotels & Resorts Worldwide, Inc. ( Starwood ) or Hilton Hotels Corporation ( Hilton )).

We are owners, as opposed to operators, of hotels. As an owner, we receive all of the operating profits or losses generated by our hotels, after we pay the hotel managers fees, which are based on the revenues and profitability of the hotels, and reimburse all of their direct and indirect operating costs.

As of June 19, 2009, we owned 20 hotels, comprising 9,586 rooms, located in the following markets: Atlanta, Georgia (3); Austin, Texas; Boston, Massachusetts; Chicago, Illinois (2); Fort Worth, Texas; Lexington, Kentucky; Los Angeles, California (2); New York, New York (2); Northern California; Oak Brook, Illinois; Orlando, Florida; Salt Lake City, Utah; Washington D.C.; St. Thomas, U.S. Virgin Islands; and Vail, Colorado.

We conduct our business through a traditional umbrella partnership REIT, or UPREIT, in which our hotel properties are owned by our operating partnership, DiamondRock Hospitality Limited Partnership, or subsidiaries of our operating partnership. We are the sole general partner of the operating partnership and currently own, either directly or indirectly, all of the limited partnership units of the 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 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 consolidated financial statements and notes thereto as of and for the year ended December 31, 2008, included in our Annual Report on Form 10-K dated February 27, 2009.

In our opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly our financial position as of June 19, 2009, the results of our operations for the fiscal quarters ended June 19, 2009 and June 13, 2008 and the periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008 and cash flows for the periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008. 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.

*Reporting Periods*

The results we report in our condensed consolidated statements of operations are based on results of our hotels reported to us by our hotel managers. Our hotel managers use different reporting periods. Marriott, the manager of most of our properties, uses a fiscal year ending on the Friday closest to December 31 and reports twelve weeks of operations for each of the first three quarters and sixteen or seventeen weeks for the fourth quarter of the year for its domestic managed hotels. In contrast, Marriott, for its non-domestic hotels (including Frenchman s Reef), Vail Resorts, manager of the Vail Marriott, Davidson Hotel Company, manager of the Westin Atlanta North at Perimeter, Hilton Hotels Corporation, manager of the Conrad Chicago, and Westin Hotel Management, L.P, manager of the Westin Boston Waterfront Hotel report results on a monthly basis. Additionally, as a REIT, we are required by U.S. federal tax laws to report results on a calendar year basis. As a result, we have adopted the reporting periods used by Marriott for its domestic hotels, except that the fiscal year always ends on December 31 to comply with REIT rules.

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The first three fiscal quarters end on the same day as Marriott's fiscal quarters but the fourth quarter ends on December 31 and the full year results, as reported in the statement of operations, always include the same number of days as the calendar year.

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Two consequences of the reporting cycle we have adopted are: (1) quarterly start dates will usually differ between years, except for the first quarter which always commences on January 1, and (2) the first and fourth quarters of operations and year-to-date operations may not include the same number of days as reflected in prior years.

While the reporting calendar we adopted is more closely aligned with the reporting calendar used by the manager of most of our properties, one final consequence of the calendar is we are unable to report any results for Frenchman's Reef, Vail Marriott, Westin Atlanta North at Perimeter, Conrad Chicago, or Westin Boston Waterfront Hotel for the month of operations that ends after its fiscal quarter-end because neither Westin Hotel Management, L.P., Hilton Hotels Corporation, Davidson Hotel Company, Vail Resorts nor Marriott make mid-month results available to us. As a result, our quarterly results of operations include results from Frenchman's Reef, the Vail Marriott, the Westin Atlanta North at Perimeter, the Conrad Chicago, and the Westin Boston Waterfront Hotel as follows: first quarter (January, February), second quarter (March to May), third quarter (June to August) and fourth quarter (September to December). While this does not affect full-year results, it does affect the reporting of quarterly results.

*Revenue Recognition*

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

*Earnings (Loss) Per Share*

Basic earnings (loss) per share is calculated by dividing net income (loss), adjusted for dividends on unvested stock grants, by the weighted-average number of common shares outstanding during the period. Diluted earnings (loss) per share is calculated by dividing net income (loss), adjusted for dividends on unvested stock grants, by the weighted-average number of common shares outstanding during the period plus other potentially dilutive securities such as stock grants 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.

We implemented the provisions of FASB Staff Position EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities*, which resulted in no significant impact on current or prior period earnings (loss) per share.

*Stock-based Compensation*

We account for stock-based employee compensation using the fair value based method of accounting under Statement of Financial Accounting Standards No. 123 (revised 2004) (SFAS 123R), *Share-Based Payment*. We record the cost of awards with service conditions based on the grant-date fair value of the award. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. No awards with performance-based or market-based conditions have been issued.

*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 review these assets for impairment if events or circumstances indicate that the asset may be impaired.

We have a favorable lease asset with an indefinite life related to the right to enter into a favorable lease under our option to develop a hotel on an undeveloped parcel of land adjacent to the Westin Boston Waterfront Hotel. The fair value estimate of the favorable lease uses a discounted cash flow method. Inputs to the estimate include observable market inputs, including current ground lease rates and discount rates, and unobservable inputs such as estimated future hotel revenues. The fair market value of the ground lease declined from \$12.1 million to \$10.8 million as of June 19, 2009 and we have recorded an impairment loss of \$1.3 million during the fiscal quarter ended June 19, 2009.

**Table of Contents***Straight-Line Rent*

We record rent expense on leases that provide for minimum rental payments that increase in pre-established amounts over the remaining term of the lease on a straight-line basis as required by U.S. GAAP.

*Concentration of Credit Risk*

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents. We maintain cash and cash equivalents with various high credit-quality financial institutions. We perform periodic evaluations of the relative credit standing of these financial institutions and limit the amount of credit exposure with any one institution.

*Use of Estimates*

The preparation of 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.

*Risks and Uncertainties*

The state of the overall economy can significantly impact hotel operational performance and thus, impact our financial position. Should any of our hotels experience a significant decline in operational performance, it may affect our ability to make distributions to our stockholders and service debt or meet other financial obligations.

**3. Property and Equipment**

Property and equipment as of June 19, 2009 (unaudited) and December 31, 2008 consists of the following (in thousands):

|                                    | <b>June 19, 2009</b> | <b>December 31,<br/>2008</b> |
|------------------------------------|----------------------|------------------------------|
| Land                               | \$ 219,590           | \$ 219,590                   |
| Land improvements                  | 7,994                | 7,994                        |
| Buildings                          | 1,664,897            | 1,658,227                    |
| Furniture, fixtures and equipment  | 264,933              | 259,154                      |
| CIP and corporate office equipment | 1,034                | 1,651                        |
|                                    | 2,158,448            | 2,146,616                    |
| Less: accumulated depreciation     | (264,946)            | (226,400)                    |
|                                    | <b>\$ 1,893,502</b>  | <b>\$ 1,920,216</b>          |

As of June 19, 2009, we did not have any accrued capital expenditures. As of December 31, 2008, we had accrued capital expenditures of \$2.6 million.

**4. Capital Stock***Common Shares*

We are authorized to issue up to 200,000,000 shares of common stock, \$.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.

On April 17, 2009, we completed a follow-on public offering of our common stock. We sold 17,825,000 shares of common stock, including the underwriters' overallotment of 2,325,000 shares, at an offering price of \$4.85 per share. The net proceeds to us, after deduction of offering costs, were approximately \$82.1 million.

**Table of Contents***Preferred Shares*

We are authorized to issue up to 10,000,000 shares of preferred stock, \$.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 19, 2009 and December 31, 2008, there were no shares of preferred stock outstanding.

*Operating Partnership Units*

Holders of operating partnership units have certain redemption rights, which 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 19, 2009 and December 31, 2008, there were no operating partnership units held by unaffiliated third parties.

**5. Stock Incentive Plans**

As of June 19, 2009, we have issued or committed to issue 3,194,151 shares of our common stock under our 2004 Stock Option and Incentive Plan, as amended, including 1,978,595 shares of unvested restricted common stock and a commitment to issue 466,819 units of deferred common stock.

*Restricted Stock Awards*

As of June 19, 2009, our officers and employees have been awarded 3,066,967 shares of restricted common stock, including those shares which have since vested. Shares issued to our officers and employees 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, 2009 to June 19, 2009 is as follows:

|                                     | <b>Number of<br/>Shares</b> | <b>Weighted-<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|-------------------------------------|-----------------------------|------------------------------------------------------------|
| Unvested balance at January 1, 2009 | 605,809                     | \$ 13.02                                                   |
| Granted                             | 1,515,955                   | 2.82                                                       |
| Vested                              | (135,985)                   | 15.29                                                      |
| Forfeited                           | (7,184)                     | 14.61                                                      |
| Unvested balance at June 19, 2009   | 1,978,595                   | \$ 5.04                                                    |

The remaining share awards are expected to vest as follows: 62,748 shares during 2009, 631,082 shares during 2010, 779,448 shares during 2011 and 505,317 during 2012. As of June 19, 2009, the unrecognized compensation cost related to restricted stock awards was \$7.5 million and the weighted-average period over which the unrecognized compensation expense will be recorded is approximately 26 months. For the fiscal quarters ended June 19, 2009 and June 13, 2008, we recorded \$1.2 million and \$0.7 million, respectively, of compensation expense related to restricted stock awards. For the periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008, we recorded \$2.2 million and \$1.4 million, respectively, of compensation expense related to restricted stock awards.

*Deferred Stock Awards*

At the time of our initial public offering, we made a commitment to issue 382,500 shares of deferred stock units to our senior executive officers. These deferred stock units are fully vested and represent the promise to issue a number of shares of our common stock to each senior executive officer upon the earlier of (i) a change of control or (ii) five years after the date of grant, which was the initial public offering completion date (the Deferral Period). However, if an

executive's service with the Company is terminated for cause prior to the expiration of the Deferral Period, all deferred stock unit awards will be forfeited. The executive officers are restricted from transferring these shares until the fifth anniversary of the initial public offering completion date. As of June 19, 2009, we have a commitment to issue 466,819 shares under this plan. The share commitment increased from 382,500 to 466,819 since our initial public offering because current dividends are not paid out but instead are effectively reinvested in additional deferred stock units based on the closing price of our common stock on the dividend payment date.

