

CHOICE HOTELS INTERNATIONAL INC /DE
Form 10-Q
August 11, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

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

| | |
|---|---|
| DELAWARE (State or other jurisdiction of incorporation or organization) 1 CHOICE HOTELS CIRCLE, SUITE 400 ROCKVILLE, MD 20850 (Address of principal executive offices) (Zip Code) (301) 592-5000 (Registrant's telephone number, including area code) | 52-1209792 (I.R.S. Employer Identification No.) |
|---|---|

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

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

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

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

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

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

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

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

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

| | | | | |
|-----------------------------------|---------|---------|--------|--------|
| Cash dividends declared per share | \$0.185 | \$0.185 | \$0.37 | \$0.37 |
|-----------------------------------|---------|---------|--------|--------|

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED, IN THOUSANDS)

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

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

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

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

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

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

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

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

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

1. Company Information and Significant Accounting Policies

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

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

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

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

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

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

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

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

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Consolidated Statements of Income

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

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

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

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

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Consolidated Statements of Income

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

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

operations, net of
income taxes

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

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

Net cash provided by operating
activities

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

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

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

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Consolidated Statements of Income

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

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

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

Discontinued Operations

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

Cash and Cash Equivalents

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

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

Recently Adopted Accounting Guidance

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

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

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

Future Adoption of Recently Announced Accounting Guidance

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

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

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

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

2. Other Current Assets

Other current assets consist of the following:

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

3. Notes Receivable and Allowance for Losses

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

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

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

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

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

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

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

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

(1) Consists of default rate assumption changes

Forgivable Notes Receivable

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

Past due balances of forgivable notes receivable are as follows:

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

Mezzanine and Other Notes Receivable

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

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

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

Loans Acquired with Deteriorated Credit Quality

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

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

4. Marketing and Reservation Activities

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

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

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

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

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

5. Other Assets

Other assets consist of the following:

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

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

Equity Method Investments - Variable Interest Entities

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

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

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6. Deferred Revenue

Deferred revenue consists of the following:

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

7. Debt

Debt consists of the following at:

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

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

Senior Notes Due 2020

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

Revolving Credit Facility

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

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

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

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

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

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

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

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

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

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

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

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

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

compliance with all financial covenants under the Credit Facility.

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

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Economic Development Loans

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

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

8. Accumulated Other Comprehensive Income (Loss)

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

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

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

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

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

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

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

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

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

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

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

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

10. Fair Value Measurements

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

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

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

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

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

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

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

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

Other Financial Instruments

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

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

management decision.

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11. Income Taxes

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

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

12. Share-Based Compensation and Capital Stock

Stock Options

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

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