**Table of Contents***Stock Appreciation Rights and Dividend Equivalent Rights*

In 2008, we awarded our executive officers stock-settled stock appreciation rights ( SARs ) and dividend equivalent rights ( DERs ). The SARs/DERs vest over three years based on continued employment and may be exercised, in whole or in part, at any time after the instrument vests and before the tenth anniversary of issuance. As of June 19, 2009, we have awarded 300,225 SARs/DERs to our executive officers with an aggregate grant date fair value of approximately \$2.0 million. For the fiscal quarters ended June 19, 2009 and June 13, 2008, we recorded approximately \$0.2 million and \$0.1 million, respectively, of compensation expense related to the SARs/DERs. For the periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008, we recorded approximately \$0.3 million and \$0.2 million, respectively, of compensation expense related to the SARs/DERs. A summary of our SARs/DERs as of June 19, 2009 is as follows:

|                            | <b>Number of<br/>SARs/DERs</b> | <b>Weighted-<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|----------------------------|--------------------------------|------------------------------------------------------------|
| Balance at January 1, 2009 | 300,225                        | \$ 6.62                                                    |
| Granted                    |                                |                                                            |
| Exercised                  |                                |                                                            |
| Balance at June 19, 2009   | 300,225                        | \$ 6.62                                                    |

One-third of the SAR/DER awards vested in 2009 and the remainder are expected to vest as follows: one-third in 2010 and one-third in 2011. As of June 19, 2009, the unrecognized compensation cost related to the SAR/DER awards was \$1.1 million and the weighted-average period over which the unrecognized compensation expense will be recorded is approximately 23 months.

**6. Earnings (Loss) Per Share**

Basic earnings (loss) per share is calculated by dividing net income (loss) available to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings (loss) per share is calculated by dividing net (loss) income available to common stockholders, that has been adjusted for dilutive securities, by the weighted-average number of common shares outstanding including dilutive securities. No effect is shown for our restricted stock and SAR s when the impact is anti-dilutive.

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

|                                                                          | <b>Fiscal<br/>Quarter<br/><br/>Ended<br/>June 19, 2009<br/>(unaudited)</b> | <b>Fiscal<br/>Quarter<br/><br/>Ended<br/>June 13, 2008<br/>(unaudited)</b> | <b>Period from<br/>January 1, 2009<br/>to<br/>June 19, 2009<br/>(unaudited)</b> | <b>Period from<br/>January 1, 2008<br/>to<br/>June 13, 2008<br/>(unaudited)</b> |
|--------------------------------------------------------------------------|----------------------------------------------------------------------------|----------------------------------------------------------------------------|---------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| <b>Basic Earnings (Loss) per Share<br/>Calculation:</b>                  |                                                                            |                                                                            |                                                                                 |                                                                                 |
| Numerator:                                                               |                                                                            |                                                                            |                                                                                 |                                                                                 |
| Net income (loss)                                                        | \$ 2,457                                                                   | \$ 21,755                                                                  | \$ (2,837)                                                                      | \$ 26,932                                                                       |
| Less: dividends on unvested restricted<br>common stock                   |                                                                            | (119)                                                                      |                                                                                 | (237)                                                                           |
| Net income (loss) after dividends on<br>unvested restricted common stock | \$ 2,457                                                                   | \$ 21,636                                                                  | \$ (2,837)                                                                      | \$ 26,695                                                                       |

|                                                                       |             |            |            |            |
|-----------------------------------------------------------------------|-------------|------------|------------|------------|
| Weighted-average number of common shares outstanding basic            | 104,194,871 | 95,212,142 | 97,292,933 | 95,195,961 |
| Basic earnings (loss) per share                                       | \$ 0.02     | \$ 0.23    | \$ (0.03)  | \$ 0.28    |
| <b>Diluted Earnings (Loss) per Share Calculation:</b>                 |             |            |            |            |
| Numerator:                                                            |             |            |            |            |
| Net income (loss)                                                     | \$ 2,457    | \$ 21,755  | \$ (2,837) | \$ 26,932  |
| Less: dividends on unvested restricted common stock                   |             | (119)      |            | (237)      |
| Net income (loss) after dividends on unvested restricted common stock | \$ 2,457    | \$ 21,636  | \$ (2,837) | \$ 26,695  |
| Weighted-average number of common shares outstanding basic            | 104,194,871 | 95,212,142 | 97,292,933 | 95,195,961 |
| Unvested restricted common stock                                      | 666,921     |            |            |            |
| Unvested SARs                                                         |             |            |            |            |
| Weighted-average number of common shares outstanding diluted          | 104,861,792 | 95,212,142 | 97,292,933 | 95,195,961 |
| Diluted earnings (loss) per share                                     | \$ 0.02     | \$ 0.23    | \$ (0.03)  | \$ 0.28    |

**Table of Contents****7. Debt**

We have incurred limited recourse, property specific mortgage debt in conjunction with certain of our hotels. In the event of default, the lender may only foreclose on the pledged assets; however, in the event of fraud, misapplication of funds and other customary recourse provisions, the lender may seek payment from us. As of June 19, 2009, 12 of our 20 hotel properties were secured by mortgage debt. Our mortgage debt contains certain property specific covenants and restrictions, including minimum debt service coverage ratios that trigger cash management provisions as well as restrictions on incurring additional debt without lender consent. As of June 19, 2009, we were in compliance with the financial covenants of our mortgage debt.

The following table sets forth information regarding the Company's debt as of June 19, 2009 (unaudited), in thousands:

| <b>Property</b>                                       | <b>Principal Balance</b> | <b>Interest Rate</b>                     |
|-------------------------------------------------------|--------------------------|------------------------------------------|
| Courtyard Manhattan / Midtown East                    | \$ 40,706                | 5.195%                                   |
| Marriott Salt Lake City Downtown                      | 33,781                   | 5.50%                                    |
| Courtyard Manhattan / Fifth Avenue                    | 51,000                   | 6.48%                                    |
| Marriott Griffin Gate Resort                          | 28,066                   | 5.11%                                    |
| Renaissance Worthington                               | 57,400                   | 5.40%                                    |
| Frenchman's Reef & Morning Star Marriott Beach Resort | 61,832                   | 5.44%                                    |
| Marriott Los Angeles Airport                          | 82,600                   | 5.30%                                    |
| Orlando Airport Marriott                              | 59,000                   | 5.68%                                    |
| Chicago Marriott Downtown Magnificent Mile            | 220,000                  | 5.975%                                   |
| Renaissance Austin                                    | 83,000                   | 5.507%                                   |
| Renaissance Waverly                                   | 97,000                   | 5.503%                                   |
| Bethesda Marriott Suites                              | 5,000                    | LIBOR + 0.95 (1.27% as of June 19, 2009) |
| Senior unsecured credit facility                      |                          | LIBOR + 0.95                             |
| <br>                                                  |                          |                                          |
| Total debt                                            | \$ 819,385               |                                          |
| <br>                                                  |                          |                                          |
| Weighted-Average Interest Rate                        |                          | 5.62%                                    |

The mortgage debt on the Courtyard Manhattan/Midtown East matures on December 11, 2009. We have signed a term sheet with Massachusetts Mutual Life Insurance Company ( MassMutual ) to provide a new \$43 million of non-recourse mortgage loan on the Courtyard Manhattan/Midtown East bearing an interest rate of 8.8% and a term of five years. We have provided \$1.2 million of refundable deposits to MassMutual, but the closing of the loan is subject to numerous closing conditions, including a material adverse change clause.

We are party to a four-year, \$200.0 million unsecured credit facility (the Facility ) expiring in February 2011. We may extend the maturity date of the Facility for an additional year upon the payment of applicable fees and the satisfaction of certain other customary conditions. As of June 19, 2009, we did not have an outstanding balance on the Facility.

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Interest is paid on the periodic advances under the Facility at varying rates, based upon either LIBOR or the alternate base rate, plus an agreed upon additional margin amount. The interest rate depends upon our level of outstanding indebtedness in relation to the value of our assets from time to time, as follows:

|                            | <b>Leverage Ratio</b>     |                       |                       |                          |
|----------------------------|---------------------------|-----------------------|-----------------------|--------------------------|
|                            | <b>60% or<br/>Greater</b> | <b>55% to<br/>60%</b> | <b>50% to<br/>55%</b> | <b>Less Than<br/>50%</b> |
| Alternate base rate margin | 0.65%                     | 0.45%                 | 0.25%                 | 0.00%                    |
| LIBOR margin               | 1.55%                     | 1.45%                 | 1.25%                 | 0.95%                    |

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

|                                                                   | <b>Covenant</b> | <b>Actual at<br/>June 19, 2009</b> |
|-------------------------------------------------------------------|-----------------|------------------------------------|
| Maximum leverage ratio(1)                                         | 65%             | 44.7%                              |
| Minimum fixed charge coverage ratio(2)                            | 1.6x            | 2.4x                               |
| Minimum tangible net worth(3)                                     | \$738.4 million | \$1.4 billion                      |
| Unhedged floating rate debt as a percentage of total indebtedness | 35%             | 0.6%                               |

(1) Maximum leverage ratio is determined by dividing the total debt outstanding by the net asset value of our corporate assets and hotels. Hotel level net asset values are calculated based on the application of a contractual capitalization rate (which range from 7.5% to 8.0%) to the trailing twelve month hotel net operating income.

(2) Minimum fixed charge ratio is calculated based

on the trailing  
four quarters.

- (3) Tangible net worth is defined as the gross book value of our real estate assets and other corporate assets less our total debt and all other corporate liabilities.

The Facility requires that we maintain a specific pool of unencumbered borrowing base properties. The unencumbered borrowing base assets are subject to the following limitations and covenants:

|                                                                  | <b>Covenant</b> | <b>Actual at<br/>June 19, 2009</b> |
|------------------------------------------------------------------|-----------------|------------------------------------|
| Minimum implied debt service ratio                               | 1.5x            | N/A                                |
| Maximum unencumbered leverage ratio                              | 65%             | 0%                                 |
| Minimum number of unencumbered borrowing base properties         | 4               | 8                                  |
| Minimum unencumbered borrowing base value                        | \$150 million   | \$579.5 million                    |
| Percentage of total asset value owned by borrowers or guarantors | 90%             | 100%                               |

In addition to the interest payable on amounts outstanding under the Facility, we are required to pay unused credit facility fees equal to 0.20% of the unused portion of the Facility if the unused portion of the Facility is greater than 50% or 0.125% of the unused portion of the Facility if the unused portion of the Facility is less than 50%. We incurred interest and unused credit facility fees on the Facility of \$0.1 million and \$0.4 million for the fiscal quarters ended June 19, 2009 and June 13, 2008, respectively, and \$0.4 million and \$0.6 million for the periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008, respectively.

### **8. Fair Value of Financial Instruments**

The fair value of certain financial assets and liabilities and other financial instruments as of June 19, 2009 and December 31, 2008, in thousands, are as follows:

|      | <b>As of June 19,<br/>2009</b> |                   | <b>As of December 31,<br/>2008</b> |                   |
|------|--------------------------------|-------------------|------------------------------------|-------------------|
|      | <b>Carrying<br/>Amount</b>     | <b>Fair Value</b> | <b>Carrying<br/>Amount</b>         | <b>Fair Value</b> |
| Debt | \$ 819,385                     | \$ 721,411        | \$ 878,353                         | \$ 750,899        |

### **9. Commitments and Contingencies**

#### *Litigation*

We are not involved in any material litigation nor, to our knowledge, is any material litigation threatened against us. We are involved in routine litigation arising out of the ordinary course of business, all of which is expected to be covered by insurance and none of which is expected to have a material impact on our financial condition or results of operations.

#### *Income Taxes*

We had no accruals for tax uncertainties as of June 19, 2009 and December 31, 2008. As of June 19, 2009, all of our federal income tax returns and state tax returns for the jurisdictions in which our hotels are located remain subject to examination by the respective jurisdiction tax authorities.



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**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 risk factors discussed herein and other factors discussed from time to time in our periodic filings with the Securities and Exchange Commission. 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**

We are a lodging-focused real estate company that owns, as of July 28, 2009, 20 premium hotels and resorts that contain approximately 9,600 guestrooms. We are committed to maximizing stockholder value through investing in premium full-service hotels and, to a lesser extent, premium urban limited-service hotels located throughout the United States. Our hotels are concentrated in key gateway cities and in destination resort locations and are all operated under a brand owned by one of the top three lodging national brand companies (Marriott, Starwood or Hilton). We are owners, as opposed to operators, of hotels. As an owner, we receive all of the operating profits or losses generated by our hotels, after we pay the hotel managers fees, which are based on the revenues and profitability of the hotels, and reimburse all of their direct and indirect operating costs.

As an owner, we believe we create value by acquiring the right hotels with the right brands in the right markets, prudently financing our hotels, thoughtfully re-investing capital in our hotels, implementing profitable operating strategies, approving the annual operating and capital budgets for our hotels, and deciding if and when to sell our hotels. In addition, we are committed to enhancing the value of our operating platform by being open and transparent in our communications with investors, monitoring our corporate overhead and following corporate governance best practice.

We differentiate ourselves from our competitors because of our adherence to three basic principles:

- high-quality urban- and resort-focused branded real estate;
- conservative capital structure; and
- thoughtful asset management.

***High-Quality Urban- and Resort-Focused Branded Real Estate***

We own 20 premium hotels and resorts in North America. These hotels and resorts are primarily categorized as upper upscale as defined by Smith Travel Research and are generally located in high barrier to entry markets with multiple demand generators.

Our properties are concentrated in five key gateway cities (New York City, Los Angeles, Chicago, Boston and Atlanta) and in destination resort locations (such as the U.S. Virgin Islands and Vail, Colorado). We believe that gateway cities and destination resorts will achieve higher long-term growth because they are attractive business and leisure destinations. We also believe that these locations are better insulated from new supply due to relatively high barriers to entry and expensive construction costs.

We believe that higher quality lodging assets create more dynamic cash flow growth and superior long-term capital appreciation.

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In addition, a core tenet of our strategy is to leverage national hotel brands. We strongly believe in the value of powerful national brands because we believe that they are able to produce incremental revenue and profits compared to similar unbranded hotels. In particular, we believe that branded hotels outperform unbranded hotels in an economic downturn. Dominant national hotel brands typically have very strong reservation and reward systems and sales organizations, and all of our hotels are operated under a brand owned by one of the top three national brand companies (Marriott, Starwood or Hilton) and all but two of our hotels are managed by the brand company directly. Generally, we are interested in owning hotels that are operated under a nationally recognized brand or acquiring hotels that can be converted into a nationally branded hotel.

### ***Capital Structure***

Since our formation in 2004, we have been consistently committed to a flexible capital structure with prudent leverage levels. During 2004 through early 2007, we took advantage of the low interest rate environment by fixing our interest rates for an extended period of time. Moreover, during the peak in the commercial real estate market in the past several years, we maintained low financial leverage by funding the majority of our acquisitions through the issuance of equity. This strategy allowed us to maintain a balance sheet with a moderate amount of debt. During the peak years, we believed, and present events have confirmed, that it would be inappropriate to increase the inherent risk of a highly cyclical business through a highly levered capital structure.

We believe the current economic environment has confirmed the merits of our financing strategy. We believe that we maintain a reasonable amount of fixed interest rate mortgage debt with few near-term maturities. As of June 19, 2009, we had \$819.4 million of mortgage debt outstanding. We currently have eight hotels, with an aggregate historic cost of \$792.1 million, which are unencumbered by mortgage debt. As of June 19, 2009, our debt had a weighted-average interest rate of 5.62% and a weighted-average maturity date of 6.12 years. In addition, as of June 19, 2009, 99.4% of our debt was fixed rate.

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 endeavor to structure our hotel acquisitions so that they will not overly complicate 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 have always strived to operate our business with conservative leverage. During the current recession, our corporate goals and objectives continue to be focused on preserving and enhancing our liquidity. We have taken, or intend to take, a number of steps to achieve these goals, as follows:

We completed a follow-on public offering of our common stock on during the second quarter. We sold 17,825,000 shares of common stock, including the underwriters' overallotment of 2,325,000 shares, at an offering price of \$4.85 per share. The net proceeds to us, after deduction of offering costs, were approximately \$82.1 million. In addition, our Board of Directors recently authorized us to sell up to \$75 million of common stock.

We repaid the \$52 million outstanding on our senior unsecured credit facility during the second quarter with a portion of the proceeds from our follow-on offering.

We intend to pay our next dividend to our stockholders of record as of December 31, 2009. We expect the 2009 dividend will be in an amount equal to 100% of our 2009 taxable income. We may elect to pay up to 90 percent of our 2009 dividend in shares of our common stock, as permitted by the Internal Revenue Service's Revenue Procedure 2009-15.

We have focused on minimizing capital spending during 2009 and expect to fund approximately \$10 million of 2009 capital expenditures from corporate cash.

We explored the potential sale of certain hotels earlier in the year, but currently do not have any hotels listed for sale with a broker. We will evaluate any unsolicited offers received for any of our hotels.

We have two near-term mortgage debt maturities totaling \$68 million. The debt maturities include \$40.2 million coming due on the Courtyard Manhattan/Midtown East on December 11, 2009 and \$27.7 million coming due on the Griffin Gate Marriott in January 2010. The status of our efforts to address our near-term debt maturities is as follows:

We have signed a term sheet with Massachusetts Mutual Life Insurance Company ( MassMutual ) to provide a new \$43 million non-recourse mortgage loan on the Courtyard Manhattan/Midtown East bearing an

interest rate of 8.8% and a term of five years. The closing of the loan is subject to numerous closing conditions, including a material adverse change clause.

We are currently assessing the best alternatives to address the Griffin Gate Marriott mortgage debt maturity, including either refinancing the loan or repaying the loan with corporate cash.

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### ***Thoughtful Asset Management***

We believe that we are able to create significant value in our portfolio by utilizing our management's extensive experience and our innovative asset management strategies. Our senior management team has an established broad network of hotel industry contacts and relationships, including relationships with hotel owners, financiers, operators, project managers and contractors and other key industry participants.

In the current economic environment, we believe that our extensive lodging experience, our network of industry relationships and our asset management strategies position us to minimize the impact of declining revenues on our hotels. In particular, we are focused on controlling our property-level and corporate expenses, as well as working closely with our managers to optimize the mix of business at our hotels in order to maximize potential revenue. Our property-level cost containment includes the implementation of aggressive contingency plans at each of our hotels. The contingency plans include controlling labor expenses, eliminating hotel staff positions, adjusting food and beverage outlet hours of operation and not filling open positions. In addition, our strategy to significantly renovate many of the hotels in our portfolio from 2006 to 2008 resulted in the flexibility to significantly curtail our planned capital expenditures for 2009 and 2010.

We use our broad network of hotel industry contacts and relationships to maximize the value of our hotels. Under the regulations governing REITs, we are required to engage a hotel manager that is an eligible independent contractor through one of our subsidiaries to manage each of our hotels pursuant to a management agreement. Our philosophy is to negotiate management agreements that give us the right to exert significant influence over the management of our properties, annual budgets and all capital expenditures, and then to use those rights to continually monitor and improve the performance of our properties. We cooperatively partner with the managers of our hotels in an attempt to increase operating results and long-term asset values at our hotels. In addition to working directly with the personnel at our hotels, our senior management team also has long-standing professional relationships with our hotel managers senior executives, and we work directly with these senior executives to improve the performance of our portfolio. We believe we can create significant value in our portfolio through innovative asset management strategies such as rebranding, renovating and repositioning. We are committed to regularly evaluating our portfolio to determine if we can employ these value-added strategies at our hotels. From 2006 to 2008 we completed a significant amount of capital reinvestment in our hotels completing projects that ranged from room renovations, to a total renovation and repositioning of the hotel, to the addition of new meeting space, spa or restaurant repositioning. In connection with our renovations and repositionings, our senior management team and our asset managers are individually committed to completing these renovations on time, on budget and with minimum disruption to our hotels. As we have significantly renovated many of the hotels in our portfolio, we chose to substantially reduce capital expenditures beginning in 2009.

### **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 GAAP, as well as other financial information that is not prepared in accordance with 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
- Funds From Operations (or 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 63% of our total revenues for the fiscal quarter ended June 19, 2009, and is dictated by demand, as

measured by occupancy percentage, pricing, as measured by ADR, and our available supply of hotel rooms.

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Our ADR, occupancy percentage and RevPAR performance may be impacted by macroeconomic factors such as regional and local employment growth, personal income and corporate earnings, office vacancy rates and business relocation decisions, airport and other business and leisure travel, new hotel construction and the pricing strategies of competitors. In addition, our ADR, occupancy percentage and RevPAR performance is dependent on the continued success of Marriott and its brands as well as the Westin and Conrad brands.

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

**Outlook**

The impact of the severe economic recession on U.S. travel fundamentals and our operating results is likely to persist for some period of time. Lodging demand has historically correlated with several key economic indicators such as GDP growth, employment trends, corporate profits, consumer confidence and business investment. Although there have been recent signs that occupancy in the industry may have stabilized, the average daily rate has continued to decline. We expect lodging demand to follow its historical course and lag the general economic recovery by several quarters and thus, we anticipate a challenging operating environment for the balance of 2009 and into 2010.

New hotel supply remains a short-term negative and a long-term positive. Although the industry benefited from supply growth less than historical averages from 2004 through 2007, new hotel supply began to increase at the end of the last economic expansion. While some of those projects have been delayed or eliminated, the rate of new supply is expected to peak in 2009 and remain above historical averages in 2010. We have been or will be impacted by new supply in a few of our markets, most notably Fort Worth, Texas during 2009 and Chicago and Austin in 2010. Due to a number of factors, we expect below average supply growth for an extended period of time beginning in 2011, when we expect minimal new supply to be a significant positive for operating fundamentals.

**Our Hotels**

The following table sets forth certain operating information for each of our hotels for the period from January 1, 2009 to June 19, 2009.

| Property                                | Location                       | Number of Occupancy |       | ADR(\$)   | RevPAR(\$) | % Change from 2008 |
|-----------------------------------------|--------------------------------|---------------------|-------|-----------|------------|--------------------|
|                                         |                                | Rooms               | (%)   |           |            |                    |
| Chicago Marriott                        | Chicago, Illinois              | 1,198               | 67.9% | \$ 169.99 | \$ 115.46  | (17.6)%            |
| Los Angeles Airport Marriott            | Los Angeles, California        | 1,004               | 75.1  | 112.27    | 84.27      | (16.2)             |
| Westin Boston Waterfront Hotel (1)      | Boston, Massachusetts          | 793                 | 60.0  | 190.13    | 114.00     | (7.9)              |
| Renaissance Waverly Hotel               | Atlanta, Georgia               | 521                 | 62.6  | 137.52    | 86.11      | (17.4)             |
| Salt Lake City Marriott Downtown        | Salt Lake City, Utah           | 510                 | 54.3  | 134.59    | 73.15      | (24.0)             |
| Renaissance Worthington                 | Fort Worth, Texas              | 504                 | 68.1  | 166.43    | 113.36     | (20.7)             |
| Frenchman s Reef & Morning Star         | St. Thomas, U.S. Virgin        |                     |       |           |            |                    |
| Marriott Beach Resort (1)               | Islands                        | 502                 | 86.5  | 252.70    | 218.60     | (8.2)              |
| Renaissance Austin Hotel                | Austin, Texas                  | 492                 | 63.2  | 153.74    | 97.12      | (17.2)             |
| Torrance Marriott South Bay             | Los Angeles County, California | 487                 | 67.4  | 115.41    | 77.77      | (23.2)             |
| Orlando Airport Marriott                | Orlando, Florida               | 486                 | 78.4  | 87.07     | 68.28      | (17.2)             |
| Marriott Griffin Gate Resort            | Lexington, Kentucky            | 408                 | 57.4  | 122.83    | 70.52      | (18.3)             |
| Oak Brook Hills Marriott Resort         | Oak Brook, Illinois            | 386                 | 35.3  | 120.41    | 42.52      | (34.4)             |
| Westin Atlanta North at Perimeter (1)   | Atlanta, Georgia               | 369                 | 66.5  | 103.88    | 69.08      | (26.8)             |
| Vail Marriott Mountain Resort & Spa (1) | Vail, Colorado                 | 346                 | 67.9  | 241.82    | 164.17     | (25.3)             |
| Marriott Atlanta Alpharetta             | Atlanta, Georgia               | 318                 | 59.1  | 128.38    | 75.82      | (21.1)             |
| Courtyard Manhattan/Midtown East        | New York, New York             | 312                 | 83.2  | 204.01    | 169.69     | (33.6)             |
| Conrad Chicago (1)                      | Chicago, Illinois              | 311                 | 67.2  | 177.78    | 119.53     | (23.8)             |

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|                                                 |                    |       |       |           |           |         |
|-------------------------------------------------|--------------------|-------|-------|-----------|-----------|---------|
| Bethesda Marriott Suites                        | Bethesda, Maryland | 272   | 62.7  | 179.41    | 112.45    | (21.5)  |
| Courtyard Manhattan/Fifth Avenue                | New York, New York | 185   | 88.4  | 208.59    | 184.31    | (27.1)  |
| The Lodge at Sonoma, a Renaissance Resort & Spa | Sonoma, California | 182   | 51.4  | 176.20    | 90.59     | (33.4)  |
| TOTAL/WEIGHTED AVERAGE                          |                    | 9,586 | 66.4% | \$ 157.36 | \$ 104.53 | (19.9)% |

(1) The Frenchman s Reef & Morning Star Marriott Beach Resort, Vail Marriott Mountain Resort & Spa, Westin Atlanta North at Perimeter, Conrad Chicago and the Westin Boston Waterfront Hotel report operations on a calendar month and year basis. The period from January 1, 2009 to June 19, 2009 includes the operations for the period from January 1, 2009 to May 31, 2009 for these five hotels.

**Table of Contents****Results of Operations**

As of June 19, 2009, we owned 20 hotels. Our total assets were \$2.1 billion as of June 19, 2009. Total liabilities were \$1.0 billion as of June 19, 2009, including \$819.4 million of debt. Stockholders' equity was approximately \$1.1 billion as of June 19, 2009.

*Comparison of the Fiscal Quarter Ended June 19, 2009 to the Fiscal Quarter Ended June 13, 2008*

Our net income for the fiscal quarter ended June 19, 2009 was \$2.5 million compared to net income of \$21.8 million for the fiscal quarter ended June 13, 2008.

*Revenue.* Revenue consists primarily of the room, food and beverage and other operating revenues from our hotels. Revenues for the fiscal quarters ended June 19, 2009 and June 13, 2008, respectively, consisted of the following (in thousands):

|                       | <b>Fiscal<br/>Quarter<br/>Ended</b> | <b>Fiscal<br/>Quarter<br/>Ended</b> | <b>%<br/>Change</b> |
|-----------------------|-------------------------------------|-------------------------------------|---------------------|
|                       | <b>June 19, 2009</b>                | <b>June 13, 2008</b>                |                     |
| Rooms                 | \$ 90,228                           | \$ 116,011                          | (22.2)%             |
| Food and beverage     | 44,697                              | 55,532                              | (19.5)%             |
| Other                 | 8,682                               | 9,473                               | (8.4)%              |
| <b>Total revenues</b> | <b>\$ 143,607</b>                   | <b>\$ 181,016</b>                   | <b>(20.7)%</b>      |

Individual hotel revenues for the fiscal quarters ended June 19, 2009 and June 13, 2008, respectively, consist of the following (in millions):

|                                                           | <b>Fiscal<br/>Quarter<br/>Ended</b> | <b>Fiscal<br/>Quarter<br/>Ended</b> | <b>%<br/>Change</b> |
|-----------------------------------------------------------|-------------------------------------|-------------------------------------|---------------------|
|                                                           | <b>June 19, 2009</b>                | <b>June 13, 2008</b>                |                     |
| Chicago Marriott                                          | \$ 21.7                             | \$ 28.3                             | (23.3)%             |
| Westin Boston Waterfront Hotel (1)                        | 18.2                                | 19.0                                | (4.2)%              |
| Frenchman's Reef & Morning Star Marriott Beach Resort (1) | 14.6                                | 16.5                                | (11.5)%             |
| Los Angeles Airport Marriott                              | 10.6                                | 13.5                                | (21.5)%             |
| Renaissance Worthington                                   | 7.4                                 | 10.0                                | (26.0)%             |
| Renaissance Austin Hotel                                  | 7.2                                 | 8.5                                 | (15.3)%             |
| Renaissance Waverly Hotel                                 | 7.1                                 | 8.6                                 | (17.4)%             |
| Marriott Griffin Gate Resort                              | 6.1                                 | 7.6                                 | (19.7)%             |
| Vail Marriott Mountain Resort & Spa (1)                   | 5.5                                 | 7.3                                 | (24.7)%             |
| Conrad Chicago (1)                                        | 5.4                                 | 7.3                                 | (26.0)%             |
| Courtyard Manhattan/Midtown East                          | 5.0                                 | 7.8                                 | (35.9)%             |
| Torrance Marriott South Bay                               | 4.9                                 | 6.0                                 | (18.3)%             |
| Oak Brook Hills Marriott Resort                           | 4.9                                 | 6.8                                 | (27.9)%             |
| Orlando Airport Marriott                                  | 4.6                                 | 5.8                                 | (20.7)%             |
| Salt Lake City Marriott Downtown                          | 4.2                                 | 5.9                                 | (28.8)%             |
| Westin Atlanta North at Perimeter (1)                     | 3.7                                 | 4.6                                 | (19.6)%             |
| Bethesda Marriott Suites                                  | 3.4                                 | 4.7                                 | (27.7)%             |
| The Lodge at Sonoma, a Renaissance Resort & Spa           | 3.2                                 | 4.7                                 | (31.9)%             |

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|                                  |          |          |         |
|----------------------------------|----------|----------|---------|
| Courtyard Manhattan/Fifth Avenue | 3.0      | 4.4      | (31.8)% |
| Marriott Atlanta Alpharetta      | 2.9      | 3.7      | (21.6)% |
| Total                            | \$ 143.6 | \$ 181.0 | (20.7)% |

(1) The Frenchman s Reef & Morning Star Marriott Beach Resort, Vail Marriott Mountain Resort & Spa, Westin Atlanta North at Perimeter, Conrad Chicago and the Westin Boston Waterfront Hotel report operations on a calendar month and year basis. The fiscal quarters ended June 19, 2009 and June 13, 2008 include the operations for the period from March 1, 2009 to May 31, 2009 and March 1, 2008 to May 31, 2008, respectively, for these five hotels.

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Our total revenues declined \$37.4 million, or 20.7%, from \$181.0 million for the fiscal quarter ended June 13, 2008 to \$143.6 million for the fiscal quarter ended June 19, 2009, reflecting the continued weakness in lodging fundamentals. The decline reflects a 22.2 percent decline in RevPAR, which is the result of a 14.6 percent decrease in ADR and a 6.7 percentage point decrease in occupancy. The following are the key hotel operating statistics for our hotels for the fiscal quarters ended June 19, 2009 and June 13, 2008, respectively.

|             | <b>Fiscal<br/>Quarter<br/>Ended<br/>June 19,<br/>2009</b> | <b>Fiscal<br/>Quarter<br/>Ended<br/>June 13,<br/>2008</b> | <b>% Change</b>         |
|-------------|-----------------------------------------------------------|-----------------------------------------------------------|-------------------------|
| Occupancy % | 69.0%                                                     | 75.7%                                                     | (6.7) percentage points |
| ADR         | \$ 159.30                                                 | \$ 186.53                                                 | (14.6)%                 |
| RevPAR      | \$ 109.85                                                 | \$ 141.28                                                 | (22.2)%                 |

Our RevPAR declined in the second quarter by 22.2%. Most of the decline in RevPAR can be attributed to a significant decline in the average daily rate and reflects a number of negative trends within our primary customer segments, including a change in the mix between those segments. Our room revenue by primary customer segment in the second quarter was as follows:

|                    | <b>Fiscal Quarter Ended<br/>June 19, 2009</b> |                   | <b>Fiscal Quarter Ended<br/>June 13, 2008</b> |                   | <b>%<br/>Decrease</b> |
|--------------------|-----------------------------------------------|-------------------|-----------------------------------------------|-------------------|-----------------------|
|                    | <b>\$ in<br/>millions</b>                     | <b>% of Total</b> | <b>\$ in<br/>millions</b>                     | <b>% of Total</b> |                       |
| Business Transient | \$ 22.2                                       | 25%               | \$ 35.4                                       | 31%               | 37.0%                 |
| Group              | 34.0                                          | 38%               | 44.2                                          | 38%               | 23.2%                 |
| Leisure and Other  | 34.0                                          | 37%               | 36.4                                          | 31%               | 6.7%                  |
| Total              | \$ 90.2                                       | 100%              | \$ 116.0                                      | 100%              | 22.2%                 |

**Business Transient:** Revenue from the business transient segment, traditionally the most profitable segment for hotels, has declined more than any other customer segment. Business transient revenue was partially replaced with lower-rated government, leisure and contract business. We expect business transient demand trends to remain negative until there is an improvement in the overall economic climate in the United States.

**Group:** Groups have postponed, cancelled or reduced their meetings in response to the current economic recession. The deterioration in revenue is primarily due to a decline in group room nights and, to a much lesser extent, rate. Moreover, as there were fewer cancellations in the second quarter compared to the first quarter, the deterioration in group room nights appears to have been caused by a decline in short-term group pick-up. As of the end of the second quarter, our group booking pace was 19% lower than at the same time last year, which represents the continued deterioration of group booking trends during the year.

**Leisure and Other:** The decline in revenue from the leisure and other segment was almost entirely driven by lower average daily rates.

Food and beverage revenues decreased 19.5% from 2008, reflecting a decline in both banquet and outlet revenues. Other revenues, which primarily represent spa, golf, parking and attrition and cancellation fees, decreased 8.4% from 2008.

**Hotel operating expenses.** Hotel operating expenses consist primarily of operating expenses of our hotels, including non-cash ground rent expense. The operating expenses for the fiscal quarters ended June 19, 2009 and June 13, 2008, respectively, consist of the following (in millions):

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|                                         | Fiscal Quarter Ended |       | Fiscal Quarter Ended |       |          |
|-----------------------------------------|----------------------|-------|----------------------|-------|----------|
|                                         | June 19, 2009        |       | June 13, 2008        |       | % Change |
| Rooms departmental expenses             | \$                   | 23.0  | \$                   | 26.2  | (12.2)%  |
| Food and beverage departmental expenses |                      | 30.3  |                      | 36.4  | (16.8)%  |
| Other departmental expenses             |                      | 7.5   |                      | 8.1   | (7.4)%   |
| General and administrative              |                      | 12.2  |                      | 13.9  | (12.2)%  |
| Utilities                               |                      | 5.4   |                      | 6.6   | (18.2)%  |
| Repairs and maintenance                 |                      | 6.8   |                      | 7.1   | (4.2)%   |
| Sales and marketing                     |                      | 10.2  |                      | 11.8  | (13.6)%  |
| Base management fees                    |                      | 3.8   |                      | 5.0   | (24.0)%  |
| Incentive management fees               |                      | 1.2   |                      | 3.0   | (60.0)%  |
| Property taxes                          |                      | 6.2   |                      | 5.5   | 12.7%    |
| Ground rent Contractual                 |                      | 0.4   |                      | 0.5   | (20.0)%  |
| Ground rent Non-cash                    |                      | 1.8   |                      | 1.8   | %        |
| Total hotel operating expenses          | \$                   | 108.8 | \$                   | 125.9 | (13.6)%  |

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Our hotel operating expenses decreased \$17.1 million or 13.6%, from \$125.9 million for the fiscal quarter ended June 13, 2008 to \$108.8 million for the fiscal quarter ended June 19, 2009. Due to the poor operating fundamentals at our hotels, we have worked with our hotel managers to lower operating expenses. As a result of these cost-containment measures, and an overall decline in occupancy, we have reduced the rooms, food and beverage and other hotel departmental expenses. The primary driver for the decrease in these operating expenses is an overall decline in wages and benefits. We expect the decreases in the rooms, food and beverage, and other hotel departmental expenses to continue in 2009.

Management fees are calculated as a percentage of total revenues, as well as the level of operating profit at certain hotels. Therefore, the decline in base management fees is due to the overall decline in revenues at our hotels. We pay incentive management fees only at certain of our hotels based on operating profits. The decrease in incentive management fees of approximately \$1.8 million is due to the decline in operating profits at those hotels as well as fewer hotels earning incentive management fees in 2009 compared to 2008.

*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 \$1.6 million from \$18.1 million for the fiscal quarter ended June 13, 2008 to \$19.7 million for the fiscal quarter ended June 19, 2009. This increase is primarily the result of having additional assets in service as of June 19, 2009, due primarily to our significant 2008 capital projects at the Chicago Marriott and the Westin Boston Waterfront.

*Corporate expenses.* Our corporate expenses increased from \$3.3 million for the fiscal quarter ended June 13, 2008 to \$3.7 million for the fiscal quarter ended June 19, 2009, due primarily to an increase in stock-based compensation expense. 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.

*Interest expense.* Our interest expense decreased \$0.3 million from \$11.4 million for the fiscal quarter ended June 13, 2008 to \$11.1 million for the fiscal quarter ended June 19, 2009. The decrease in interest expense is primarily attributable to the repayment of our credit facility in April. The 2009 interest expense was comprised of mortgage debt (\$10.8 million), amortization of deferred financing costs (\$0.2 million) and interest and unused facility fees on our credit facility (\$0.1 million). The 2008 interest expense is comprised of mortgage debt (\$10.8 million), amortization of deferred financing costs (\$0.2 million) and interest and unused facility fees on our credit facility (\$0.4 million). As of June 19, 2009, we had property-specific mortgage debt outstanding on twelve of our hotels. On all but one of the hotels, we have fixed-rate secured debt, which bears interest at rates ranging from 5.11% to 6.48% per year. Our weighted-average interest rate on all debt as of June 19, 2009 was 5.62%.

*Interest income.* Interest income decreased \$0.2 million from \$0.3 million for the fiscal quarter ended June 13, 2008 to \$0.1 million for the fiscal quarter ended June 19, 2009. Although our corporate cash balances are higher in 2009, the interest rates earned on corporate cash are significantly lower.

*Income taxes.* We recorded an income tax benefit of \$3.3 million for the fiscal quarter ended June 19, 2009 and an income tax expense of \$0.9 million for the fiscal quarter ended June 13, 2008. The second quarter 2009 income tax benefit was incurred on the \$9.9 million pre-tax loss of our taxable REIT subsidiary, or TRS, for the fiscal quarter ended June 19, 2009, together with foreign income tax expense of \$0.5 million related to the taxable REIT subsidiary that owns the Frenchman's Reef & Morning Star Marriott Beach Resort. The second quarter 2008 income tax expense was incurred on the \$0.6 million pre-tax income of our TRS for the fiscal quarter ended June 13, 2008, together with foreign income tax expense of \$0.5 million related to the taxable REIT subsidiary that owns the Frenchman's Reef & Morning Star Marriott Beach Resort.

*Comparison of the Period from January 1, 2009 to June 19, 2009 to the Period from January 1, 2008 to June 13, 2008*

We incurred a net loss for the period from January 1, 2009 to June 19, 2009 of \$2.8 million compared to net income of \$26.9 million for the period from January 1, 2008 to June 13, 2008.



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*Revenue.* Revenue consists primarily of the room, food and beverage and other operating revenues from our hotels. Revenues for the periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008, respectively, consisted of the following (in thousands):

|                   | <b>Period from<br/>January 1,<br/>2009<br/>to June 19,<br/>2009</b> | <b>Period from<br/>January 1,<br/>2008<br/>to June 13,<br/>2008</b> | <b>%<br/>Change</b> |
|-------------------|---------------------------------------------------------------------|---------------------------------------------------------------------|---------------------|
| Rooms             | \$ 165,343                                                          | \$ 201,938                                                          | (18.1)%             |
| Food and beverage | 81,587                                                              | 95,614                                                              | (14.7)%             |
| Other             | 15,221                                                              | 16,327                                                              | (6.8)%              |
| Total revenues    | \$ 262,151                                                          | \$ 313,879                                                          | (16.5)%             |

Individual hotel revenues for the periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008, respectively, consist of the following (in millions):

|                                                           | <b>Period from<br/>January 1,<br/>2009<br/>to June 19,<br/>2009</b> | <b>Period from<br/>January 1,<br/>2008<br/>to June 13,<br/>2008</b> | <b>%<br/>Change</b> |
|-----------------------------------------------------------|---------------------------------------------------------------------|---------------------------------------------------------------------|---------------------|
| Chicago Marriott                                          | \$ 36.4                                                             | \$ 39.2                                                             | (7.1)%              |
| Westin Boston Waterfront Hotel (1)                        | 25.2                                                                | 27.9                                                                | (9.7)%              |
| Frenchman s Reef & Morning Star Marriott Beach Resort (1) | 24.6                                                                | 27.7                                                                | (11.2)%             |
| Los Angeles Airport Marriott                              | 23.6                                                                | 27.9                                                                | (15.4)%             |
| Renaissance Worthington                                   | 16.0                                                                | 19.5                                                                | (17.9)%             |
| Renaissance Austin Hotel                                  | 14.8                                                                | 16.7                                                                | (11.4)%             |
| Renaissance Waverly Hotel                                 | 14.3                                                                | 17.3                                                                | (17.3)%             |
| Vail Marriott Mountain Resort & Spa (1)                   | 11.6                                                                | 15.6                                                                | (25.6)%             |
| Orlando Airport Marriott                                  | 11.2                                                                | 13.4                                                                | (16.4)%             |
| Marriott Griffin Gate Resort                              | 9.9                                                                 | 11.6                                                                | (14.7)%             |
| Salt Lake City Marriott Downtown                          | 9.8                                                                 | 12.3                                                                | (20.3)%             |
| Torrance Marriott South Bay                               | 9.5                                                                 | 11.7                                                                | (18.8)%             |
| Courtyard Manhattan/Midtown East                          | 9.4                                                                 | 13.8                                                                | (31.9)%             |
| Oak Brook Hills Marriott Resort                           | 7.9                                                                 | 10.1                                                                | (21.8)%             |
| Conrad Chicago (1)                                        | 7.6                                                                 | 9.8                                                                 | (22.4)%             |
| Bethesda Marriott Suites                                  | 6.9                                                                 | 8.3                                                                 | (16.9)%             |
| Westin Atlanta North at Perimeter (1)                     | 6.2                                                                 | 8.3                                                                 | (25.3)%             |
| Marriott Atlanta Alpharetta                               | 6.0                                                                 | 7.3                                                                 | (17.8)%             |
| Courtyard Manhattan/Fifth Avenue                          | 5.9                                                                 | 7.8                                                                 | (24.4)%             |
| The Lodge at Sonoma, a Renaissance Resort & Spa           | 5.4                                                                 | 7.7                                                                 | (29.9)%             |
| Total                                                     | \$ 262.2                                                            | \$ 313.9                                                            | (16.5)%             |

- (1) The Frenchmans Reef & Morning Star Marriott Beach Resort, Vail Marriott Mountain Resort & Spa, Westin Atlanta North at Perimeter, Conrad Chicago and the Westin Boston Waterfront Hotel report operations on a calendar month and year basis. The periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008 include the operations for the period from January 1, 2009 to May 31, 2009 and January 1, 2008 to May 31, 2008, respectively, for these five hotels.

Our total revenues declined \$51.7 million, or 16.5%, from \$313.9 million for the period from January 1, 2008 to June 13, 2008 to \$262.2 million for the period from January 1, 2009 to June 19, 2009, reflecting the continued weakness in lodging fundamentals. The decline reflects a 19.9 percent decline in RevPAR, which is the result of a 12.8 percent decrease in ADR and a 5.9 percentage point decrease in occupancy. In addition, the operations for the first half of 2009 of our Marriott-managed hotels include five additional days as compared to the comparable period of 2008. The following are the key hotel operating statistics for our hotels for the periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008, respectively.

|             | <b>Period from<br/>January 1,<br/>2009<br/>to June 19,<br/>2009</b> | <b>Period from<br/>January 1,<br/>2008<br/>to June 13,<br/>2008</b> | <b>% Change</b>         |
|-------------|---------------------------------------------------------------------|---------------------------------------------------------------------|-------------------------|
| Occupancy % | 66.4%                                                               | 72.3%                                                               | (5.9) percentage points |
| ADR         | \$ 157.36                                                           | \$ 180.48                                                           | (12.8)%                 |
| RevPAR      | \$ 104.53                                                           | \$ 130.53                                                           | (19.9)%                 |

Food and beverage revenues decreased 14.7% from 2008, reflecting a decline in both banquet and outlet revenues. Other revenues, which primarily represent spa, golf, parking and attrition and cancellation fees, decreased 6.8% from 2008.

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*Hotel operating expenses.* Hotel operating expenses consist primarily of operating expenses of our hotels, including non-cash ground rent expense. The operating expenses for the periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008, respectively, consist of the following (in millions):

|                                         | <b>Period from<br/>January 1,<br/>2009<br/>to June 19,<br/>2009</b> | <b>Period from<br/>January 1,<br/>2008<br/>to June 13,<br/>2008</b> | <b>%<br/>Change</b> |
|-----------------------------------------|---------------------------------------------------------------------|---------------------------------------------------------------------|---------------------|
| Rooms departmental expenses             | \$ 43.0                                                             | \$ 47.4                                                             | (9.3)%              |
| Food and beverage departmental expenses | 56.9                                                                | 65.3                                                                | (12.9)%             |
| Other hotel expenses                    | 14.0                                                                | 14.9                                                                | (6.0)%              |
| General and administrative              | 23.1                                                                | 25.5                                                                | (9.4)%              |
| Utilities                               | 10.8                                                                | 11.4                                                                | (5.3)%              |
| Repairs and maintenance                 | 13.0                                                                | 13.4                                                                | (3.0)%              |
| Sales and marketing                     | 18.8                                                                | 21.4                                                                | (12.2)%             |
| Base management fees                    | 6.9                                                                 | 8.6                                                                 | (19.8)%             |
| Incentive management fees               | 1.4                                                                 | 4.4                                                                 | (68.2)%             |
| Property taxes                          | 12.3                                                                | 10.6                                                                | 16.0%               |
| Ground rent Contractual                 | 0.9                                                                 | 1.0                                                                 | (10.0)%             |
| Ground rent Non-cash                    | 3.6                                                                 | 3.5                                                                 | 2.9%                |
| Total hotel operating expenses          | \$ 204.7                                                            | \$ 227.4                                                            | (10.0)%             |

Our hotel operating expenses decreased \$22.7 million or 10.0%, from \$227.4 million for the period from January 1, 2008 to June 13, 2008 to \$204.7 million for the period from January 1, 2009 to June 19, 2009. Due to the decreased occupancy levels at our hotels, we have worked with our hotel managers to lower operating expenses. As a result of these cost-containment measures, and an overall decline in occupancy, we have reduced the rooms, food and beverage and other hotel departmental expenses. The primary driver for the decrease in these operating expenses is an overall decline in wages and benefits. We expect the decreases in the rooms, food and beverage, and other hotel departmental expenses to continue in 2009.

Management fees are calculated as a percentage of total revenues, as well as the level of operating profit at certain hotels. Therefore, the decline in base management fees is due to the overall decline in revenues at our hotels. We pay incentive management fees only at certain of our hotels based on operating profits. The decrease in incentive management fees of approximately \$3.0 million is due to the decline in operating profits at those hotels, as well as fewer hotels earning incentive management fees in 2008.

*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 \$3.6 million from \$34.8 million for the period from January 1, 2008 to June 13, 2008 to \$38.4 million for the period from January 1, 2009 to June 19, 2009. This increase is primarily the result of having additional assets in service as of June 19, 2009, due primarily to our significant 2008 capital projects at the Chicago Marriott and the Westin Boston Waterfront.

*Corporate expenses.* Our corporate expenses increased from \$6.3 million for the period from January 1, 2008 to June 13, 2008 to \$7.4 million for the period from January 1, 2009 to June 19, 2009, due primarily to an increase in stock-based compensation expense. 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.

*Interest expense.* Our interest expense increased \$0.5 million from \$22.1 million for the period from January 1, 2008 to June 13, 2008 to \$22.6 million for the period from January 1, 2009 to June 19, 2009. The increase in interest expense is primarily attributable to the period from January 1, 2009 to June 19, 2009 having five additional days of interest expense compared to the period from January 1, 2008 to June 13, 2008 as well as lower interest expense on our credit facility in 2009 and higher capitalized interest recorded for the period from January 1, 2008 to June 13, 2008. The 2009 interest expense was comprised of mortgage debt (\$21.8 million), amortization of deferred financing costs (\$0.4 million) and interest and unused facility fees on our credit facility (\$0.4 million). The 2008 interest expense is comprised of mortgage debt (\$21.1 million), amortization of deferred financing costs (\$0.4 million) and interest and unused facility fees on our credit facility (\$0.6 million).

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As of June 19, 2009, we had property-specific mortgage debt outstanding on twelve of our hotels. On all but one of the hotels, we have fixed-rate secured debt, which bears interest at rates ranging from 5.11% to 6.48% per year. Our weighted-average interest rate on all debt as of June 19, 2009 was 5.62%.

*Interest income.* Interest income decreased \$0.6 million from \$0.8 million for the period from January 1, 2008 to June 13, 2008 to \$0.2 million for the period from January 1, 2009 to June 19, 2009 due to lower interest rates in 2009. Although our corporate cash balances are higher in 2009, the interest rates earned on corporate cash are approaching zero.

*Income taxes.* We recorded an income tax benefit of \$9.3 million and \$2.8 million for the periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008, respectively. The 2009 income tax benefit was incurred on the \$25.6 million pre-tax loss of our taxable REIT subsidiary, or TRS, for the period from January 1, 2009 to June 19, 2009, together with foreign income tax expense of \$0.7 million related to the taxable REIT subsidiary that owns the Frenchman's Reef & Morning Star Marriott Beach Resort. The 2008 income tax expense was incurred on the \$9.9 million pre-tax loss of our TRS for the period from January 1, 2008 to June 13, 2008, together with foreign income tax expense of \$0.9 million related to the taxable REIT subsidiary that owns the Frenchman's Reef & Morning Star Marriott Beach Resort.

### **Liquidity and Capital Resources**

The current recession and related financial crisis has resulted in the continued deleveraging of the global financial system. As banks and other financial intermediaries reduce their leverage and incur losses on their existing portfolio of loans, the amount of capital that they are able to lend has materially decreased. As a result, it is a very difficult borrowing environment for all borrowers, even those that have strong balance sheets. While we have low leverage and a significant number of high quality unencumbered assets, we are uncertain if we could currently obtain new debt, or refinance existing debt, on reasonable terms or at all in the current market.

Our short-term liquidity requirements consist primarily of funds necessary to fund future distributions to our stockholders to maintain our REIT status as well as to pay for operating expenses and other expenditures directly associated with our hotels, including capital expenditures as well as payments of interest and principal. We currently expect that our operating cash flows will be sufficient to meet our short-term liquidity requirements generally through net cash provided by operations, existing cash balances and, if necessary, short-term borrowings under our credit facility.

Our long-term liquidity requirements consist primarily of funds necessary to pay for the costs of acquiring additional hotels, renovations, expansions and other capital expenditures that need to be made periodically to our hotels, scheduled debt payments and making distributions to our stockholders. We expect to meet our long-term liquidity requirements through various sources of capital, cash provided by operations and borrowings, as well as through our issuances of additional equity or debt securities. Our ability to incur additional debt is dependent upon a number of factors, including the current state of the overall credit markets, our degree of leverage, the value of our unencumbered assets and borrowing restrictions imposed by existing lenders. Our ability to raise additional equity is also dependent on a number of factors including the current state of the capital markets, investor sentiment and use of proceeds.

### ***Our Financing Strategy***

Since our formation in 2004, we have been consistently committed to a flexible capital structure with prudent leverage levels. During 2004 through early 2007, we took advantage of the low interest rate environment by fixing our interest rates for an extended period of time. Moreover, during the peak in the commercial real estate market in the past several years, we maintained low financial leverage by funding the majority of our acquisitions through the issuance of equity. This strategy allowed us to maintain a balance sheet with a moderate amount of debt. During the peak years, we believed, and present events have confirmed, that it would be inappropriate to increase the inherent risk of a highly cyclical business through a highly levered capital structure.

We believe the current economic environment has confirmed the merits of our financing strategy. We believe that we maintain a reasonable amount of fixed interest rate mortgage debt with few near-term maturities. As of June 19, 2009, we had \$819.4 million of mortgage debt outstanding. We currently have eight hotels, with an aggregate historic cost of \$792.1 million, which are unencumbered by mortgage debt. As of June 19, 2009, our debt had a weighted-average

interest rate of 5.62% and a weighted-average maturity date of 6.12 years. In addition, as of June 19, 2009, 99.4% of our debt was fixed rate.

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 endeavor to structure our hotel acquisitions so that they will not overly complicate 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.

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We have always strived to operate our business with conservative leverage. During the current recession, our corporate goals and objectives continue to be focused on preserving and enhancing our liquidity. We have taken, or intend to take, a number of steps to achieve these goals, as follows:

We completed a follow-on public offering of our common stock during the second quarter. We sold 17,825,000 shares of common stock, including the underwriters' overallotment of 2,325,000 shares, at an offering price of \$4.85 per share. The net proceeds to us, after deduction of offering costs, were approximately \$82.1 million. In addition, our Board of Directors recently authorized us to sell up to \$75 million of common stock.

We repaid the \$52 million outstanding on our senior unsecured credit facility during the second quarter with a portion of the proceeds from our follow-on offering.

We intend to pay our next dividend to our stockholders of record as of December 31, 2009. We expect the 2009 dividend will be in an amount equal to 100% of our 2009 taxable income. We may elect to pay up to 90 percent of our 2009 dividend in shares of our common stock, as permitted by the Internal Revenue Service's Revenue Procedure 2009-15.

We have focused on minimizing capital spending during 2009 and expect to fund approximately \$10 million of 2009 capital expenditures from corporate cash.

We explored the potential sale of certain hotels earlier in the year, but currently do not have any hotels listed for sale with a broker. We will evaluate any unsolicited offers received for any of our hotels.

We have two near-term mortgage debt maturities totaling \$68 million. The debt maturities include \$40.2 million coming due on the Courtyard Manhattan/Midtown East on December 11, 2009 and \$27.7 million coming due on the Griffin Gate Marriott in January 2010. The status of our efforts to address our near-term debt maturities is as follows:

We have signed a term sheet with MassMutual to provide a new \$43 million non-recourse mortgage loan on the Courtyard Manhattan/Midtown East bearing an interest rate of 8.8% and a term of five years. The closing of the loan is subject to numerous closing conditions, including a material adverse change clause.

We are currently assessing the best alternatives to address the Griffin Gate Marriott mortgage debt maturity, including either refinancing the loan or repaying loan with corporate cash.

**Credit Facility**

We are party to a four-year, \$200.0 million unsecured credit facility (the Facility) expiring in February 2011. We may extend the maturity date of the Facility for an additional year upon the payment of applicable fees and the satisfaction of certain other customary conditions. On April 17, 2009, we repaid the outstanding balance of \$52.0 million under the Facility with a portion of the proceeds from our follow-on public offering of common stock.

Interest is paid on the periodic advances under the Facility at varying rates, based upon either LIBOR or the alternate base rate, plus an agreed upon additional margin amount. The interest rate depends upon our level of outstanding indebtedness in relation to the value of our assets from time to time, as follows:

|                            | <b>Leverage Ratio</b>     |                       |                       |                          |
|----------------------------|---------------------------|-----------------------|-----------------------|--------------------------|
|                            | <b>60% or<br/>Greater</b> | <b>55% to<br/>60%</b> | <b>50% to<br/>55%</b> | <b>Less Than<br/>50%</b> |
| Alternate base rate margin | 0.65%                     | 0.45%                 | 0.25%                 | 0.00%                    |
| LIBOR margin               | 1.55%                     | 1.45%                 | 1.25%                 | 0.95%                    |

Our Facility contains various corporate financial covenants. A summary of the most restrictive covenants is as follows:

|                                                                   | <b>Covenant</b> | <b>Actual at<br/>June 19, 2009</b> |
|-------------------------------------------------------------------|-----------------|------------------------------------|
| Maximum leverage ratio(1)                                         | 65%             | 44.7%                              |
| Minimum fixed charge coverage ratio(2)                            | 1.6x            | 2.4x                               |
| Minimum tangible net worth(3)                                     | \$738.4 million | \$1.4 billion                      |
| Unhedged floating rate debt as a percentage of total indebtedness | 35%             | 0.6%                               |



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- (1) Maximum leverage ratio is determined by dividing the total debt outstanding by the net asset value of our corporate assets and hotels. Hotel level net asset values are calculated based on the application of a contractual capitalization rate (which range from 7.5% to 8.0%) to the trailing twelve month hotel net operating income.
- (2) Minimum fixed charge ratio is calculated based on the trailing four quarters.
- (3) Tangible net worth is defined as the gross book value of our real estate assets and other corporate assets less our total debt and all other corporate liabilities.

Our Facility requires that we maintain a specific pool of unencumbered borrowing base properties. The unencumbered borrowing base assets are subject to the following limitations and covenants:

**Actual at**

|                                                                  | <b>Covenant</b> | <b>June 19, 2009</b> |
|------------------------------------------------------------------|-----------------|----------------------|
| Minimum implied debt service ratio                               | 1.5x            | N/A                  |
| Maximum unencumbered leverage ratio                              | 65%             | 0%                   |
| Minimum number of unencumbered borrowing base properties         | 4               | 8                    |
| Minimum unencumbered borrowing base value                        | \$150 million   | \$579.5 million      |
| Percentage of total asset value owned by borrowers or guarantors | 90%             | 100%                 |

If we were to default under any of the above covenants, we would be obligated to repay all amounts outstanding under our Facility and our Facility would terminate. Our ability to comply with two most restrictive financial covenants, the maximum leverage ratio and the fixed charge coverage ratio, depend primarily on our EBITDA. The following table shows the impact of various hypothetical scenarios on those two covenants.

|                                     | <b>Covenant</b> | <b>EBITDA Change from 2008</b> |             |             |             |             |
|-------------------------------------|-----------------|--------------------------------|-------------|-------------|-------------|-------------|
|                                     |                 | <b>-10%</b>                    | <b>-20%</b> | <b>-30%</b> | <b>-40%</b> | <b>-50%</b> |
| Maximum leverage ratio              | 65%             | 42%                            | 47%         | 53%         | 62%         | 74%         |
| Minimum fixed charge coverage ratio | 1.6x            | 2.6x                           | 2.3x        | 2.0x        | 1.7x        | 1.4x        |

In addition to the interest payable on amounts outstanding under the Facility, we are required to pay unused credit facility fees equal to 0.20% of the unused portion of the Facility if the unused portion of the Facility is greater than 50% or 0.125% of the unused portion of the Facility if the unused portion of the Facility is less than 50%. We incurred interest and unused credit facility fees on the Facility of \$0.1 million and \$0.4 million for the fiscal quarters ended June 19, 2009 and June 13, 2008, respectively. We incurred interest and unused credit facility fees on the Facility of \$0.4 million and \$0.6 million for the periods from January 1, 2009 to June 19, 2009 and January 1, 2008 to June 13, 2008, respectively. As of June 19, 2009, we did not have an outstanding balance on the Facility.

#### **Sources and Uses of Cash**

Our principal sources of cash are net cash flow from hotel operations, borrowing under mortgage debt, draws on the Facility and the proceeds from our equity offerings. Our principal uses of cash are debt service, asset acquisitions, capital expenditures, operating costs, corporate expenses and dividends.

*Cash Provided by Operating Activities.* Our cash provided by operating activities was \$30.3 million for the period from January 1, 2009 to June 19, 2009, which is the result of our \$2.8 million net loss adjusted for the impact of several non-cash charges, including \$38.4 million of depreciation, \$3.6 million of non-cash straight line ground rent, \$0.4 million of amortization of deferred financing costs, \$1.3 million of an impairment loss, and \$2.5 million of stock compensation, offset by \$0.8 million of amortization of unfavorable agreements, \$0.3 million of amortization of deferred income and unfavorable working capital changes of \$12.1 million.

Our cash provided by operating activities was \$48.0 million for the period from January 1, 2008 to June 13, 2008, which is the result of our \$26.9 million net income adjusted for the impact of several non-cash charges, including \$34.8 million of depreciation, \$3.6 million of non-cash straight line ground rent, \$0.4 million of amortization of deferred financing costs, \$0.8 million of yield support received and \$1.6 million of stock compensation, offset by \$0.8 million of amortization of unfavorable agreements, \$0.3 million of amortization of deferred income and unfavorable working capital changes of \$19.0 million.

*Cash Used In Investing Activities.* Our cash used in investing activities was \$14.2 million for the period from January 1, 2009 to June 19, 2009. During the period from January 1, 2009 to June 19, 2009, we incurred capital expenditures at our hotels of \$13.3 million and a decrease in restricted cash of \$1.0 million.

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Our cash used in investing activities was \$33.6 million for the period from January 1, 2008 to June 13, 2008. During the period from January 1, 2008 to June 13, 2008, we incurred capital expenditures at our hotels of \$36.8 million and a decrease in restricted cash of \$1.8 million, which was offset by the receipt of \$5.0 million of key money related to the Chicago Marriott Downtown.

*Cash Provided by Financing Activities.* Our cash provided by financing activities was \$21.7 million for the period from January 1, 2009 to June 19, 2009 consisted of \$2.0 million of scheduled debt principal payments, \$0.2 million of share repurchases, \$57.0 million in repayments of our credit facility, \$0.4 million of costs related to the sale of common stock, \$1.2 million of deposits for the Courtyard Midtown refinancing, and \$0.1 million of vested dividend payments to SAR/DER holders, offset by \$82.6 million in proceeds from the sale of common stock.

Our cash used in financing activities was \$19.2 million for the period from January 1, 2008 to June 13, 2008 consisted of \$1.4 million of scheduled debt principal payments, \$3.2 million of share repurchases, and \$46.6 million of dividend payments offset by \$32.0 million in net draws under our credit facility.

### **Dividend Policy**

We intend to distribute to our stockholders dividends equal to our REIT taxable income so as to avoid paying corporate income tax and excise tax on our earnings (other than the earnings of our TRS and TRS lessees, 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, 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.

We intend to issue our next dividend to our stockholders of record as of December 31, 2009. We expect the 2009 dividend will be an amount equal to 100% of our 2009 taxable income. Depending on our 2009 liquidity needs, we may elect to pay a portion of our 2009 dividend in shares of our common stock, as permitted by the Internal Revenue Service's Revenue Procedure 2009-15.

### **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 and fixtures at our hotels. 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 19, 2009, we have set aside \$27.5 million for capital projects in property improvement funds. Funds held in property improvement funds for one hotel are typically not permitted to be applied to any other property.

Although we have significantly curtailed the capital expenditures at our hotels, we continue to benefit from the extensive capital investments made from 2006 to 2008, during which time many of our hotels were fully renovated. In 2009, we have focused our capital expenditures primarily on life safety, capital preservation, and return-on-investment projects. The total budget in 2009 for capital improvements is \$35 million, only \$10 million of which is expected to be funded from corporate cash and the balance to be funded from hotel escrow reserves. We spent approximately \$13.3 million on capital improvements during the period from January 1, 2009 through June 19, 2009, of which approximately \$3.7 million was funded from corporate cash.

### **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.

**Table of Contents****Non-GAAP Financial Measures**

We use the following two non-GAAP financial measures that we believe are useful to investors as key measures of our operating performance: (1) EBITDA and (2) FFO. These measures should not be considered in isolation or as a substitute for measures of performance in accordance with GAAP.

EBITDA represents net (loss) 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 indebtedness use EBITDA as a measure of financial compliance. We also use EBITDA as one measure in determining the value of hotel acquisitions and dispositions.

|                                                   | <b>Fiscal<br/>Quarter<br/><br/>Ended<br/>June 19,<br/>2009</b> | <b>Fiscal<br/>Quarter<br/><br/>Ended<br/>June 13,<br/>2008</b> | <b>Period from<br/>January 1,<br/>2009<br/>to June 19,<br/>2009</b> | <b>Period from<br/>January 1,<br/>2008<br/>to June 13,<br/>2008</b> |
|---------------------------------------------------|----------------------------------------------------------------|----------------------------------------------------------------|---------------------------------------------------------------------|---------------------------------------------------------------------|
|                                                   | (in thousands)                                                 |                                                                |                                                                     |                                                                     |
| Net income (loss)                                 | \$ 2,457                                                       | \$ 21,755                                                      | \$ (2,837)                                                          | \$ 26,932                                                           |
| Interest expense                                  | 11,086                                                         | 11,430                                                         | 22,584                                                              | 22,125                                                              |
| Income tax (benefit) expense                      | (3,319)                                                        | 886                                                            | (9,297)                                                             | (2,836)                                                             |
| Real estate related depreciation and amortization | 19,729                                                         | 18,069                                                         | 38,446                                                              | 34,756                                                              |
| EBITDA                                            | \$ 29,953                                                      | \$ 52,140                                                      | \$ 48,896                                                           | \$ 80,977                                                           |

We compute FFO in accordance with standards established by the National Association of Real Estate Investment Trusts, which defines FFO as net (loss) income (determined in accordance with GAAP), excluding gains (losses) from sales of property, plus depreciation and amortization. We believe that the presentation of FFO provides useful information to investors regarding our operating performance because it is a measure of our operations without regard to specified non-cash items, such as real estate depreciation and amortization and gain or loss on sale of assets. We also use FFO as one measure in assessing our results.

|                                                   | <b>Fiscal<br/>Quarter<br/><br/>Ended<br/>June 19,<br/>2009</b> | <b>Fiscal<br/>Quarter<br/><br/>Ended<br/>June 13,<br/>2008</b> | <b>Period from<br/>January 1,<br/>2009<br/>to June 19,<br/>2009</b> | <b>Period from<br/>January 1,<br/>2008<br/>to June 13,<br/>2008</b> |
|---------------------------------------------------|----------------------------------------------------------------|----------------------------------------------------------------|---------------------------------------------------------------------|---------------------------------------------------------------------|
|                                                   | (in thousands)                                                 |                                                                |                                                                     |                                                                     |
| Net income (loss)                                 | \$ 2,457                                                       | \$ 21,755                                                      | \$ (2,837)                                                          | \$ 26,932                                                           |
| Real estate related depreciation and amortization | 19,729                                                         | 18,069                                                         | 38,446                                                              | 34,756                                                              |
| FFO                                               | \$ 22,186                                                      | \$ 39,824                                                      | \$ 35,609                                                           | \$ 61,688                                                           |

### **Critical Accounting Policies**

Our consolidated financial statements include the accounts of the DiamondRock Hospitality Company and all consolidated subsidiaries. The preparation of financial statements in conformity with U.S. generally accepted accounting principles, or GAAP, 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 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 materially from these estimates. We evaluate our estimates and judgments, including those related to the impairment of long-lived assets, on an ongoing basis. We base our estimates on experience and on various other assumptions that are believed to be reasonable under the circumstances. All of our significant accounting policies are disclosed in the notes to our consolidated financial statements. The following represent certain critical accounting policies that require us to exercise our business judgment or make significant estimates:

*Investment in Hotels.* Acquired hotels, land improvements, building and furniture, fixtures and equipment and identifiable intangible assets are initially recorded at fair value in accordance with Statement of Financial Accounting Standards No. 141, *Business Combinations*. Additions to property and equipment, including current buildings, improvements, furniture, fixtures and equipment are recorded at cost. Property and equipment are depreciated using the straight-line method over an estimated useful life of 15 to 40 years for buildings and land improvements and one to ten years for furniture and equipment. Identifiable intangible assets are typically related to contracts, including ground lease agreements and hotel management agreements, which are recorded at fair value. Above-market and below-market contract values are based on the present value of the difference between contractual amounts to be paid pursuant to the contracts acquired and our estimate of the fair market contract rates for corresponding contracts. Contracts acquired that are at market do not have significant value. We typically enter into a new hotel management agreement based on market terms at the time of acquisition. Intangible assets are amortized using the straight-line method over the remaining non-cancelable term of the related agreements. In making estimates of fair values for purposes of allocating purchase price, we may utilize a number of sources that may be obtained in connection with the acquisition or financing of a property and other market data. Management also considers information obtained about each property as a result of its pre-acquisition due diligence in estimating the fair value of the tangible and intangible assets acquired.

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We review our investments in hotels for impairment whenever events or changes in circumstances indicate that the carrying value of the investments in hotels may not be recoverable. Events or circumstances that may cause us to perform a review include, but are not limited to, adverse changes in the demand for lodging at our properties due to declining national or local economic conditions and/or new hotel construction in markets where our 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 an investment in a hotel exceed the hotel's carrying value. If the estimated undiscounted future cash flows are less than the carrying amount of the asset, an adjustment to reduce the carrying value to the estimated fair market value is recorded and an impairment loss is recognized.

*Revenue Recognition.* Hotel revenues, including room, golf, food and beverage, and other hotel revenues, are recognized as the related services are provided.

*Stock-based Compensation.* We account for stock-based employee compensation using the fair value based method of accounting described in Statement of Financial Accounting Standards No. 123 (revised 2004) (SFAS 123R),

*Share-Based Payment.* We record the cost of awards with service conditions based on the grant-date fair value of the award. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. No awards with performance-based or market-based conditions have been issued.

*Income Taxes.* Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to 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 in the period when the new rate is enacted.

We have elected to be treated as a REIT under the provisions of the Internal Revenue Code and, as such, are not subject to federal income tax, provided we distribute all of our taxable income annually to our stockholders and comply with certain other requirements. In addition to paying federal and state income tax on any retained income, we are subject to taxes on built-in-gains on sales of certain assets. Additionally, our taxable REIT subsidiaries are subject to federal, state and foreign income tax.

### **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. Historically, we have experienced approximately two-thirds of our annual income in the second and fourth fiscal quarters.

### **New Accounting Pronouncements Not Yet Implemented**

There are no new unimplemented accounting pronouncements that are expected to have a material impact on our results of operations, financial position or cash flows.

### **Item 3. Qualitative Disclosure 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. As of June 19, 2009, we were exposed to interest rate risk on only \$5.0 million of our debt, as the remaining 99.4% of our debt was fixed rate.

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**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 Commissions 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****Item 1. Legal Proceedings**

We are not involved in any material litigation nor, to our knowledge, is any material litigation threatened against us other than routine litigation arising out of the ordinary course of business or which is expected to be covered by insurance and none of which is expected to have a material impact on our business, financial condition or results of operations.

**Item 1A. Risk Factors**

There have been no material changes in the risk factors described in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

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

None.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Submission of Matters to a Vote of Security Holders**

The Company held its Annual Meeting of Stockholders on April 30, 2009. The proposals in front of our stockholders and the results of voting on such proposals were as noted below.

Election of Directors: the following persons were elected as directors for a one-year term and until their respective successors are duly elected and qualified.

|                     | <b>VOTES FOR</b> | <b>VOTES WITHHELD</b> |
|---------------------|------------------|-----------------------|
| William W. McCarten | 76,289,109       | 9,860,766             |
| Mark W. Brugger     | 78,551,055       | 7,598,819             |
| John L. Williams    | 77,511,444       | 8,638,431             |
| Daniel Altobello    | 79,461,516       | 6,688,358             |
| W. Robert Grafton   | 79,479,365       | 6,670,510             |
| Maureen L. McAvey   | 79,054,890       | 7,094,984             |
| Gilbert T. Ray      | 79,462,470       | 6,687,405             |

Ratification of Independent Auditors: the selection of KPMG LLP as our independent auditors for fiscal year ending December 31, 2009 was ratified. The voting results were as follows:

| <b>VOTES FOR</b> | <b>VOTES AGAINST</b> | <b>VOTES ABSTAINED</b> |
|------------------|----------------------|------------------------|
| 85,000,059       | 1,144,488            | 5,327                  |

**Item 5. Other Information**

None.

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**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 dated January 9, 2007*)
- 3.2.1 Second Amended and Restated Bylaws 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)*)
- 3.2.2 Amendment No. 1 to Second 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 March 7, 2006*)
- 4.1 Form of Certificate for Common Stock for 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)*)
- 10.1 Sales Agreement, dated July 27, 2009 by and among DiamondRock Hospitality Company, DiamondRock Hospitality Limited Partnership and Cantor Fitzgerald & Co.
- 31.1 Certification of Chief Executive Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of Chief Financial Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer Required by Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended.

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**SIGNATURE**

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

DiamondRock Hospitality Company

December 7, 2009

/s/ Sean M. Mahoney

/s/ Michael D. Schechter

Sean M. Mahoney  
Executive Vice President and  
Chief Financial Officer

Michael D. Schechter  
Executive Vice President,  
General Counsel and Corporate Secretary

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**EXHIBIT INDEX**

**Exhibit**

- 10.1 Sales Agreement, dated July 27, 2009 by and among DiamondRock Hospitality Company, DiamondRock Hospitality Limited Partnership and Cantor Fitzgerald & Co.
- 31.1 Certification of Chief Executive Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of Chief Financial Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer Required by Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended.