

CHOICE HOTELS INTERNATIONAL INC /DE

Form 10-Q

November 08, 2018

Table of Contents

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

---

FORM 10-Q

---

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

FOR THE QUARTERLY PERIOD ENDED September 30, 2018

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 52-1209792  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

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)

(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 every Interactive Data File required to be submitted 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 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, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

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

Edgar Filing: CHOICE HOTELS INTERNATIONAL INC /DE - Form 10-Q

Act.

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

CLASS

SHARES OUTSTANDING AT OCTOBER 31, 2018

Common Stock, Par Value \$0.01 per share 55,980,838

---

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES  
INDEX

PAGE NO.

PART I. FINANCIAL INFORMATION:

<u>Item 1—Financial Statements (Unaudited)</u>	<u>3</u>
<u>Consolidated Statements of Income -- For the three and nine months ended September 30, 2018 and 2017</u>	<u>3</u>
<u>Consolidated Statements of Comprehensive Income -- For the three and nine months ended September 30, 2018 and 2017</u>	<u>4</u>
<u>Consolidated Balance Sheets -- As of September 30, 2018 and December 31, 2017</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows -- For the nine months ended September 30, 2018 and 2017</u>	<u>6</u>
<u>Notes to Consolidated Financial Statements</u>	<u>7</u>
<u>Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>19</u>
<u>Item 3—Quantitative and Qualitative Disclosures About Market Risk</u>	<u>37</u>
<u>Item 4—Controls and Procedures</u>	<u>38</u>

PART II. OTHER INFORMATION:

<u>Item 1—Legal Proceedings</u>	<u>38</u>
<u>Item 1A—Risk Factors</u>	<u>38</u>
<u>Item 2—Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>39</u>
<u>Item 3—Defaults Upon Senior Securities</u>	<u>39</u>
<u>Item 4—Mine Safety Disclosures</u>	<u>39</u>
<u>Item 5—Other Information</u>	<u>39</u>
<u>Item 6—Exhibits</u>	<u>40</u>

<u>SIGNATURES</u>	<u>41</u>
-------------------	-----------

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
<b>REVENUES</b>				
Royalty fees	\$ 111,009	\$ 103,322	\$ 290,926	\$ 263,215
Initial franchise and relicensing fees	6,262	5,729	18,957	17,263
Procurement services	11,620	8,810	39,391	30,545
Marketing and reservation system	152,367	142,915	416,715	382,245
Other	10,232	9,154	30,336	26,546
Total revenues	291,490	269,930	796,325	719,814
<b>OPERATING EXPENSES</b>				
Selling, general and administrative	38,191	46,573	125,325	124,356
Depreciation and amortization	3,815	1,601	10,537	4,986
Marketing and reservation system	138,316	128,661	394,112	365,435
Total operating expenses	180,322	176,835	529,974	494,777
Gain (loss) on sale of land and building, net	—	(32)	) 82	(32)
Operating income	111,168	93,063	266,433	225,005
<b>OTHER INCOME AND EXPENSES, NET</b>				
Interest expense	11,706	11,399	34,720	33,884
Interest income	(1,966)	) (1,575)	) (5,218)	) (4,277)
Other gains	(972)	) (778)	) (1,355)	) (2,251)
Equity in net (income) loss of affiliates	(43)	) 274	5,358	3,213
Total other income and expenses, net	8,725	9,320	33,505	30,569
Income before income taxes	102,443	83,743	232,928	194,436
Income tax expense	22,484	26,554	48,044	62,293
Net income	\$ 79,959	\$ 57,189	\$ 184,884	\$ 132,143
Basic earnings per share	\$ 1.42	\$ 1.01	\$ 3.27	\$ 2.34
Diluted earnings per share	\$ 1.41	\$ 1.01	\$ 3.24	\$ 2.33
Cash dividends declared per share	\$ 0.215	\$ 0.215	\$ 0.645	\$ 0.645

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

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net income	\$79,959	\$57,189	\$184,884	\$132,143
Other comprehensive income, net of tax:				
Amortization of loss on cash flow hedge	215	215	646	646
Foreign currency translation adjustment	(250 )	851	(1,264 )	2,842
Other comprehensive (loss) income, net of tax	(35 )	1,066	(618 )	3,488
Comprehensive income	\$79,924	\$58,255	\$184,266	\$135,631

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

Table of Contents

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

	September 30, 2018	December 31, 2017
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 30,916	\$ 235,336
Receivables (net of allowance for doubtful accounts of \$15,509 and \$12,221, respectively)	185,586	125,870
Income taxes receivable	308	—
Notes receivable, net of allowance	32,642	13,256
Other current assets	31,163	25,967
Total current assets	280,615	400,429
Property and equipment, at cost, net	117,610	83,374
Goodwill	173,641	80,757
Intangible assets, net	263,923	100,492
Notes receivable, net of allowances	83,034	80,136
Investments, employee benefit plans, at fair value	21,542	20,838
Investments in unconsolidated entities	107,905	134,226
Deferred income taxes	32,730	27,224
Other assets	80,037	67,715
Total assets	\$ 1,161,037	\$ 995,191
<b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>		
Current liabilities		
Accounts payable	\$ 71,684	\$ 67,839
Accrued expenses and other current liabilities	78,591	84,315
Deferred revenue	65,810	52,142
Current portion of long-term debt	1,099	1,232
Liability for guest loyalty program	82,346	79,123
Total current liabilities	299,530	284,651
Long-term debt	781,433	725,292
Long-term deferred revenue	107,370	98,459
Deferred compensation and retirement plan obligations	26,137	25,566
Income taxes payable	26,276	29,041
Deferred income taxes	—	39
Liability for guest loyalty program	50,085	48,701
Other liabilities	38,285	42,043
Total liabilities	1,329,116	1,253,792
Commitments and Contingencies		
Common stock, \$0.01 par value; 160,000,000 shares authorized; 95,065,638 shares issued at September 30, 2018 and December 31, 2017; 56,223,839 and 56,679,968 shares outstanding at September 30, 2018 and December 31, 2017, respectively	951	951
Additional paid-in-capital	209,053	182,448
Accumulated other comprehensive loss	(5,317	) (4,699 )
Treasury stock, at cost; 38,841,799 and 38,385,670 shares at September 30, 2018 and December 31, 2017, respectively	(1,148,441	) (1,064,573 )

Edgar Filing: CHOICE HOTELS INTERNATIONAL INC /DE - Form 10-Q

Retained earnings	775,675	627,272
Total shareholders' deficit	(168,079 )	(258,601 )
Total liabilities and shareholders' deficit	\$ 1,161,037	\$ 995,191

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

5

---

Table of Contents

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

	Nine Months Ended September 30,	
	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 184,884	\$ 132,143
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,537	4,986
Depreciation and amortization – marketing and reservation system	14,687	15,454
Franchise agreement acquisition cost amortization	6,662	5,190
(Gain) loss on disposal of assets	(58	) 32
Provision for bad debts, net	6,279	3,694
Non-cash stock compensation and other charges	11,455	20,215
Non-cash interest and other (income) loss	492	(451
Deferred income taxes	(5,610	) 51,126
Equity in net losses from unconsolidated joint ventures, less distributions received	7,122	4,278
Franchise agreement acquisition cost, net of reimbursements	(40,554	) (21,443
Change in working capital and other, net of acquisition	(49,059	) (50,205
Net cash provided by operating activities	146,837	165,019
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Investment in property and equipment	(34,129	) (17,514
Investment in intangible assets	(1,665	) (2,376
Proceeds from sales of assets	3,053	—
Business acquisition, net of cash acquired	(231,317	) —
Asset acquisition, net of cash acquired	(3,179	) —
Contributions to equity method investments	(9,050	) (44,876
Distributions from equity method investments	1,429	4,307
Purchases of investments, employee benefit plans	(2,441	) (2,140
Proceeds from sales of investments, employee benefit plans	2,646	2,150
Issuance of notes receivable	(28,876	) (18,565
Collections of notes receivable	4,747	630
Other items, net	(1,065	) 109
Net cash used in investing activities	(299,847	) (78,275
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net borrowings (repayments) pursuant to revolving credit facilities	56,400	(39,974
Principal payments on long-term debt	(477	) (484
Purchase of treasury stock	(109,266	) (8,887
Dividends paid	(36,628	) (36,483
Debt issuance costs	(2,590	) —
Proceeds from issuance of long term debt	528	—
Proceeds from transfer of interest in notes receivable	173	24,237
Proceeds from exercise of stock options	41,155	9,799
Net cash used in financing activities	(50,705	) (51,792
Net change in cash and cash equivalents	(203,715	) 34,952
Effect of foreign exchange rate changes on cash and cash equivalents	(705	) 1,433
Cash and cash equivalents at beginning of period	235,336	202,463

Edgar Filing: CHOICE HOTELS INTERNATIONAL INC /DE - Form 10-Q

Cash and cash equivalents at end of period	\$30,916	\$238,848
Supplemental disclosure of cash flow information:		
Cash payments during the period for:		
Income taxes, net of refunds	\$50,806	\$31,254
Interest, net of capitalized interest	\$41,746	\$41,119
Non-cash investing and financing activities:		
Dividends declared but not paid	\$12,087	\$12,167
Investment in property and equipment acquired in accounts payable	\$1,743	\$758

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

Table of Contents

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

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements of Choice Hotels International, Inc. and its subsidiaries (together the "Company") have been prepared by the Company in accordance with United States of America generally accepted accounting principles ("GAAP") 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 the Company's 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 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, 2017 and notes thereto included in the Company's Annual Report on Form 10-K, filed with the SEC on March 1, 2018 (the "10-K"). Interim results are not necessarily indicative of the entire year results. All inter-company transactions and balances between Choice Hotels International, Inc. and its subsidiaries have been eliminated in consolidation.

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

On February 1, 2018, the Company acquired 100% of the issued and outstanding equity interest of WoodSpring Hotels Franchise Services ("WoodSpring"). The transaction has been accounted for using the acquisition method of accounting and accordingly, assets acquired and liabilities assumed were recorded at their fair values as of the acquisition date. The results of WoodSpring have been consolidated with the Company since February 1, 2018. See Note 15 for additional information.

On August 20, 2018, the Company entered into an Amended and Restated Senior Unsecured Credit Agreement ("Restated Credit Agreement"). In accordance with the Restated Credit Agreement, each of the entities that was a guarantor in accordance with the former credit agreement were released from their obligations and the guarantees were terminated. As a result, the Company is no longer required to prepare quarterly condensed consolidating statements of income, comprehensive income, balance sheets, and cash flows segregated by parent entity, guarantor entities, and non-guarantor entities. See Note 6 for additional information.

Summary of Significant Accounting Policies

The Company's significant accounting policies are detailed in Note 1 "Summary of Significant Accounting Policies" in the Annual Report on Form 10-K for the year ended December 31, 2017. The significant accounting policies that changed in 2018 are set forth below.

Recently Adopted Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue From Contracts with Customers (Topic 606) and issued subsequent amendments to the initial guidance at various points of 2015 and 2016 within ASU 2015-14, ASU 2016-08, ASU 2016-10, ASU 2016-12, and ASU 2016-20 (these ASUs collectively referred to as "Topic 606"). The Company adopted Topic 606 as of January 1, 2018 using the full retrospective method of adoption. The provisions of Topic 606 impacted the Company's revenue recognition as follows:

-

Initial and relicensing fees earned upon execution of a franchise agreement are recognized as revenue ratably as services are provided over the enforceable period of the franchise license arrangement. This represents a change from prior practice, whereby the Company typically recognized revenue for initial and relicensing fees in full in the period of agreement execution.

• Sales commissions, which are paid upon the execution of a franchise agreement, are recognized ratably over the period a hotel is expected to remain in the Company's franchise system rather than expensed as incurred.

7

---

Table of Contents

Franchise agreement acquisition costs are capitalized as intangible assets, as opposed to notes receivable.

Amortization of franchise agreement acquisition costs are recognized as a reduction of revenue rather than as a component of depreciation and amortization.

Revenue related to the Choice Privileges program, which is reported as a component of marketing and reservation system fees, is deferred as points are awarded and recognized upon point redemption, net of reward reimbursements paid to a third-party. Previously, revenue was recognized on a gross basis at the time the points were issued with a corresponding deferral of revenue equal to the expected future costs of the award. Deferred revenue was then recognized as actual points were redeemed and costs for those redemptions incurred.

Topic 606 also impacted the Company's accounting for surpluses and deficits generated from marketing and reservation system activities. The Company has historically, consistent with its existing agreements, not earned a profit or generated a loss from marketing and reservation activities, and as a result, the Company recorded excess marketing and reservation system revenues or expenses as assets or liabilities on the Company's balance sheet prior to the adoption of Topic 606. However, as a result of the adoption of Topic 606, the Company will no longer defer revenues and expenses or record assets and liabilities when system revenues exceed expenses in the current period or vice versa. The Company intends to manage these activities to break-even over time but anticipates that net income or loss may be generated quarterly due to the seasonal nature of the hotel industry and annually based on the level of investments needed for new initiatives that benefit our franchisees.

All amounts and disclosures set forth in this Form 10-Q reflect the necessary adjustments required for the adoption of Topic 606, including the reclassification of prior year balances to conform to current year presentation. See Note 2 for further details on the adoption of Topic 606 and impact to the Company's significant accounting policies. In accordance with Topic 606 requirements, the disclosure of the impact of adoption on the Company's prior period consolidated statements of income and balance sheet is presented below. The adoption of Topic 606 had no impact to cash from or used in operating, financing, or investing activities, but resulted in certain reclassifications within cash flows from operating activities, on the prior period consolidated statement of cash flows.

	Three Months Ended		
	September 30, 2017		
	As	Adoption	As
	Previously	of Topic	As
	Reported	606	Adjusted
Statement of Income	(in thousands, except per share amounts)		
Total revenues	\$295,088	\$(25,158)	\$269,930
Total operating expenses	217,222	(40,387)	176,835
Income before income taxes	68,514	15,229	83,743
Income taxes	20,919	5,635	26,554
Net income	47,595	9,594	57,189
Diluted earnings per share	0.84	0.17	1.01

	Nine Months Ended September		
	30, 2017		
	As	Adoption	As
	Previously	of Topic	As
	Reported	606	Adjusted
Statement of Income	(in thousands, except per share amounts)		
Total revenues	\$769,785	\$(49,971)	\$719,814
Total operating expenses	561,906	(67,129)	494,777

Edgar Filing: CHOICE HOTELS INTERNATIONAL INC /DE - Form 10-Q

Income before income taxes	177,278	17,158	194,436
Income taxes	55,944	6,349	62,293
Net income	121,334	10,809	132,143
Diluted earnings per share	2.14	0.19	2.33

8

---

Table of Contents

	December 31, 2017		
	As Previously Reported (1)(2)	Adoption of Topic 606	As Adjusted
Balance Sheet	(in thousands)		
Receivables (net of allowance for doubtful accounts)	\$ 125,452	\$ 418	\$ 125,870
Current notes receivable, net of allowances	13,904	(648 )	13,256
Other current assets	28,241	(2,274 )	25,967
Intangible assets, net	14,672	85,820	100,492
Notes receivable, net of allowances	147,993	(67,857)	80,136
Deferred income tax asset	13,335	13,889	27,224
Other assets	29,479	38,236	67,715
Accounts payable <sup>(1)</sup>	67,839	—	67,839
Accrued expenses and other current liabilities <sup>(1)</sup>	84,315	—	84,315
Current deferred revenue <sup>(2)</sup>	13,190	38,952	52,142
Current liability for guest loyalty program <sup>(2)</sup>	79,183	(60 )	79,123
Deferred revenue <sup>(1)(2)</sup>	18,335	80,124	98,459
Liability for guest loyalty program <sup>(2)</sup>	48,738	(37 )	48,701
Other liabilities <sup>(1)(2)</sup>	46,939	(4,896 )	42,043
Retained earnings	673,771	(46,499)	627,272

<sup>(1)</sup> The Company performed reclassifications of certain payroll taxes from Accrued expenses and other current liabilities to Accounts payable totaling \$4.3 million, and the entirety of Income taxes payable to Accrued expenses and other current liabilities totaling \$2.8 million. In addition, \$4.3 million was reclassified from Other liabilities to Deferred revenue.

<sup>(2)</sup> As a result of adoption of Topic 606 and in accordance with reporting requirements, the Company performed revisions to the presentation within Total liabilities in the consolidated balance sheet to add non-current Deferred revenue and current and non-current Liability for guest loyalty program line items. Amounts originally captured in current Deferred revenue and Other liabilities have been reclassified to the new line items in the table above.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15") and in November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230) Restricted Cash ("ASU 2016-18"), which collectively provide additional guidance on nine specific cash flow issues. The Company adopted ASU 2016-15 and ASU 2016-18 on January 1, 2018, and it did not have an impact on the Company's consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory ("ASU 2016-16"). ASU 2016-16 provides guidance on recognition of current income tax consequences for inter-company asset transfers (other than inventory) at the time of transfer. The Company adopted this ASU on January 1, 2018, and it did not have an impact on the Company's consolidated financial statements.

In February 2017, the FASB issued ASU 2017-05, Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets ("ASU 2017-05"). ASU 2017-05 clarifies the scope and accounting of a financial asset that meets the definition of an "in-substance nonfinancial asset" and adds guidance for partial sales of nonfinancial assets. The Company adopted this ASU on January 1, 2018, and it did not have an impact on the Company's consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation - Stock Compensation: Scope of Modification Accounting ("ASU 2017-09"), which clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award changes as a result of the change in terms or conditions. ASU 2017-09 will be applied prospectively to awards modified on or after the adoption date. The Company adopted this ASU on January 1, 2018, and it did not have an impact on the Company's consolidated financial statements.

## Table of Contents

### Recently Issued Accounting Standards

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) ("ASU 2016-02"). ASU 2016-02 requires lessees to recognize most leases on their balance sheet by recording a liability for its lease obligation and an asset for its right to use the underlying asset as of the lease commencement date. The standard requires entities to determine whether an arrangement contains a lease or a service agreement as the accounting treatment is different between the two arrangements. The standard also requires the lessee to evaluate whether a lease is a financing lease or an operating lease as the accounting and presentation guidance between the two are different. ASU 2016-02 also modifies the classification criteria and accounting for sales-type and direct financing leases for lessors. The standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company intends to adopt the standard on January 1, 2019 using the modified retrospective approach and apply the package of practical expedients available upon adoption. The Company is currently assessing the impact that ASU 2016-02 will have on its financial statements and disclosures. The Company expects the ASU to have a material effect on its consolidated balance sheet as a result of recognizing a lease obligation and right-of-use asset for the Company's operating leases. This differs from present day treatment of operating leases, which primarily are not captured on the Company's consolidated balance sheet in accordance with current GAAP. The Company also expects the ASU to have a significant impact on the extent of lease disclosures in the financial statements. The Company does not expect a material effect on its consolidated statements of income.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement ("ASU 2018-13"). ASU 2018-13 modifies disclosure requirements on fair value measurements. The guidance is effective for annual reporting periods beginning after December 15, 2019 and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the potential impact that ASU 2018-13 will have on the financial statement disclosures.

In August 2018, the FASB issued ASU 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract ("ASU 2018-15"). ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The guidance is effective for annual reporting periods beginning after December 15, 2019 and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the timing of adoption and the potential impact that ASU 2018-15 will have on the financial statements and disclosures.

## 2. Revenue

### Revenue Recognition

Revenues are primarily derived from franchise agreements with third-party hotel owners. The majority of the Company's performance obligations are a series of distinct services, as described in more detail below, for which the Company receives variable consideration through franchise fees. The Company enters into franchise agreements to provide franchisees with a limited non-exclusive license to utilize the Company's registered brand trade names and trademarks, marketing and reservation services, and other miscellaneous franchise services. These agreements typically have an initial term from five to thirty years, with provisions permitting franchisees or the Company to terminate the franchise agreement upon designated anniversaries of the hotel opening before the end of the initial term. An up-front initial or relicensing fee is assessed to third-party hotel owners to affiliate with our brands, which is typically paid prior to agreement execution and is non-refundable. After hotel opening, fees are generated based on a percentage of gross room revenues or as designated transactions and events occur (such as when a reservation is delivered to the hotel through a specified channel) and are due to the Company in the following month.

The franchise agreements are comprised of multiple performance obligations, which may require significant judgment in identifying. The primary performance obligations are as follows:

License of brand intellectual property and related services (“brand intellectual property”): Grants the right to access the Company’s intellectual property associated with brand trade names, trademarks, reservation systems, property management systems and related services.

Material rights for free or discounted goods or services to hotel guests: Primarily consists of the points issued under the Company’s guest loyalty program, Choice Privileges.

Point in time sale of goods: The Company administers the delivery of chip-enabled credit card readers to its franchisees to aid in compliance with industry standards in exchange for a fee. Revenue is recognized at the point in time shipment is made to the franchisee within Other revenue. The Company determined the standalone selling price is equal to the amount invoiced to the franchisee.

Brand intellectual property

Fees generated from the brand intellectual property are recognized to revenue over time as hotel owners pay for access to these services for the duration of the franchise agreement. Franchise fees are typically based on the sales or usage of the underlying hotel, with the exception of fixed up-front fees that usually represent an insignificant portion of the transaction price. The variable consideration is recognizable after the completion of a hotel stay. As a result, variable transaction price is determined for the period when the underlying gross room revenues and transactions or events which generate fees are known.

Franchise fees include the following:

Royalty fees. Royalty fees are earned in exchange for a license to brand intellectual property typically based on a percentage of gross room revenues. These fees are billed and collected monthly and revenues are recognized in the same period that the underlying gross room revenues are earned by the Company’s franchisees.

Initial franchise and relicensing fees. Initial and relicensing fees are charged when (i) new hotels enter the franchise system; (ii) there is a change of ownership; or (iii) existing franchise agreements are extended. These revenues are recognized as revenue ratably as services are provided over the enforceable period of the franchise agreement. The enforceable period is the period from hotel opening to the first point the franchisee or the Company can terminate the franchise agreement without incurring a significant penalty. Deferred revenues from initial and relicensing fees will typically be recognized over a five to ten-year period, unless the franchise agreement is terminated and the hotel exits the franchise system whereby remaining deferred amounts will be recognized to revenue in the period of termination.

Other revenue. Other revenue is a combination of miscellaneous non-marketing and reservation system fees, inclusive of quality assurance non-compliance and franchisee training fees, and is recognized in the period the designated transaction or event has occurred.

The Company’s franchise agreements require the payment of marketing and reservation system fees. The Company is obligated to use these marketing and reservation system fees to provide marketing and reservation services such as advertising, providing a centralized reservation and property management system, providing reservation and revenue management services, and performing certain franchise services to support the operation of the overall franchise system. These services are comprised of multiple fees including the following:

Fees based on a percentage of gross room revenues are recognized in the period the gross room revenue was earned, based on the underlying hotel’s sales or usage.

Fees based on the occurrence of a designated transaction or event are recognized in the period the transaction or event occurred.

System implementation fees charged to franchisees are deferred and recognized as revenue over the enforceable period of the franchise agreement.

Marketing and reservation system activities also include revenues generated from the Company’s guest loyalty program. The revenue recognition of this program is discussed in Material rights for free or discounted good or services to hotel guests below.

Marketing and reservation system expenses are those expenses incurred to facilitate the delivery of marketing and reservation system services, including direct expenses and an allocation of costs for certain administrative activities required to carry out marketing and reservation services. Marketing and reservation system expenses are recognized as

services are incurred or goods are received, and as such may not equal marketing and reservation system revenues in a specific period but are expected to equal revenues earned from franchisees over time. The Company's 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 and recover such advances in future periods through additional fee assessments or reduced spending.

**Material rights for free or discounted good or services to hotel guests**

Choice Privileges is the Company's frequent guest loyalty program, which enables members to earn points based on their spending levels with the Company's franchisees. The points, which the Company accumulates and tracks on the members' behalf, may be redeemed for free accommodations or other benefits (e.g., gift cards to participating retailers). The Company collects from franchisees a percentage of program members' gross room revenue from completed stays to operate the program. At such time points are redeemed for free accommodations or other benefits, the Company reimburses franchisees or third parties based on a rate derived in accordance with the franchise or vendor agreement.

Loyalty points represent a performance obligation attributable to usage of the points, and thus revenues are recognized at the point in time when the loyalty points are redeemed by members for benefits. The transaction price is variable and determined in the period when the loyalty points are earned and the underlying gross room revenues are known. No loyalty program revenues are recognized at the time the loyalty points are issued.

The Company is an agent in coordinating delivery of the services between the loyalty program member and franchisee or third party, and as a result, revenues are recognized net of the cost of redemptions. The estimated fair value of future redemptions is reflected in current and non-current Liability for guest loyalty program in our consolidated balance sheets. The liability for guest loyalty program is developed based on an estimate of the eventual redemption rates and point values using various actuarial methods. These significant judgments determine the required point liability attributable to outstanding points, which is relieved as redemption costs are processed. The amount of the loyalty program fees in excess of the point liability represents current and non-current Deferred revenue, which is recognized to revenue as points are redeemed including an estimate of future forfeitures ("breakage"). The anticipated redemption pattern of the points is the basis for current and non-current designation of each liability. As of September 30, 2018, the current and non-current deferred revenue balances are \$32.8 million and \$19.9 million, respectively. Loyalty program point redemption revenues are recognized within marketing and reservation system revenue in the consolidated statements of income.

The Company also earns revenues on contracts incidental to the support of operations for franchised hotels, including purchasing operations.

**Partnerships**

The Company maintains various agreements with third-party partners, including the co-branding of the Choice Privileges credit card. The agreements typically provide for use of the Company's marks, limited access to the Company's distribution channels, and sale of Choice Privileges points, in exchange for fees primarily comprising variable consideration paid each month. Choice Privileges members can earn points through participation in the partner's program.

Partnership agreements include multiple performance obligations. The primary performance obligations are brand intellectual property and material rights for free or discounted goods or services to hotel guests. Allocation of fixed and variable consideration to the performance obligations is based on standalone selling price as estimated based on market and income methods, which represent significant judgments. The amounts allocated to brand intellectual property are recognized on a gross basis over time using the output measure of time elapsed, primarily within Procurement services revenue. The amounts allocated to material rights for free or discounted goods or services to hotel guests are recognized to revenue as points are redeemed including an estimate of breakage, primarily within marketing and reservation system revenue.

**Qualified Vendors**

The Company generates procurement services revenues from qualified vendors. Procurement services revenues are generally based on marketing services provided by the Company on behalf of the qualified vendors to hotel owners and guests. The Company provides these services in exchange for either fixed consideration or a percentage of revenues earned by the qualified vendor pertaining to purchases by the Company's franchisees or guests. Fixed consideration is paid in installments based on a contractual schedule, with an initial payment typically due at contract

execution. Variable consideration is typically paid quarterly after sales to franchisees or guests have occurred. Qualified vendor agreements comprise a single performance obligation, which is satisfied over time based on the access afforded and services provided to the qualified vendor for the stated duration of the agreement. Fixed consideration is allocated and recognized ratably to each period over the term of the agreement. Variable consideration is determined and recognized in the period when sales to franchisees or guests from vendors are known or cash payment has been remitted. Qualified vendor revenues are recognized within Procurement services revenue.

#### Other

The Company is party to other non-franchising agreements that generate revenue within Other revenue in the consolidated statements of income which are primarily Software as a Service (“SaaS”) arrangements for non-franchised hoteliers and vacation rental management companies. SaaS agreements typically include fixed consideration for installment and other initiation fees paid at contract onset, and variable consideration for recurring subscription revenue paid monthly. SaaS agreements comprise a single performance obligation, which is satisfied over time based on the access to the software for the stated duration of the agreement. Fixed consideration is allocated and recognized ratably to each period over the term of the agreement. Variable consideration is determined at the conclusion of each period, and allocated to and recognized in the current period.

#### Contract Liabilities

Contract liabilities relate to (i) advance consideration received, such as initial franchise and relicensing fees paid when a franchise agreement is executed and system implementation fees paid at time of installation, for services considered to be part of the brand intellectual property performance obligation and (ii) amounts received when points are issued under the Choice Privileges loyalty program but for which revenue is not yet recognized since the related points have not been redeemed. Initial and relicensing fees paid on WoodSpring franchise agreements executed after February 1, 2018 are included in the "Increases to the contract liability balance due to cash received" caption in the table below. No WoodSpring amounts are included in the "Revenue recognized in the period" caption, as WoodSpring balances were not included in the contract liability balance as of December 31, 2017. See Note 15 for additional information. Significant changes in the contract liabilities balances during the period December 31, 2017 to September 30, 2018 are as follows:

	(in thousands)
Balance as of December 31, 2017	\$ 132,339
Increases to the contract liability balance due to cash received	66,518
Revenue recognized in the period	(49,681 )
Balance as of September 30, 2018	\$ 149,176
Remaining Performance Obligations	

The aggregate amount of transaction price allocated to unsatisfied or partially unsatisfied performance obligations is \$149.2 million as of September 30, 2018. This amount represents fixed transaction price that will be recognized as revenue in future periods, which is primarily captured in the balance sheet as current and non-current deferred revenue.

Based on practical expedient elections permitted by Topic 606, the Company does not disclose the value of unsatisfied performance obligations for (i) variable consideration subject to the sales or usage-based royalty constraint or comprising a component of a series (including franchise, partnership, qualified vendor, and SaaS agreements), (ii) variable consideration for which we recognize revenue at the amount to which we have the right to invoice for services performed, or (iii) contracts with an expected original duration of one year or less. Additionally, as part of transition to Topic 606, the Company elected to not disclose the amount of the transaction price allocated to the remaining performance obligations as of December 31, 2017 or provide an explanation of when revenue is expected to be recognized.

#### Capitalized Franchise Agreement Costs

Sales commissions earned by Company personnel upon execution of a franchise agreement (“franchise sales commissions”) meet the requirement to be capitalized as an incremental cost of obtaining a contract with a customer. Capitalized franchise sales commission are amortized on a straight-line basis over the estimated benefit period of the arrangement, unless the franchise agreement is terminated and the hotel exits the system whereby remaining capitalized amounts will be expensed in the period of termination. The estimated benefit period is equal to or greater

than the period of enforceable rights on the franchise agreement. Capitalized franchise sales commissions are \$46.1 million within Other assets as of September 30, 2018. Amortization expense and impairment loss for the three and nine months ended September 30, 2018 was \$2.0 million and \$6.2 million, respectively, and is reflected within selling, general and administrative expenses.

The Company makes certain payments to customers as an incentive to enter in to new franchise agreements (“Franchise agreement acquisition cost”). These payments are recognized as an adjustment to transaction price and capitalized as an intangible asset. Franchise agreement acquisition cost intangibles are amortized on a straight-line basis over the estimated benefit period of the arrangement as an offset to royalty fees and marketing and reservation system fees. Impairments from hotel terminations are recorded within the selling, general and administrative expenses and marketing and reservations expenses.

#### Sales Taxes

The Company presents taxes collected from customers and remitted to governmental authorities on a net basis and therefore they are excluded from revenues in the consolidated financial statements.

#### Disaggregation of Revenue

The following table presents our revenues by over time and point in time recognition:

	Three Months Ended September 30, 2018			Three Months Ended September 30, 2017		
	Over time	Point in time	Total	Over time	Point in time	Total
Revenues:	(in thousands)			(in thousands)		
Royalty fees	\$ 111,009	\$—	\$ 111,009	\$ 103,322	\$—	\$ 103,322
Initial franchise and relicensing fees	6,262	—	6,262	5,729	—	5,729
Procurement services	10,949	671	11,620	8,310	500	8,810
Marketing and reservation system	139,577	12,790	152,367	138,222	4,693	142,915
Other	9,769	122	9,891	6,912	1,891	8,803
Total Topic 606 revenues	\$ 277,566	\$ 13,583	291,149	\$ 262,495	\$ 7,084	269,579
Non-Topic 606 revenues			341			351
			\$ 291,490			\$ 269,930
	Nine Months Ended September 30, 2018			Nine Months Ended September 30, 2017		
	Over time	Point in time	Total	Over time	Point in time	Total
Revenues:	(in thousands)			(in thousands)		
Royalty fees	\$ 290,926	\$—	\$ 290,926	\$ 263,215	\$—	\$ 263,215
Initial franchise and relicensing fees	18,957	—	18,957	17,263	—	17,263
Procurement services	37,433	1,958	39,391	29,259	1,286	30,545
Marketing and reservation system	371,321	45,394	416,715	351,638	30,607	382,245
Other	28,313	979	29,292	20,566	4,933	25,499
Total Topic 606 revenues	\$ 746,950	\$ 48,331	795,281	\$ 681,941	\$ 36,826	718,767
Non-Topic 606 revenues			1,044			1,047
			\$ 796,325			\$ 719,814

Non-Topic 606 revenues represent revenue from operations of office buildings and parking lots and are presented in Other revenues in the consolidated statements of income.

As presented in Note 12, the Corporate & Other amounts represent \$3.7 million and \$2.9 million for the three months ended September 30, 2018 and 2017, respectively, and \$10.7 million and \$8.0 million for nine months ended September 30, 2018 and 2017, respectively, and are included in the Over time column of Other revenues and Non-Topic 606 revenues row. The remaining revenues relate to the hotel franchising segment.



Table of Contents

## 3. Other Current Assets

Other current assets consist of the following:

	September 30, 2018	December 31, 2017
	(in thousands)	
Prepaid expenses	\$20,306	\$ 14,205
Other current assets	3,857	4,762
Land held for sale	7,000	7,000
Total	\$31,163	\$ 25,967

Land held for sale represents certain parcels of land previously acquired by the Company as part of its program to incent franchise development in strategic markets for the Company's Cambria Hotels brand. During the nine months ended September 30, 2018, the Company sold one parcel of land, classified as a long-term asset as of December 31, 2017, with a total book value of \$3.0 million recognizing a gain on sale of \$82 thousand. As of September 30, 2018, the Company has \$7.0 million of Land held for sale, which represents one parcel of land that is expected to be sold prior to March 31, 2019.

## 4. Notes Receivable and Allowance for Losses

The following table shows the composition of the Company's notes receivable balances:

	September 30, 2018	December 31, 2017
	(in thousands)	
Credit Quality Indicator		
Senior	\$89,568	\$ 73,700
Subordinated	25,728	18,647
Unsecured	2,517	3,182
Total notes receivable	117,813	95,529
Allowance for losses on non-impaired loans	490	490
Allowance for losses on receivables specifically evaluated for impairment	1,647	1,647
Total loan reserves	2,137	2,137
Net carrying value	\$115,676	\$ 93,392
Current portion, net	\$32,642	\$ 13,256
Long-term portion, net	83,034	80,136
Total	\$115,676	\$ 93,392

The Company utilizes the level of security it has in the notes receivable as its primary credit quality indicator (i.e., senior, subordinated or unsecured) when determining the appropriate allowances for uncollectible loans. 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 Company determined that approximately \$1.7 million and \$1.8 million of its subordinated notes receivable were impaired at September 30, 2018 and December 31, 2017, respectively, and recorded allowance for credit losses on these impaired loans totaling \$1.6 million at both September 30, 2018 and December 31, 2017. The average notes receivable on non-accrual status was approximately \$1.8 million for both the nine months ended September 30, 2018 and 2017, respectively. Approximately \$43 thousand and \$44 thousand of interest income on impaired loans was recognized on a cash basis during the nine months ended September 30, 2018 and 2017, respectively. The Company provided loan reserves on non-impaired loans totaling \$0.5 million at September 30, 2018 and December 31, 2017. There were no changes in total loan reserves between December 31, 2017 and September 30, 2018.

The Company has identified loans totaling approximately \$10.8 million and \$2.1 million, respectively, with stated interest rates that are less than market rate, representing a total discount of \$1.6 million and \$0.1 million as of September 30, 2018 and

11

---

Table of Contents

December 31, 2017, respectively. These discounts are reflected as a reduction of the outstanding loan amounts and are amortized over the life of the related loan.

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

	> 90 30-89 days Past Due	Total Past Due	Total Current	Total Notes Receivable
As of September 30, 2018 (in thousands)				
Senior	\$—	—\$	—\$89,568	\$ 89,568
Subordinated	—	—	25,728	25,728
Unsecured	—	—	2,517	2,517
	\$—	—\$	—\$117,813	\$ 117,813
As of December 31, 2017				
Senior	\$—	—\$	—\$73,700	\$ 73,700
Subordinated	—	—	18,647	18,647
Unsecured	—	—	3,182	3,182
	\$—	—\$	—\$95,529	\$ 95,529

## Variable Interest through Notes Issued

The Company has issued notes receivables to certain entities that have created variable interests in these borrowers totaling \$59.4 million and \$35.2 million as of September 30, 2018 and December 31, 2017, respectively. The Company has determined that it is not the primary beneficiary of these variable interest entities ("VIEs"). Each of these loans have stated fixed and/or variable interest amounts.

## Transfer of interest

On September 12, 2017, the Company entered into an agreement to transfer \$24.2 million of a \$49.1 million outstanding note receivable with a maturity date of November 30, 2019 to a third party. In the first quarter of 2018, an additional \$0.2 million was transferred for a total of \$24.4 million. The transaction did not qualify as a sale and therefore the outstanding note receivable was not de-recognized on the balance sheet. The one-time cash proceeds were recorded as unrestricted cash and the future obligation to transfer principal and interest received under the note has been recorded within Other long-term liabilities. The Company retains responsibility for collecting and distributing cash received on the note and interest paid to the participant is reflected as interest expense in the Company's consolidated statements of income. As of September 30, 2018 and December 31, 2017, Other long-term liabilities includes \$24.4 million and \$24.2 million, respectively, pursuant to this transaction.

## 5. Investments in Unconsolidated Entities

The Company maintains a portfolio of investments owned through noncontrolling interests in equity method investments with one or more partners. Investments in unconsolidated entities include investments in joint ventures totaling \$102.9 million and \$130.2 million at September 30, 2018 and December 31, 2017, respectively, that the Company determined to be VIEs. These investments relate to the Company's program to offer equity support to qualified franchisees to develop and operate Cambria 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 these VIEs. The Company based its qualitative analysis on its review of the design of the entity, its organizational structure including decision-making ability and the relevant development, operating management and financial agreements. Although the Company is not the primary beneficiary of these VIEs, it does exercise significant influence through its equity ownership and as a result the Company's investment in these entities is accounted for under the equity method. For the three months

ended September 30, 2018 and 2017, the Company recognized losses totaling \$1.1 million and \$1.3 million, respectively, from these investments. For the nine months ended September 30, 2018 and 2017, the Company recognized losses totaling \$7.6 million and \$5.1 million, 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 guaranties described in Note 13 of these financial statements.

During the third quarter of 2018, a partner in a VIE previously accounted for under the equity method of accounting exercised a put option to the Company for its membership interest. As a result, the Company paid \$3.2 million for the remaining interest and the purchase was accounted for as an asset acquisition. The financial results of the 100% owned entity have been consolidated in the Company's financial statements since August 9, 2018.

## 6. Debt

Debt consists of the following:

	September 30, 2018	December 31, 2017
	(in thousands)	
\$400 million senior unsecured notes with an effective interest rate of 6.0% less deferred issuance costs of \$3.4 million and \$3.9 million at September 30, 2018 and December 31, 2017, respectively	\$396,643	\$396,057
\$250 million senior unsecured notes with an effective interest rate of 6.19% less a discount and deferred issuance costs of \$0.6 million and \$0.8 million at September 30, 2018 and December 31, 2017, respectively	249,412	249,182
\$600 million senior unsecured credit facility with an effective interest rate of 3.23%, less deferred issuance costs of \$3.1 million at September 30, 2018	123,255	—
\$450 million senior unsecured credit facility with an effective interest rate of 2.84%, less deferred issuance costs of \$2.1 million at December 31, 2017	—	67,936
Fixed rate collateralized mortgage with an effective interest rate of 4.57%, plus a fair value adjustment of \$0.4 million and \$0.6 million at September 30, 2018 and December 31, 2017, respectively	8,364	8,853
Economic development loans with an effective interest rate of 3.0% at September 30, 2018 and December 31, 2017, respectively	4,240	3,712
Other notes payable	618	784
Total debt	\$782,532	\$726,524
Less current portion	1,099	1,232
Total long-term debt	\$781,433	\$725,292

### Restated Senior Unsecured Credit Facility

On August 20, 2018, the Company entered into the Restated Credit Agreement, which amended and restated the Company's existing senior unsecured revolving credit agreement, dated July 21, 2015 (the "Former Credit Agreement"). The Former Credit Agreement provided for a \$450 million unsecured revolving credit facility (the "Revolver") with a final maturity date of July 21, 2021.

The Restated Credit Agreement increases the commitments under the Revolver to \$600 million and extends the final maturity date of the Revolver to August 20, 2023, subject to optional one-year extensions that can be requested by the Company prior to each of the first, second and third anniversaries of the closing date of the Restated Credit Agreement. The effectiveness of such extensions is subject to the consent of the lenders under the Restated Credit Agreement and certain customary conditions. The Restated Credit Agreement also provides that up to \$35 million of borrowings under the Revolver may be used for alternative currency loans and up to \$25 million of borrowings under the Revolver may be used for swingline loans. The Company may from time to time designate one or more wholly owned subsidiaries of the Company as additional borrowers under the Restated Credit Agreement, subject to the consent of the lenders and certain customary conditions.

Pursuant to the Restated Credit Agreement, the previous guarantee by certain of the Company's subsidiaries of its obligations under the Revolver (as increased by the Restated Credit Agreement) was released. As a result, as of

August 20, 2018, there are no subsidiary guarantors under the Revolver. However, if certain subsidiaries of the Company subsequently incur certain recourse debt or become obligors in respect of certain recourse debt of the Company or certain of its other subsidiaries, the Restated Credit Agreement requires such obligated subsidiaries to guarantee the Company's obligations under the Revolver. In the event that these subsidiary guarantees are triggered under the Revolver, the same subsidiary guarantees would be required under the Company's 5.75% Senior Notes due 2022 and 5.70% Senior Notes due 2020 and certain hedging and bank product arrangements, if any, with lenders that are parties to the Restated Credit Agreement.

The Company may at any time prior to the final maturity date increase the amount of the Revolver or add one or more term loan facilities under the Restated Credit Agreement by up to an additional \$250 million in the aggregate to the extent that any one or more lenders commit to being a lender for the additional amount of such term loan facility and certain other customary conditions are met.

The Restated Credit Agreement provides that the Company may elect to have borrowings under the Revolver bear interest at a rate equal to (i) LIBOR plus a margin ranging from 90 to 150 basis points or (ii) a base rate plus a margin ranging from 0 to 50 basis points, in each case, with the margin determined according to the Company's senior unsecured long-term debt rating or under circumstances as set forth in the Restated Credit Agreement, the Company's total leverage ratio in the event that such total leverage ratio is less than 2.5 to 1.0.

A total of \$3.2 million in debt issuance costs were capitalized as part of the Restated Credit Facility, including \$1.7 million in costs incurred on the Restated Credit Facility and remaining unamortized costs of \$1.5 million attributable to the Former Credit Facility. The capitalized debt issuance costs are amortized on a straight-line basis, which is not materially different than the effective interest method, through the maturity. Amortization of these costs is included in interest expense in the consolidated statements of income. Additionally, the Restated Credit Agreement requires the Company to pay a fee on the total commitments under the Revolver, calculated on the basis of the actual daily amount of the commitments under the Revolver (regardless of usage) times a percentage per annum ranging from 0.075% to 0.25% (depending on the Company's senior unsecured long-term debt rating or under circumstances as set forth in the Restated Credit Agreement, the Company's total leverage ratio in the event that such total leverage ratio is less than 2.5 to 1.0).

The Restated Credit Agreement requires that the Company and its restricted subsidiaries comply with various covenants, including with respect to restrictions on liens, incurring indebtedness, making investments and effecting mergers and/or asset sales. With respect to dividends, the Company may not declare or make any payment if there is an existing event of default or if the payment would create an event of default.

The Restated Credit Agreement imposes financial maintenance covenants requiring the Company to maintain a consolidated fixed charge coverage ratio of at least 2.5 to 1.0 and a total leverage ratio of not more than 4.5 to 1.0 or, on up to two nonconsecutive occasions, 5.5 to 1.0 for up to three consecutive quarters following a material acquisition commencing with the fiscal quarter in which such material acquisition occurred. If the Company achieves and maintains an Investment Grade Rating, as defined in the Restated Credit Agreement, then the Company will not need to comply with the consolidated fixed charge coverage ratio covenant.

The Restated Credit Agreement includes customary events of default, the occurrence of which, following any applicable cure period, would permit the lenders to, among other things, declare the principal, accrued interest and other obligations of the Company under the Restated Credit Agreement to be immediately due and payable. At September 30, 2018, the Company was in compliance with all financial covenants under the Restated Credit Agreement.

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

For additional information regarding other debt, see the "Debt" caption under the "Liquidity and Capital Resources" section in Management's Discussion and Analysis of Financial Condition and Results of Operations.

## 7. Accumulated Other Comprehensive Loss

The following represents the changes in accumulated other comprehensive loss, net of tax, by component for the nine months ended September 30, 2018:

	Loss on Cash Flow Hedge	Foreign Currency Items	Total
	(in thousands)		
Beginning balance, December 31, 2017	\$(2,298)	\$ (2,401 )	\$(4,699)
Other comprehensive income before reclassification	—	(1,264 )	(1,264 )
Amounts reclassified from accumulated other comprehensive loss	646	—	646
Net current period other comprehensive income	646	(1,264 )	(618 )
Ending balance, September 30, 2018	\$(1,652)	\$ (3,665 )	\$(5,317)

Table of Contents

The amounts below were reclassified from accumulated other comprehensive loss to the following line items in the Company's Consolidated Statements of Income during the three and nine months ended September 30, 2018. There is no income tax expense or benefit attributable to the components below.

Component	Amount Reclassified from Accumulated Other Comprehensive Loss		Affected Line Item in the Consolidated Statement of Income
	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018	
Loss on cash flow hedge:	(in thousands)		
Interest rate contract	\$ 215	\$ 646	Interest expense

## 8. Fair Value Measurements

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

Level 1: Quoted prices in active markets for identical assets and liabilities. The Company's Level 1 assets consist of marketable securities (primarily mutual funds) held in the Company's Deferred Compensation Plan.

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 Deferred Compensation Plan and those recorded in cash and cash equivalents.

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

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 nine months ended September 30, 2018.

As of September 30, 2018 and December 31, 2017, the Company had the following assets measured at fair value on a recurring basis:

Assets	Fair Value Measurements at Reporting Date Using			
	Total	Level 1	Level 2	Level 3
As of September 30, 2018	(in thousands)			
Mutual funds <sup>(1)</sup>	\$21,928	\$21,928	\$—	\$—
Money market funds <sup>(1)</sup>	1,790	—	1,790	—
	\$23,718	\$21,928	\$1,790	\$—
As of December 31, 2017				
Money market funds, included in cash and cash equivalents	\$50,419	\$—	\$50,419	\$—
Mutual funds <sup>(1)</sup>	20,869	20,869	—	—
Money market funds <sup>(1)</sup>	1,702	—	1,702	—
	\$72,990	\$20,869	\$52,121	\$—

(1) Included in Investments, employee benefit plans at fair value and Other current assets 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 Restated Credit Agreement adjust frequently based on current market rates; accordingly its carrying amount approximates fair value.

The Company estimates the fair value of notes receivable, which approximate their carrying value, utilizing an analysis of future cash flows and credit worthiness for similar types of arrangements. Based upon the availability of market data, the notes receivable have been classified as Level 3 inputs. The primary sensitivity in these calculations is based on the selection of appropriate interest and discount rates. For further information on the notes receivables, see Note 4.

The money market funds previously included in cash and cash equivalents were used to fund the WoodSpring acquisition on February 1, 2018. See Note 15 for further information on the acquisition. The fair values of the Company's \$250 million and \$400 million Senior Notes are classified as Level 2 as the significant inputs are observable in an active market. At September 30, 2018 and December 31, 2017, the \$250 million senior notes had an approximate fair value of \$260.3 million and \$269.2 million, respectively. At September 30, 2018 and December 31, 2017, the \$400 million Senior Notes had an approximate fair value of \$423.0 million and \$440.1 million, respectively.

Fair value estimates 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.

#### 9. Income Taxes

The effective income tax rates were 21.9% and 31.7% for the three months ended September 30, 2018 and 2017, respectively. The effective income tax rates were 20.6% and 32.0% for the nine months ended September 30, 2018 and 2017, respectively.

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The Act reduces the U.S. federal corporate income tax rate from 35.0% to 21.0%, requires companies to pay a one-time transition tax on earnings of foreign subsidiaries that were previously tax deferred, and creates new taxes on certain foreign-sourced earnings. The Company applied the guidance in Staff Accounting Bulletin 118 ("SAB 118") when accounting for the enactment-date effects of the Act. As of September 30, 2018, the Company finalized its calculations related to the tax effects of the Act and there were no significant changes to the impacts estimated as part of the year ended 2017 provision for income taxes.

The effective income tax rate for the three months ended September 30, 2018 was slightly higher than the U.S. federal income tax rate of 21.0% primarily due to an unfavorable \$1.0 million adjustment to the SAB 118 deferred tax asset impairment estimate and the impact of state income taxes, partially offset by excess tax benefits from share-based compensation of \$0.5 million, a favorable \$0.2 million adjustment to the SAB 118 transition tax estimate, and the impact of foreign operations.

The effective income tax rate for the nine months ended September 30, 2018 was lower than the U.S. federal income tax rate of 21.0% due to excess tax benefits from share-based compensation of \$4.0 million, a favorable \$0.2 million adjustment to the SAB 118 transition tax estimate, and the impact of foreign operations, partially offset by an unfavorable \$1.0 million adjustment to the SAB 118 deferred tax asset impairment estimate and the impact of state income taxes.

The effective income tax rate for the three and nine months ended September 30, 2017 was lower than the U.S. federal income tax rate of 35.0% due to excess tax benefits from share-based compensation of \$0.9 million and \$2.7 million, respectively, and the impact of foreign operations, partially offset by state income taxes.

The Act subjects a U.S. shareholder to a minimum tax on “global intangible low-taxed income” (“GILTI”) earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740 No. 5, Accounting for Global Intangible Low-Taxed Income, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI resulting from those items in the year the tax is incurred. The Company has elected to recognize the resulting tax on GILTI as a period expense in the period the tax is incurred and expects to incur tax for the year ended December 31, 2018.

Due to the recent changes resulting from the Act, the Company has implemented a new foreign dividend policy effective during the quarter ended September 30, 2018. As a result of the new policy, the Company intends to limit any future foreign distributions to income which has been previously subject to US taxation, for which relevant taxes have been recorded. Nonetheless, the Company will continue to assert that any other outside basis difference of the foreign subsidiaries will be permanently (or indefinitely) reinvested outside of the U.S. Consequently, the Company will not record any additional deferred taxes for this item in 2018.

Table of Contents

## 10. Share-Based Compensation and Capital Stock

The components of the Company's pretax share-based compensation expense and associated income tax benefits are as follows for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
(In millions)	2018	2017	2018	2017
Stock options	\$0.6	\$6.4	\$1.9	\$8.6
Restricted stock	1.7	3.9	5.0	7.3
Performance vested restricted stock units	1.4	3.7	4.0	5.8
Total	\$3.7	\$14.0	\$10.9	\$21.7
Income tax benefits	\$0.9	\$5.2	\$2.6	\$8.0

In conjunction with the acceleration of the Company's chief executive officer succession plan, stock option, restricted stock and performance vested restricted stock unit ("PVRSU") expense for the three and nine months ended September 30, 2017, included an additional \$5.5 million, \$2.1 million and \$2.5 million, respectively, of accelerated recognition of share based payment awards.

A summary of stock-based award activity as of September 30, 2018 and changes during the nine months ended are presented below:

	Stock Options			Restricted Stock		Performance Vested Restricted Stock Units	
	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2018	1,976,326	\$ 50.80		348,876	\$ 57.05	294,204	\$ 56.95
Granted	109,045	81.55		101,325	81.21	97,490	81.55
Exercised/Vested	(829,214 )	49.63		(94,981 )	55.88	(31,048 )	60.60
Expired	(2,018 )	63.47		—	—	—	—
Forfeited	(59,250 )	55.94		(41,574 )	59.78	(24,687 )	64.16
Outstanding at September 30, 2018	1,194,889	\$ 54.14	3.7 years	313,646	\$ 64.84	335,959	\$ 63.21
Options exercisable at September 30, 2018	757,276	\$ 49.59	3.0 years				

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:

	2018
	Grants
Risk-free interest rate	2.58 %
Expected volatility	21.17 %
Expected life of stock option	4.6 years
Dividend yield	1.05 %
Requisite service period	4 years
Contractual life	7 years
Weighted average fair value of options granted (per option)	\$ 16.27

Restricted stock awards generally vest ratably over the service period beginning with the first anniversary of the grant date. Vesting service period of shares granted during the three and nine months ended September 30, 2018 range from 12 - 48 months.

14

---

Table of Contents

The Company has granted PVRsUs to certain employees. The vesting of these stock awards is contingent upon the Company achieving performance targets over a 36-month performance period and the employees' continued employment. The performance conditions affect the number of shares that will ultimately vest and can range between 0% and 200% of the shares granted.

## Share Repurchases and Redemptions

The Company purchased 495,930 and 1,285,270 shares of common stock under the share repurchase program at a total cost of \$38.5 million and \$101.9 million during the three and nine months ended September 30, 2018, respectively.

During the three and nine months ended September 30, 2018, the Company redeemed 2,683 and 90,872 shares of common stock at a total cost of approximately \$0.2 million and \$7.3 million, respectively, from employees to satisfy the option exercise price and statutory minimum tax-withholding requirements related to the exercising of stock options and vesting of performance vested restricted stock units and restricted stock grants. These redemptions were outside the share repurchase program.

## 11. Earnings Per Share

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

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
(In thousands, except per share amounts)				
Computation of Basic Earnings Per Share:				
Numerator:				
Net income	\$79,959	\$57,189	\$184,884	\$132,143
Income allocated to participating securities	(447 )	(402 )	(1,081 )	(938 )
Net income available to common shareholders	\$79,512	\$56,787	\$183,803	\$131,205
Denominator:				
Weighted average common shares outstanding – basic	56,025	56,161	56,283	56,059
Basic earnings per share	\$1.42	\$1.01	\$3.27	\$2.34
Computation of Diluted Earnings Per Share:				
Numerator:				
Net income	\$79,959	\$57,189	\$184,884	\$132,143
Income allocated to participating securities	(444 )	(400 )	(1,073 )	(933 )
Net income available to common shareholders	\$79,515	\$56,789	\$183,811	\$131,210
Denominator:				
Weighted average common shares outstanding – basic	56,025	56,161	56,283	56,059
Diluted effect of stock options and PVRsUs	405	344	505	357
Weighted average common shares outstanding – diluted	56,430	56,505	56,788	56,416
Diluted earnings per share	\$1.41	\$1.01	\$3.24	\$2.33

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

At September 30, 2018 and 2017, the Company had 1.2 million and 2.1 million outstanding stock options, respectively. Stock options are included in the diluted EPS calculation using the treasury stock method and average

market prices during the period, unless the stock options would be anti-dilutive. For the three and nine months ended September 30, 2018, 0.1 million anti-dilutive stock options were excluded from the diluted EPS calculation. For the three and nine months ended September 30, 2017, the Company excluded 0.4 million of anti-dilutive stock options from the diluted EPS calculation.

Table of Contents

PVRSUs are also included in the diluted EPS calculation when the performance conditions have been met at the reporting date. However, at September 30, 2018 and 2017, PVRSUs totaling 318,215 and 297,548, respectively, were excluded from the computation since the performance conditions had not been met.

## 12. Reportable Segment Information

**Hotel Franchising:** Hotel franchising includes the Company's hotel franchising operations consisting of its twelve brands. The twelve brands are aggregated within this segment in consideration of their similar economic characteristics, types of customers, distribution channels and regulatory business environments. Revenues from the hotel franchising business include royalty fees, initial franchise and relicensing fees, marketing and reservation system fees, procurement services revenue and other franchising related revenue. The Company is obligated under its hotel franchise agreements to provide marketing and reservation services appropriate for the operation of its systems. These services do not represent separate reportable segments as their operations are directly related to the Company's hotel franchising business. The revenues received from franchisees that are used to pay for part of the Company's ongoing operations are included in hotel franchising revenues and are offset by the related expenses paid for marketing and reservation activities to calculate hotel franchising operating income.

The financial results for the three and nine months ended September 30, 2017 have been updated to reflect the Company's adoption of Topic 606 as discussed in Note 1. In addition, the financial results related to SkyTouch are now reported as a component of Corporate & Other.

The Company evaluates its hotel franchising segment based primarily on the results of the segment without allocating corporate expenses, income taxes or indirect general and administrative expenses, which are included in the Corporate & Other column. Corporate & Other revenues include rental income related to an office building owned by the Company, as well as revenues related to the Company's vacation rental activities and its SaaS technology solutions divisions which provide cloud-based property management software to non-franchised hoteliers and vacation rental management companies. Equity in earnings or losses from hotel franchising related joint ventures is allocated to the Company's hotel franchising segment. The Company does not allocate interest expense, interest income, other gains and losses or income taxes to its segments.

The following table presents the financial information for the Company's hotel franchising segment:

(In thousands)	Three Months Ended September 30, 2018			Three Months Ended September 30, 2017		
	Hotel Franchising	Corporate & Other	Consolidated	Hotel Franchising	Corporate & Other	Consolidated
Revenues	\$287,813	\$ 3,677	\$ 291,490	\$267,071	\$ 2,859	\$ 269,930
Operating income (loss)	\$126,025	\$ (14,857 )	\$ 111,168	\$116,500	\$ (23,437 )	\$ 93,063
Income (loss) before income taxes	\$126,068	\$ (23,625 )	\$ 102,443	\$116,225	\$ (32,482 )	\$ 83,743
	Nine Months Ended September 30, 2018			Nine Months Ended September 30, 2017		
(In thousands)	Hotel Franchising	Corporate & Other	Consolidated	Hotel Franchising	Corporate & Other	Consolidated
Revenues	\$785,621	\$ 10,704	\$ 796,325	\$711,843	\$ 7,971	\$ 719,814
Operating income (loss)	\$308,048	\$ (41,615 )	\$ 266,433	\$276,203	\$ (51,198 )	\$ 225,005
Income (loss) before income taxes	\$302,690	\$ (69,762 )	\$ 232,928	\$272,989	\$ (78,553 )	\$ 194,436

## Table of Contents

### 13. Commitments and Contingencies

The Company is not a party to any litigation other than litigation in the ordinary course of business. The Company's management and legal counsel do not expect that the ultimate outcome of any of its currently ongoing legal proceedings, individually or collectively, will have a material adverse effect on the Company's financial position, results of operations or cash flows.

#### Contingencies

The Company entered in to various limited payment guaranties with regards to the Company's VIEs supporting the VIE's efforts to develop and own hotels franchised under the Company's brands. Under these limited payment guaranties, the Company has agreed to guarantee a portion of the outstanding debt until certain conditions are met such as (a) the loan matures, (b) certain debt covenants are achieved, (c) the maximum amount guaranteed by the Company is paid in full or (d) the Company, through its affiliates, ceases to be a member of the VIE. The maximum exposure of principal incidental to these limited payment guaranties is \$13.0 million, plus unpaid expenses and accrued unpaid interest. The Company believes the likelihood of having to perform under the aforementioned limited payment guaranties is remote as of September 30, 2018 and December 31, 2017. In the event of performance, the Company has recourse for two of the transactions in the form of a membership interest pledge as collateral for the guaranty.

The Company transferred a portion of an outstanding note receivable to a third party for \$24.4 million. Under the agreement, the counter party may require the Company to purchase the outstanding interest in the note if the Company declares a default against the borrower and enters into foreclosure proceedings. The Company believes the likelihood of foreclosure on the note is remote as of September 30, 2018.

#### Commitments

The Company has the following commitments outstanding at September 30, 2018:

The Company provides financing in the form of franchise agreement acquisition payments to franchisees for property improvements, hotel development efforts and other purposes. At September 30, 2018, the Company had commitments to extend an additional \$220.7 million for these purposes provided certain conditions are met by its franchisees.

The Company committed to make additional capital contributions totaling \$12.2 million to existing unconsolidated and consolidated joint ventures related to the construction of various hotels to be operated under the Company's Cambria Hotels brand.

The Company committed to provide financing in the form of mezzanine loans or credit facilities to franchisees for Choice brand development efforts. The Company has committed to provide an aggregate of approximately \$10.1 million, upon certain conditions being met. As of September 30, 2018, \$2.4 million have been disbursed.

In March 2018, the Company entered into a construction loan agreement for the rehabilitation and development of a former office building into a hotel through a consolidated joint venture with a commercial lender, which is secured by the building. The construction loan can be drawn up to \$34.9 million. The Company has a carve-out guaranty and the unaffiliated joint venture partner has a completion guaranty in relation to the loan, in which both parties are required to meet certain financial covenants relating to liquidity and net worth. The rehabilitation of the building is considered a qualified asset in which requires a significant amount of time to prepare for its intended use. Therefore, any interest costs incurred during the development period of the building is considered an element of the historical cost of the qualifying asset. At September 30, 2018, the Company has not drawn on the construction loan or recorded any capitalized interest costs.

The Company's franchise agreements require the payment of franchise fees, which include marketing and reservation system fees. These fees are described in Note 2. In accordance with terms of our franchise agreements, 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. To the extent revenues collected exceed expenditures incurred, the Company has a commitment to the franchisee system to make expenditures in future years. Conversely, to the extent expenditures incurred exceed revenues collected, the Company has the contractual enforceable right to assess and collect such amounts.

In the ordinary course of business, the Company enters into numerous agreements that contain standard indemnities whereby the Company indemnifies another party for breaches of representations and warranties or possible environmental contamination issues. Such indemnifications are granted under various agreements, including those governing (i) purchases or sales of assets

## Table of Contents

or businesses, (ii) leases of real estate, (iii) licensing of trademarks, (iv) access to credit facilities, (v) issuances of debt or equity securities, and (vi) certain operating agreements. The indemnifications issued are for the benefit of the (i) buyers in sale agreements and sellers in purchase agreements, (ii) landlords in lease contracts, (iii) franchisees in licensing agreements, (iv) financial institutions in credit facility arrangements, (v) underwriters in debt or equity security issuances and (vi) parties under certain operating agreements. In addition, these parties are also generally indemnified against any third party claim resulting from the transaction that is contemplated in the underlying agreement. While some of these indemnities extend only for the duration of the underlying agreement, many survive the expiration of the term of the agreement or extend into perpetuity (unless subject to a legal statute of limitations). There are no specific limitations on the maximum potential amount of future payments that the Company could be required to make under these indemnities, nor is the Company able to develop an estimate of the maximum potential amount of future payments to be made under these indemnifications as the triggering events are not subject to predictability. With respect to certain of the aforementioned indemnities, such as indemnifications of landlords against third party claims for the use of real estate property leased by the Company, the Company maintains insurance coverage that mitigates potential liability.

### 14. Transactions with Unconsolidated Joint Ventures

The Company has a management fee arrangement for marketing services with a joint venture partner. For the three and nine months ended September 30, 2018, fees earned and payroll costs reimbursed under this arrangement totaled \$0.6 million and \$1.4 million, respectively. For the three and nine months ended September 30, 2017, fees earned and payroll costs reimbursed under this arrangement totaled \$0.5 million and \$1.3 million, respectively.

The Company has entered into franchise agreements with certain of the unconsolidated joint ventures discussed in Note 5. Pursuant to these franchise agreements, for the three months ended September 30, 2018 and 2017, the Company recorded royalty and marketing reservation system fees of approximately \$7.3 million and \$7.2 million, respectively. For the nine months ended September 30, 2018 and 2017, the Company has recorded royalty and marketing reservation system fees of approximately \$18.2 million and \$16.1 million, respectively. The Company recorded \$2.1 million and \$1.3 million as a receivable due from these joint ventures as of September 30, 2018 and December 31, 2017, respectively. In addition, the Company paid commissions of \$65 thousand and \$66 thousand for the three months ended September 30, 2018 and 2017, respectively, and \$0.2 million and \$0.1 million for the nine months ended September 30, 2018 and 2017, respectively, to an on-line travel agent for which the Company is a joint venture member.

### 15. Acquisition

On February 1, 2018, the Company acquired 100% of the issued and outstanding equity interest of WoodSpring. At the time of the acquisition, WoodSpring franchised 239 economy extended stay hotels across 35 U.S. states. The total consideration was \$231.6 million, which consisted of cash paid, net of cash acquired, of \$231.3 million as well as liabilities assumed of \$0.4 million and a preliminary working capital adjustment of \$0.1 million. The transaction has been accounted for using the acquisition method of accounting and accordingly, assets acquired, and liabilities assumed were recorded at their fair values as of the acquisition date. The results of WoodSpring have been consolidated with the Company since February 1, 2018 and are included in the Company's hotel franchising segment. The Company allocated the purchase price based upon a preliminary assessment of the fair value of the assets and liabilities assumed as of February 1, 2018. The Company completed its assessment of the WoodSpring acquisition in the third quarter of 2018, identifying no adjustments to the fair value determination. As a result, the purchase price allocation is final as of the third quarter of 2018, with no adjustments made from the preliminary allocation.

Table of Contents

The fair value of the assets and liabilities is as follows:

	(in thousands)
Cash	\$ 250
Accounts receivables	1,258
Prepaid	23
Contract assets	115,000
Tradename	22,000
Goodwill	93,384
Accounts payable	(348 )
Total Consideration	\$ 231,567

The purchase price was based on the projected business growth and cash flows over the next several years and indicated a value that was in excess of the current net book value of the business, resulting in the recognition of various identifiable intangible assets and goodwill as follows:

	(in thousands)	Useful Life
Franchise agreements acquired	\$ 115,000	12-20 years
WoodSpring tradename	22,000	Indefinite
Goodwill	93,384	Indefinite
Total	\$ 230,384	

The excess value recorded in goodwill is expected to be recovered through growth within the existing customer base, improvements in hotel RevPAR and new agreements signed with new franchisees and developers. The full amount of goodwill is deductible for tax purposes. The Company's pro forma results of operations for this acquisition have not been presented here because the effect of this acquisition was not material to the Company's consolidated results of operations.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the consolidated financial condition and results of operations of Choice Hotels International, Inc. and its subsidiaries (together the "Company") contained in this report. MD&A is provided as a supplement to-and should be read in conjunction with-our consolidated financial statements and the accompanying notes.

Effective January 1, 2018, the Company adopted Accounting Standards Update No. 2014-09, Revenue From Contracts with Customers (Topic 606) and subsequent amendments to the initial guidance ("Topic 606"). The Company adopted Topic 606 under the full retrospective method. As a result, the Company's results from operations for the three and nine months ended September 30, 2017 have been revised to reflect the requirements of Topic 606.

### Overview

We are primarily a hotel franchisor with franchise agreements representing 6,922 hotels open and 1,050 hotels under construction, awaiting conversion or approved for development as of September 30, 2018, with 561,380 rooms and 85,473 rooms, respectively, in 50 states, the District of Columbia and over 40 countries and territories outside the United States. Our brand names include Ascend Hotel Collection®, Cambria® Hotels, Comfort®, Comfort Suites®, Sleep Inn®, Quality®, Clarion®, MainStay Suites®, Suburban Extended Stay Hotel®, WoodSpring Suites®, Econo Lodge®, and Rodeway Inn® (collectively, the "Choice brands").

On February 1, 2018, the Company acquired all of the issued and outstanding equity interests of WoodSpring Hotels Franchise Services LLC (“WSFS”). WSFS is the franchisor of WoodSpring Suites and at acquisition had 239 units (28,680 rooms) operating in the economy extended stay segment in 35 states in the United States. The transaction has been accounted for using the acquisition method of accounting and accordingly, assets acquired and liabilities assumed were recorded at their fair values of the acquisition date. The acquisition allowed the Company to accelerate its growth in the economy extended stay segment. The results of WSFS have been consolidated within the Company’s hotel franchising segment since February 1, 2018.

## Table of Contents

The Company's domestic franchising operations are conducted through direct franchising relationships while its international franchise operations are conducted through a combination of direct franchising and master franchising relationships. Master franchising relationships are governed by master franchising agreements which generally provide the master franchisee with the right to use our brands and sub-license the use of our brands in a specific geographic region, usually for a fee.

Our business strategy is to conduct direct franchising in those international markets where both franchising is an accepted business model and we believe our brands can achieve significant scale. We typically elect to enter into master franchise agreements in those markets where direct franchising is currently not a prevalent or viable business model. When entering into master franchising relationships, we strive to select partners that have professional hotel and asset management capabilities together with the financial capacity to invest in building the Choice brands in their respective markets. Master franchising relationships typically provide lower revenues to the Company as the master franchisees are responsible for managing certain necessary services (such as training, quality assurance, reservations and marketing) to support the franchised hotels in the master franchise area and therefore, retain a larger percentage of the hotel franchise fees to cover their expenses. In certain circumstances, the Company has and may continue to make equity investments in our master franchisees. As a result of master franchise relationships and international market conditions, our revenues are primarily concentrated in the United States. Therefore, our description of the franchise system is primarily focused on the domestic operations.

Our Company generates revenues, income and cash flows primarily from initial, relicensing and continuing royalty fees attributable to our franchise agreements. Revenues are also generated from qualified vendor arrangements and other sources. The hotel industry is seasonal in nature. For most hotels, demand is lower in November through February than during the remainder of the year. Our principal source of revenues is franchise fees based on the gross room revenues or number of rooms of our franchised properties. The Company's franchise fee revenues reflect the industry's seasonality and historically have been lower in the first and fourth quarters than in the second and third quarters.

With a focus on hotel franchising instead of ownership, we benefit from the economies of scale inherent in the franchising business. The fee and cost structure of our business provides opportunities to improve operating results by increasing the number of franchised hotel rooms and effective royalty rates of our franchise contracts resulting in increased initial and relicensing fee revenue; ongoing royalty fees and procurement services revenues. In addition, our operating results can also be improved through our company-wide efforts related to improving property level performance. The Company currently estimates, based on its current domestic portfolio of hotels under franchise, that a 1% change in revenue per available room ("RevPAR") or rooms under franchise would increase or decrease royalty revenues by approximately \$3.5 million and a 1 basis point change in the Company's effective royalty rate would increase or decrease annual domestic royalties by approximately \$0.7 million. In addition to these revenues, we also collect marketing and reservation system fees to support centralized marketing and reservation activities for the franchise system.

The principal factors that affect the Company's results are: the number and relative mix of franchised hotel rooms in the various hotel lodging price categories; growth in the number of hotel rooms under franchise; occupancy and room rates achieved by the hotels under franchise; the effective royalty rate achieved; the level of franchise sales and relicensing activity; and our ability to manage costs. The number of rooms at franchised properties and occupancy and room rates at those properties significantly affect the Company's results because our fees are based upon room revenues or the number of rooms at franchised hotels. The key industry standard for measuring hotel-operating performance is RevPAR, which is calculated by multiplying the percentage of occupied rooms by the average daily room rate realized. Our variable overhead costs associated with franchise system growth of our established brands have historically been less than incremental royalty fees generated from new franchises. Accordingly, continued growth of our franchise business should enable us to realize benefits from the operating leverage in place and improve operating results.

We are required by our franchise agreements to use the marketing and reservation system fees we collect for system-wide marketing and reservation activities. These expenditures, which include advertising costs and costs to maintain our central reservations and property management systems, help to enhance awareness and consumer preference for our brands and deliver guests to our franchisees. Greater awareness and preference promotes long-term growth in business delivery to our franchisees and increases the desirability of our brands to hotel owners and developers, which ultimately increases franchise fees earned by the Company.

Our Company articulates its mission as a commitment to our franchisees' profitability by providing our franchisees with hotel franchises that strive to generate the highest return on investment of any hotel franchise. We have developed an operating system dedicated to our franchisees' success that focuses on delivering guests to our franchised hotels and reducing costs for our hotel owners.

We believe that executing our strategic priorities creates value for our shareholders. Our Company focuses on two key goals:

20

---

Table of Contents

**Profitable Growth.** Our success is dependent on improving the performance of our hotels, increasing our system size by selling additional hotel franchises, effective royalty rate improvement and maintaining a disciplined cost structure. We attempt to improve our franchisees' revenues and overall profitability by providing a variety of products and services designed to increase business delivery to and/or reduce operating and development costs for our franchisees. These products and services include national marketing campaigns, maintaining a guest loyalty program, a central reservation system, property and yield management programs and systems, revenue management services, quality assurance standards and qualified vendor relationships. We believe that healthy brands, which deliver a compelling return on investment for franchisees, will enable us to sell additional hotel franchises and raise royalty rates. We have multiple brands that meet the needs of many types of guests, and can be developed at various price points and applied to both new and existing hotels. This ensures that we have brands suitable for creating growth in a variety of market conditions. Improving the performance of the hotels under franchise, growing the system through additional franchise sales and improving franchise agreement pricing while maintaining a disciplined cost structure are the keys to profitable growth.

**Maximizing Financial Returns and Creating Value for Shareholders.** Our capital allocation decisions, including capital structure and uses of capital, are intended to maximize our return on invested capital and create value for our shareholders. We believe our strong and predictable cash flows create a strong financial position that provides us a competitive advantage. We maintain a capital structure that generates high financial returns and use our excess cash flow to provide returns to our shareholders primarily through share repurchases, dividends or investing in growth opportunities.

Historically, we have returned value to our shareholders through share repurchases and dividends. In 1998, we instituted a share repurchase program which has generated substantial value for our shareholders. Since the program's inception through September 30, 2018, we have repurchased 50.0 million shares (including 33.0 million prior to the two-for-one stock split effected in October 2005) of common stock at a total cost of \$1.4 billion. Considering the effect of the two-for-one stock split, the Company has repurchased 83.0 million shares at an average price of \$16.37 per share. The Company purchased 1.3 million shares of common stock under the share repurchase program at a total cost of \$101.9 million during the nine months ended September 30, 2018. At September 30, 2018, we had approximately 2.7 million shares remaining under the current share repurchase authorization. We currently believe that our cash flows from operations will support our ability to complete the current repurchase authorization. Upon completion of the current authorization, our board of directors will evaluate the advisability of additional share repurchases.

The Company commenced paying quarterly dividends in 2004 and in 2012 the Company elected to pay a special cash dividend totaling approximately \$600 million. The Company currently maintains the payment of a quarterly dividend totaling \$0.215 per share on its common shares outstanding; however, the declaration of future dividends is subject to the discretion of the board of directors. During the nine months ended September 30, 2018, we paid cash dividends totaling approximately \$36.6 million. We expect to continue to pay dividends in the future, subject to declaration by our board of directors as well as future business performance, economic conditions, changes in income tax regulations and other factors including limitations in the Company's credit facility. Based on the present outstanding share count and an annual dividend rate of \$0.86 per common share outstanding, we expect that aggregate annual regular dividends for 2018 would be approximately \$48.7 million.

The Company also allocates capital to financing, investment and guaranty support to incent franchise development for certain brands in strategic markets and to exploring growth opportunities in business areas that are adjacent or complementary to our core hotel franchising business, which leverage our core competencies and are additive to our franchising business model. The timing and amount of these investments are subject to market and other conditions. Notwithstanding investments in these alternative growth strategies, the Company expects to continue to return value to its shareholders over time through a combination of share repurchases and dividends.

We believe our growth investments and strategic priorities, when properly implemented, will enhance our profitability, maximize our financial returns and continue to generate value for our shareholders. The ultimate measure of our success will be reflected in the items below.

Results of Operations: Royalty fees, operating income, net income and diluted earnings per share ("EPS") represent key measurements of these value drivers. These measurements are primarily driven by the operations of our hotel franchise system and, therefore, our analysis of the Company's operations is primarily focused on the size, performance and potential growth of the hotel franchise system as well as our variable overhead costs. Since our hotel franchising activities represents approximately 99% of total revenues, our discussion of our results from operations primarily relate to our hotel franchising activities.

Our discussion of the hotel franchising activities also excludes the Company's marketing and reservation system revenues and expenses. The Company's franchise agreements require the payment of marketing and reservation system fees to be used exclusively by the Company for expenses associated with providing franchise services such as central reservation systems,

Table of Contents

national marketing and media advertising. The Company is obligated to expend the marketing and reservation system fees it collects from franchisees in accordance with the franchise agreements. Furthermore, franchisees are required to reimburse the Company for any deficits generated by these marketing and reservation system activities. Over time, the Company expects cumulative revenues and expenses to break even and therefore no income or loss will be generated. As a result, the Company excludes the financial impacts of this program from the analysis of its operations.

Due to the seasonal nature of the Company's hotel franchising business or multi-year investments that are required to support franchise operations, quarterly or annual deficits and surpluses may be generated. During the three months ended September 30, 2018 and 2017, marketing and reservation system revenues exceeded expenses by \$14.1 million and \$14.3 million, respectively. During the nine months ended September 30, 2018 and 2017, marketing and reservation system revenues exceeded expenses by \$22.6 million and \$16.8 million, respectively.

Refer to MD&A heading "Operations Review" for additional analysis of our results.

**Liquidity and Capital Resources:** Historically, the Company has generated significant cash flows from operations. Since our business has not historically required significant reinvestment of capital, we typically utilize cash in ways that management believes provide the greatest returns to our shareholders which include share repurchases and dividends. However, we may determine to utilize cash for acquisitions and other investments in the future. We believe the Company's cash flow from operations and available financing capacity is sufficient to meet the expected future operating, investing and financing needs of the business.

Refer to MD&A heading "Liquidity and Capital Resources" for additional analysis.

**Inflation:** Inflation has been moderate in recent years and has not had a significant impact on our business.

#### Non-GAAP Financial Statement Measurements

The Company utilizes certain measures which do not conform to generally accepted accounting principles accepted in the United States ("GAAP") when analyzing and discussing its results with the investment community. This information should not be considered as an alternative to any measure of performance as promulgated under GAAP. The Company's calculation of these measurements may be different from the calculations used by other companies and therefore, comparability may be limited. We have included a reconciliation of these measures to the comparable GAAP measurement below as well as our reasons for reporting these non-GAAP measures.

**Hotel Franchising Revenues:** The Company utilizes franchising revenues, which exclude revenues from marketing and reservation system activities, SaaS technology solutions divisions, vacation rental activities, and revenue generated from the ownership of an office building that is leased to a third-party, rather than total revenues when analyzing the performance of the business. Marketing and reservation activities are excluded from hotel franchising revenues since the Company is contractually required by its franchise agreements to utilize the fees collected specifically for franchisee marketing and reservation activities. Our SaaS technology solutions divisions and vacation rental activities are excluded from hotel franchising revenues since those operations do not reflect the Company's core hotel franchising business but represent adjacent, complementary lines of business. This non-GAAP measure is a commonly used measure of performance in our industry and facilitates comparisons between the Company and its competitors.

#### Calculation of Hotel Franchising Revenues

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
	(in thousands)		(in thousands)	
Total Revenues	\$291,490	\$269,930	\$796,325	\$719,814
Adjustments:				
Marketing and reservation system revenues	(152,367 )	(142,915 )	(416,715 )	(382,245 )
Non-hotel franchising activities	(3,677 )	(2,859 )	(10,704 )	(7,971 )
Hotel Franchising Revenues	\$135,446	\$124,156	\$368,906	\$329,598



Table of Contents

## Operations Review

## Comparison of Operating Results for the Three-Month Periods Ended September 30, 2018 and 2017

Summarized financial results for the three months ended September 30, 2018 and 2017 are as follows:

(In thousands)	2018	2017
<b>REVENUES</b>		
Royalty fees	\$ 111,009	\$ 103,322
Initial franchise and relicensing fees	6,262	5,729
Procurement services	11,620	8,810
Marketing and reservation system	152,367	142,915
Other	10,232	9,154
Total revenues	291,490	269,930
<b>OPERATING EXPENSES</b>		
Selling, general and administrative	38,191	46,573
Depreciation and amortization	3,815	1,601
Marketing and reservation system	138,316	128,661
Total operating expenses	180,322	176,835
Gain (loss) on sale of land and building, net	—	(32 )
Operating income	111,168	93,063
<b>OTHER INCOME AND EXPENSES, NET</b>		
Interest expense	11,706	11,399
Interest income	(1,966 )	(1,575 )
Other gains	(972 )	(778 )
Equity in net (income) loss of affiliates	(43 )	274
Total other income and expenses, net	8,725	9,320
Income before income taxes	102,443	83,743
Income tax expense	22,484	26,554
Net income	\$ 79,959	\$ 57,189

## Results of Operations

The Company recorded income before income taxes of \$102.4 million for the three month period ended September 30, 2018, a \$18.7 million or 22% increase from the same period of the prior year. The increase in income before income taxes primarily reflects a \$18.1 million increase in operating income, a \$0.4 million increase in interest income, and a \$0.3 million increase in equity in net (income) loss of affiliates partially offset by a \$0.3 million increase in interest expense.

Operating income increased \$18.1 million primarily due to a \$11.3 million or 9% increase in the Company's hotel franchising revenues, a \$8.4 million decrease in SG&A expenses, and a \$0.8 million increase in non-hotel franchising revenues partially offset by a \$2.2 million increase in depreciation and amortization expenses. The primary reasons for these fluctuations are described in more detail below.

## Hotel Franchising Revenues

Hotel franchising revenues were \$135.4 million for the three months ended September 30, 2018 compared to \$124.2 million for the three months ended September 30, 2017, an increase of \$11.3 million or 9%. The increase in hotel franchising revenues is primarily due to a \$7.7 million or 7% increase in royalty revenues, a \$2.8 million or 32% increase in procurement services revenues, a \$0.5 million or 9% increase in initial franchise and relicensing fees, and a \$0.3 million increase in non-compliance, contract termination fees and other franchise revenues.



Table of Contents

## Royalty Fees

Domestic royalty fees for the three months ended September 30, 2018 increased \$7.7 million to \$105.0 million from \$97.3 million for the three months ended September 30, 2017, an increase of 8%.

The increase in domestic royalties reflect an 9.6% increase in the number of domestic franchised hotel rooms and an increase in the effective royalty rate partially offset by a 1.4% decrease in domestic RevPAR. System-wide RevPAR decreased due to a 160 basis point decrease in occupancy rates, partially offset by a 0.9% increase in average daily rates. The decline in occupancy rates in the third quarter 2018 primarily relate to weather-related events such as hurricanes that drove higher occupancy rates in the third quarter of 2017 and the timing of the fourth of July holiday which fell on a Wednesday in the third quarter 2018 compared to Tuesday in the prior year. These items either resulted in either lower leisure travel demand in the quarter or provided tougher comparable prior period results. In addition, lobby and room renovations at over 1,000 of the Company's Comfort brand franchises resulted in lower occupancy in the third quarter of 2018. The Company's effective royalty rate for the domestic hotel system increased from 4.60% for the three months ended September 30, 2017 to 4.72% for the three months ended September 30, 2018. The increase in the effective royalty rate is attributable to improved royalty rate pricing on recently executed domestic franchise agreements, annual contractual royalty rate increases contained in existing franchise agreements and the acquisition of WSFS. Overall, the acquisition of WSFS on February 1, 2018 increased domestic royalties for the three months ended September 30, 2018 by \$5.5 million.

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

	Three Months Ended			Three Months Ended			Change		
	September 30, 2018			September 30, 2017					
	Average			Average			Average		
	Daily	Occupancy	RevPAR	Daily	Occupancy	RevPAR	Daily	Occupancy	RevPAR
	Rate			Rate			Rate		
Comfort Inn	\$101.37	71.8 %	\$ 72.74	\$101.25	73.9 %	\$ 74.82	0.1%	(210 )	bps (2.8)%
Comfort Suites	101.55	73.5 %	74.59	101.43	75.5 %	76.55	0.1%	(200 )	bps (2.6)%
Sleep	87.95	69.6 %	61.24	86.85	71.3 %	61.88	1.3%	(170 )	bps (1.0)%
Quality	85.61	66.2 %	56.66	85.44	67.2 %	57.43	0.2%	(100 )	bps (1.3)%
Clarion	90.98	63.9 %	58.12	89.83	67.3 %	60.46	1.3%	(340 )	bps (3.9)%
Econo Lodge	68.56	60.2 %	41.26	68.87	61.7 %	42.51	(0.5)%	(150 )	bps (2.9)%
Rodeway	69.75	61.9 %	43.18	70.78	63.0 %	44.56	(1.5)%	(110 )	bps (3.1)%
WoodSpring Suites*	46.89	82.6 %	38.74	43.39	84.3 %	36.60	8.1%	(170 )	bps 5.8%
MainStay	86.69	75.1 %	65.13	80.42	74.8 %	60.17	7.8%	30	bps 8.2%
Suburban	57.42	78.3 %	44.98	52.46	78.9 %	41.39	9.5%	(60 )	bps 8.7%
Cambria Hotels	149.48	75.0 %	112.06	142.84	79.1 %	112.95	4.6%	(410 )	bps (0.8)%
Ascend Hotel Collection	135.93	62.1 %	84.35	137.02	60.9 %	83.40	(0.8)%	120	bps 1.1%
Total*	\$86.83	68.6 %	\$ 59.52	\$86.02	70.2 %	\$ 60.37	0.9%	(160)	bps (1.4)%

\* WSFS was acquired on February 1, 2018; however Average Daily Rate, Occupancy, and RevPar reflect operating performance for the three months ended September 30, 2018 and 2017 as if the brand had been acquired on January 1, 2017.

The number of total domestic rooms on-line increased by 9.6% to 445,274 rooms as of September 30, 2018 from 406,452 as of September 30, 2017. The total number of domestic hotels on-line increased by 6.8% to 5,787 as of September 30, 2018 from 5,421 as of September 30, 2017. The increase in units and rooms is primarily attributable to the acquisition of WSFS, which added 239 hotels and 28,680 rooms on the date of acquisition, and the growth of the Quality brand, which added 93 hotels and 6,323 rooms on-line compared to September 30, 2017.



Table of Contents

A summary of domestic hotels and rooms on-line at September 30, 2018 and 2017 by brand is as follows:

	September 30, 2018		September 30, 2017		Variance					
	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms	%	%	%	%
Comfort Inn	1,060	82,998	1,083	84,427	(23 )	(1,429 )	(2.1 )	(1.7 )	%	%
Comfort Suites	574	44,661	566	43,857	8	804	1.4	1.8	%	%
Sleep	388	27,614	382	27,365	6	249	1.6	0.9	%	%
Quality	1,602	124,271	1,509	117,948	93	6,323	6.2	5.4	%	%
Clarion	166	21,641	160	21,267	6	374	3.8	1.8	%	%
Econo Lodge	824	49,978	839	51,322	(15 )	(1,344 )	(1.8 )	(2.6 )	%	%
Rodeway	606	34,824	595	34,331	11	493	1.8	1.4	%	%
WoodSpring Suites	247	29,632	—	—	247	29,632	NM	NM		
MainStay	62	4,273	57	4,135	5	138	8.8	3.3	%	%
Suburban	52	5,529	59	6,578	(7 )	(1,049 )	(11.9 )	(15.9 )	%	%
Cambria Hotels	39	5,563	31	4,160	8	1,403	25.8	33.7	%	%
Ascend Hotel Collection	167	14,290	140	11,062	27	3,228	19.3	29.2	%	%
Total Domestic Franchises	5,787	445,274	5,421	406,452	366	38,822	6.8	9.6	%	%

International royalty fees for the three months ended September 30, 2018 increased \$40 thousand to \$6.0 million, an increase of 0.7% compared to the three months ended September 30, 2017. The increase in international royalty fees resulted primarily from an increase in the number of international rooms on-line. International rooms on-line increased by 2,564 from 113,542 as of September 30, 2017 to 116,106 as of September 30, 2018, with the total number of hotels on-line decreasing by 1 from 1,136 as of September 30, 2017 to 1,135 as of September 30, 2018. International rooms increased by 2.3% despite the net decline in hotels due to a focus on new entrants with higher per unit room counts than currently in the Company's international franchised hotel portfolio.

#### Initial Franchise and Relicensing Fees

Initial franchise fees are fees paid to the Company when a franchisee executes a franchise agreement; relicensing fees include fees charged to new owners of a franchised property whenever an ownership change occurs and the property remains in the franchise system, as well as fees required to renew existing franchise agreements.

During the third quarter of 2018, the Company executed 159 domestic franchise agreements representing 13,001 rooms compared to 133 franchising agreements representing 11,241 rooms for the third quarter of 2017. The acquisition of WSFS resulted in 11 new construction franchise agreements during the three months ended September 30, 2018. Domestic franchise agreements executed for new construction hotels totaled 48 representing 4,364 rooms during the three months ended September 30, 2018 compared to 35 contracts representing 3,123 rooms for the three months ended September 30, 2017. Conversion hotel executed franchise agreements totaled 111 representing 8,637 rooms for the three months ended September 30, 2018 compared to 98 agreements representing 8,118 rooms for the three months ended September 30, 2017.

The Company executed 97 domestic relicensing contracts during the three months ended September 30, 2018, compared to 115 executed during the three months ended September 30, 2017. The Company executed 8 domestic renewal agreements during the three months ended September 30, 2018, compared to 6 executed during the three months ended September 30, 2017.

Initial franchise and relicensing fees are generally collected at the time the franchise agreement is executed. However, the recognition of revenue is deferred until the hotel is open or the franchise agreement is terminated. Upon hotel opening, revenue is recognized ratably as services are provided over the enforceable period of the franchise license

agreement. Upon the termination of a franchise agreement, previously deferred initial and relicensing fees are recognized immediately in the period the agreement is terminated. Initial franchise and relicensing fee revenue increased \$0.5 million or 9% from \$5.7 million to \$6.3 million during the three months ended September 30, 2018, and 2017, respectively.

As of September 30, 2018, the Company had 968 franchised hotels with 77,709 rooms under construction, awaiting conversion or approved for development in its domestic system as compared to 751 hotels and 58,340 rooms at September 30, 2017. The number of new construction franchised hotels in the Company's domestic pipeline increased 33% to 704 at September 30, 2018 from 530 at September 30, 2017. The growth in the number of new construction hotels in the domestic pipeline reflects the increase in new construction franchise agreements executed over the last several years and the acquisition of WSFS on

Table of Contents

February 1, 2018. New construction hotels typically average 18 to 36 months to open after the franchise agreement is executed. The number of conversion franchised hotels in the Company's domestic pipeline increased by 43 hotels or 19% from 221 hotels at September 30, 2017 to 264 hotels at September 30, 2018, primarily due to the timing of hotel openings and the timing of signing new conversion franchise agreements. Conversion hotels typically open three to six months after the execution of a franchise agreement. The Company had an additional 82 franchised hotels with 7,764 rooms under construction, awaiting conversion or approved for development in its international system as of September 30, 2018 compared to 66 hotels and 6,261 rooms at September 30, 2017. While the Company's hotel pipeline provides a strong platform for growth, a hotel in the pipeline does not always result in an open and operating hotel due to various factors.

**Procurement Services:** Revenues increased \$2.8 million or 32% from \$8.8 million for the three months ended September 30, 2017 to \$11.6 million for the three months ended September 30, 2018. The increase in revenues primarily reflects the implementation of new brand programs as well as an increase in the volume of business transacted with existing and new qualified vendors and strategic alliance partners.

**Other Revenue:** Revenue increased \$1.1 million from the three months ended September 30, 2017 to \$10.2 million for the three months ended September 30, 2018. The increase in other revenue primarily reflects a \$0.8 million increase in revenues from the Company's non-hotel franchising lines of business as well as a \$0.3 million increase in other revenues associated with the hotel franchising segment.

**Selling, General and Administrative Expenses:** The cost to operate the business is reflected in SG&A on the consolidated statements of income. SG&A expenses were \$38.2 million for the three months ended September 30, 2018, which decreased \$8.4 million from the three months ended September 30, 2017.

SG&A expenses for the three months ended September 30, 2018 and 2017 include approximately \$5.2 million and \$4.4 million, respectively, related to the Company's alternative growth initiatives and expenses related to operations of an office building leased to a third party. SG&A from non-franchising activities increased \$0.8 million from the same period of the prior year primarily due to increased expenses of vacation rental activities.

In the third quarter of 2017, the Company recorded a \$1.2 million impairment of below market lease acquisition costs associated with the office building that reduced third quarter 2017 SG&A costs. SG&A expenses for the three months ended September 30, 2017 also include \$12.0 million of compensation expenses related to the acceleration of the Company's chief executive officer succession plan.

Excluding SG&A expenses for non-hotel franchising activities, the impairment of below market lease acquisition costs and expenses related to the chief executive succession plan, SG&A for the three months ended September 30, 2018 increased \$1.6 million or 5% to \$33.0 million in the current year due to general costs increases to support the hotel franchising business.

**Depreciation and Amortization:** Depreciation and amortization expense for the three months ended September 30, 2018 increased \$2.2 million to \$3.8 million from the same period of the prior year primarily due to the acquisition of WSFS on February 1, 2018. Amortization totaling \$1.9 million was recorded related to the portion of the purchase price allocated to the contract asset acquisition costs.

**Interest Income:** Interest income increased \$0.4 million from \$1.6 million for the three months ended September 30, 2017 to \$2.0 million for the same period of the current year. The increase in interest income primarily reflects the issuance of additional notes receivable related to the Company's program to incent development of its Cambria Hotel brand in new markets.

**Equity in Net (Income) Loss of Affiliates:** The Company recorded net income of \$43 thousand from its unconsolidated joint ventures for the three months ended September 30, 2018, compared to net losses of \$0.3 million for the three months ended September 30, 2017. The fluctuations in net (income) losses from affiliates is primarily attributable to the operational ramp up for several recently opened hotel projects owned by unconsolidated joint ventures. These investments relate to the Company's program to offer equity support to qualified franchisees to develop and operate Cambria Hotels in strategic markets.

**Income Tax Expense:** The effective income tax rates were 21.9% and 31.7% for the three months ended September 30, 2018 and 2017, respectively. The effective income tax rate for the three months ended September 30, 2018 was

slightly higher than the U.S. federal income tax rate of 21.0% primarily due to an unfavorable \$1.0 million adjustment to the Staff Accounting Bulletin 118 ("SAB 118") deferred tax asset impairment estimate and the impact of state income taxes, partially offset by excess tax benefits from share-based compensation of \$0.5 million, a favorable \$0.2 million adjustment to the SAB 118 transition tax estimate, and the impact of foreign operations. The effective income tax rate for the three months ended

26

---

Table of Contents

September 30, 2017 was lower than the U.S. federal income tax rate of 35.0% due to excess tax benefits from share-based compensation of \$0.9 million and the impact of foreign operations, partially offset by state income taxes.

## Operations Review

Comparison of Operating Results for the Nine-Month Periods Ended September 30, 2018 and 2017

Summarized financial results for the nine months ended September 30, 2018 and 2017 are as follows:

(In thousands)	2018	2017
<b>REVENUES:</b>		
Royalty fees	\$290,926	\$263,215
Initial franchise and relicensing fees	18,957	17,263
Procurement services	39,391	30,545
Marketing and reservation system	416,715	382,245
Other	30,336	26,546
Total revenues	796,325	719,814
<b>OPERATING EXPENSES:</b>		
Selling, general and administrative	125,325	124,356
Depreciation and amortization	10,537	4,986
Marketing and reservation system	394,112	365,435
Total operating expenses	529,974	494,777
Gain (loss) on sale of land and building, net	82	(32 )
Operating income	266,433	225,005
<b>OTHER INCOME AND EXPENSES, NET:</b>		
Interest expense	34,720	33,884
Interest income	(5,218 )	(4,277 )
Other gains	(1,355 )	(2,251 )
Equity in net losses of affiliates	5,358	3,213
Total other income and expenses, net	33,505	30,569
Income before income taxes	232,928	194,436
Income tax expense	48,044	62,293
Net income	\$184,884	\$132,143

## Results of Operations

The Company recorded income before income taxes of \$232.9 million for the nine month period ended September 30, 2018, a \$38.5 million, or 20% increase from the same period of the prior year. The increase in income before income taxes reflects a \$41.4 million increase in operating income, as well as a \$0.9 million increase in interest income, offset by an increase in net loss of affiliates of \$2.1 million, a \$0.9 million decrease in other gains, and a \$0.8 million increase in interest expense.

Operating income increased \$41.4 million as the Company's hotel franchising revenues increased by \$39.3 million or 12%, a \$5.8 million increase in the net surplus generated from marketing and reservation system activities, and a \$2.7 million increase in non-hotel franchising revenues partially offset by a \$5.6 million increase in depreciation and amortization expenses and a \$1.0 million increase in SG&A expenses. The primary reasons for these fluctuations are described in more detail below.

## Hotel Franchising Revenues

Hotel franchising revenues were \$368.9 million for the nine months ended September 30, 2018 compared to \$329.6 million for the nine months ended September 30, 2017, a \$39.3 million or 12% increase. The increase in hotel franchising revenues is primarily due to a \$27.7 million or 11% increase in royalty revenues, a \$8.8 million or 29% increase in procurement services revenues, a \$1.7 million increase in initial franchise and relicensing fees, and a \$1.1 million increase in non-compliance, contract termination fees and other franchise revenues.

## Royalty Fees

Domestic royalty fees for the nine months ended September 30, 2018 increased \$27.3 million to \$274.4 million, a 11% increase compared to the nine months ended September 30, 2017. The increase in royalties is attributable to a 1.4% increase in RevPAR, an 9.6% increase in the number of domestic franchised hotel rooms from September 30, 2017 to September 30, 2018, and an increase in the effective royalty rate. System-wide RevPAR increased due to a 1.8% increase in average daily rates offset by a

27

---

Table of Contents

20 basis point decrease in occupancy rates. The slight decline in occupancy rates for the nine months ended September 30, 2018 primarily relate to weather-related events such as hurricanes that drove higher occupancy rates in the third quarter of 2017 resulting in lower demand in the current year since comparable weather-related events did not occur. In addition, lobby and room renovations at over 1,000 of the Company's Comfort brand franchises have negatively impacted occupancy rates in 2018. The effective royalty rate for the domestic hotel system increased to 4.73% for the nine months ended September 30, 2018, compared to 4.59% for the prior year period. The increase in the effective royalty rate is attributable to improved royalty rate pricing on recently executed domestic franchise agreements, contractual royalty rate increases contained in existing franchise agreements and the acquisition of WSFS. Overall, the acquisition of WSFS on February 1, 2018 increased domestic royalties for the nine months ended September 30, 2018 by \$14.1 million.

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

	Nine Months Ended September 30, 2018			Nine Months Ended September 30, 2017			Change		
	Average			Average			Average		
	Daily Rate	Occupancy	RevPAR	Daily Rate	Occupancy	RevPAR	Daily Rate	Occupancy	RevPAR
Comfort Inn	\$96.34	66.8 %	\$ 64.37	\$95.42	67.8 %	\$ 64.70	1.0 %	(100) bps	(0.5) %
Comfort Suites	99.21	71.0 %	70.48	98.05	71.4 %	70.01	1.2 %	(40) bps	0.7 %
Sleep	85.82	66.6 %	57.19	83.93	67.1 %	56.34	2.3 %	(50) bps	1.5 %
Quality	81.51	61.7 %	50.33	80.46	61.5 %	49.50	1.3 %	20 bps	1.7 %
Clarion	86.25	59.8 %	51.55	85.09	61.7 %	52.53	1.4 %	(190) bps	(1.9) %
Econo Lodge	64.25	56.0 %	36.00	63.71	56.1 %	35.74	0.8 %	(10) bps	0.7 %
Rodeway	65.36	58.0 %	37.88	65.73	57.9 %	38.04	(0.6) %	10 bps	(0.4) %
WoodSpring Suites*	46.19	80.9 %	37.37	42.12	81.2 %	34.19	9.7 %	(30) bps	9.3 %
MainStay	83.32	71.3 %	59.44	76.65	69.7 %	53.42	8.7 %	160 bps	11.3 %
Suburban	55.69	76.8 %	42.77	51.99	77.1 %	40.10	7.1 %	(30) bps	6.7 %
Cambria Hotels	146.11	72.3 %	105.68	136.93	75.1 %	102.83	6.7 %	(280) bps	2.8 %
Ascend Hotel Collection	129.21	58.7 %	75.79	128.86	56.6 %	72.87	0.3 %	210 bps	4.0 %
Total*	\$82.86	64.8 %	\$ 53.65	\$81.37	65.0 %	\$ 52.93	1.8 %	(20) bps	1.4 %

\*WSFS was acquired on February 1, 2018; however Average Daily Rate, Occupancy, and RevPar reflect operating performance for the nine months ended September 30, 2018 and 2017 as if the brand had been acquired on January 1, 2017.

International royalty fees for the nine months ended September 30, 2018 increased \$0.4 million to \$16.6 million, an increase of 3% compared to the nine months ended September 30, 2017. The increase in international royalty fees resulted primarily from improvements in RevPAR in countries in which we operate and a 2.3% increase in the number of international rooms on-line.

#### Initial Franchise and Relicensing Fees

Initial franchise fees are fees paid to the Company when a franchisee executes a franchise agreement; relicensing fees include fees charged to new owners of a franchised property whenever an ownership change occurs and the property remains in the franchise system, as well as fees required to renew existing franchise agreements.

During the nine months ended September 30, 2018, the Company executed 469 domestic franchise agreements representing 38,665 rooms compared to 415 franchise agreements representing 31,833 rooms for the nine months ended September 30, 2017. The acquisition of WSFS resulted in 55 new construction franchise agreements, including 19 with WoodSpring's largest franchisee in the nine months ended September 30, 2018.

Domestic franchise agreements executed for new construction hotels totaled 190 representing 16,456 rooms during the nine months ended September 30, 2018 compared to 129 franchise agreements representing 9,768 rooms for the nine months ended September 30, 2017. Conversion hotel executed franchise agreements totaled 279 representing 22,209

rooms for the nine months ended September 30, 2018 compared to 286 franchise agreements representing 22,065 rooms for the nine months ended September 30, 2017.

## Table of Contents

The Company executed 319 domestic relicensing contracts during the nine months ended September 30, 2018, compared to 352 executed during the nine months ended September 30, 2017. The Company executed 20 domestic renewal agreements during the nine months ended September 30, 2018, compared to 12 executed during the nine months ended September 30, 2017.

Initial franchise and relicensing fees are generally collected at the time the franchise agreement is executed. However, the recognition of revenue is deferred until the hotel is open or the franchise agreement is terminated. Upon hotel opening, revenue is recognized ratably as services are provided over the enforceable period of the franchise license agreement. Upon the termination of a franchise agreement, previously deferred initial and relicensing fees are recognized immediately in the period the agreement is terminated. Initial franchise and relicensing fee revenue increased \$1.7 million or 10% from \$17.3 million to \$19.0 million during the nine months ended September 30, 2017 and 2018, respectively.

Procurement Services: Revenues increased \$8.9 million or 29% from \$30.5 million for the nine months ended September 30, 2017 to \$39.4 million for the nine months ended September 30, 2018. The increase in revenues primarily reflects the implementation of new brand programs as well as an increase in the volume of business transacted with existing and new qualified vendors and strategic alliance partners.

Other Revenue: Revenue increased \$3.8 million from the nine months ended September 30, 2017 to \$30.3 million for the nine months ended September 30, 2018. The increase in other revenue primarily reflects a \$2.7 million increase in revenues from the Company's non-hotel franchising lines of business as well as a \$1.1 million increase in other revenues associated with the hotel franchising segment.

Selling, General and Administrative Expenses: The cost to operate the business is reflected in SG&A on the consolidated statements of income. SG&A expenses were \$125.3 million for the nine months ended September 30, 2018, an increase of \$1.0 million or 1% from the nine months ended September 30, 2017.

SG&A expenses for the nine months ended September 30, 2018 and 2017 include approximately \$14.9 million and \$13.5 million, respectively, related to the Company's alternative growth initiatives and expenses related to the operations of an office building leased to a third party. SG&A from non-franchising activities increased \$1.4 million from the same period of the prior year primarily due to increased expenses of vacation rental activities.

For the nine months ended September 30, 2018, the Company incurred \$5.5 million in transaction and transition related costs in conjunction with the acquisition of WSFS on February 1, 2018. In the nine months ended September 30, 2017, the Company recorded a \$1.2 million impairment of below market lease acquisition costs associated with the office building that reduced SG&A costs. In addition, SG&A expenses for the nine months ended September 30, 2017 also include \$12.0 million of compensation expenses related to the acceleration of the Company's chief executive officer succession plan.

Excluding SG&A for non-hotel franchising activities, the impact of WSFS transaction and transition related costs, the impairment of below market lease acquisition costs, and expenses related to the chief executive succession plan, SG&A for the nine months ended September 30, 2018 increased \$4.8 million or 5% due to general cost increases to support the hotel franchising business.

Depreciation and Amortization: Depreciation and amortization expense for the nine months ended September 30, 2018 increased \$5.6 million to \$10.5 million for the same period of the prior year primarily due to the acquisition of WSFS on February 1, 2018. Amortization totaling \$5.1 million was recorded related to the portion of the purchase price allocated to the contract asset acquisition costs.

Interest Income: Interest income increased \$0.9 million from \$4.3 million to \$5.2 million for the same period of the current year. The increase in interest income primarily reflects the issuance of additional notes receivable related to the Company's program to incent development of its Cambria Hotel brand in new markets.

Other Gains: Other gains decreased from a gain of \$2.3 million for the nine months ended September 30, 2017 to a gain of \$1.4 million for same period of the current year due to fluctuations in the fair value of investments held in the Company's non-qualified employee benefit plans.

Equity in Net Losses of Affiliates: The Company recorded net losses of \$5.4 million from its unconsolidated joint ventures for the nine months ended September 30, 2018, compared to net losses of \$3.2 million for the nine months ended September 30, 2017. The fluctuations in net loss from affiliates is primarily attributable to the results from operations during the ramp-up period of operations for several recently opened hotel projects owned by unconsolidated joint ventures. These investments

## Table of Contents

relate to the Company's program to offer equity support to qualified franchisees to develop and operate Cambria Hotels in strategic markets.

**Income Tax Expense:** The effective income tax rates were 20.6% and 32.0% for the nine months ended September 30, 2018 and 2017, respectively. The effective income tax rate for the nine months ended September 30, 2018 was lower than the U.S. federal income tax rate of 21.0% due to excess tax benefits from share-based compensation of \$4.0 million, a favorable \$0.2 million adjustment to the SAB 118 transition tax estimate, and the impact of foreign operations, partially offset by an unfavorable \$1.0 million adjustment to the SAB 118 deferred tax asset impairment estimate and the impact of state income taxes. The effective income tax rate for the nine months ended September 30, 2017 was lower than the U.S. federal income tax rate of 35.0% due to excess tax benefits from share-based compensation of \$2.7 million and the impact of foreign operations, partially offset by state income taxes.

### Liquidity and Capital Resources

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

### Operating Activities

During the nine months ended September 30, 2018 and 2017, net cash provided by operating activities totaled \$146.8 million and \$165.0 million, respectively. Operating cash flows decreased \$18.2 million primarily due to an increase in cash outflows related to franchise agreement acquisition costs partially offset by an increase in operating income, excluding certain non-cash charges.

In conjunction with brand and development programs, we make certain payments to franchisees as an incentive to enter into new franchise agreements or perform designated improvements to properties under existing franchise agreements. We recognize such payments as an adjustment to transaction price and capitalize as an intangible asset. These intangibles are amortized on a straight-line basis over the estimated benefit period of the arrangement as an offset to revenues. If the franchisee remains in the franchise system in good standing over the term specified in the incentive agreement, the Company forgives the incentive ratably. If the franchisee exits our franchise system or is not operating their franchise in accordance with our quality or credit standards, the franchisee must repay the unamortized incentive payment plus interest. During the nine months ended September 30, 2018 and 2017, the Company's net advances for these purposes totaled \$40.6 million and \$21.4 million, respectively. The timing and amount of these cash flows is dependent on various factors including the implementation of various development and brand incentive programs, the level of franchise sales and the timing of hotel openings. At September 30, 2018, the Company had commitments to extend an additional \$220.7 million for these purposes provided certain conditions are met by its franchisees.

The Company's franchise agreements require the payment of marketing and reservation system fees. In accordance with the terms of our franchise agreements, the Company is obligated to use these marketing and reservation system fees to provide marketing and reservation services such as advertising, providing a centralized reservation and property management system, providing reservation and revenue management services, and performing certain franchise services to support the operation of the overall franchise system.

Marketing and reservation system expenses are those expenses incurred to facilitate the delivery of marketing and reservation system services, including direct expenses and an allocation of costs for certain administrative activities required to carry out marketing and reservation services. Marketing and reservation system expenses are recognized as services are incurred or goods are received, and as such may not equal marketing and reservation system revenues in a specific period but are expected to equal revenues earned from franchisees over time. To the extent revenues collected exceed expenditures incurred, the Company has a commitment to the franchisee system to make expenditures in future years. Conversely, to the extent expenditures incurred exceed revenues collected, the Company has the contractual enforceable right to recover such advances in future periods through additional fee assessments or reduced spending.

### Investing Activities

Cash utilized for investing activities totaled \$299.8 million and \$78.3 million for the nine months ended September 30, 2018 and 2017, respectively. The increase in cash utilized for investing activities for the nine months ended September 30, 2018 primarily reflects the following items:

During the nine months ended September 30, 2018, the Company completed the acquisition of the brand and franchise business of WoodSpring Suites. The acquisition closed on February 1, 2018 and added 239 new extended-stay hotels in 35 states to the

## Table of Contents

Company's portfolio. The acquisition was funded with cash on hand and available borrowings. The total cash consideration was \$231.3 million, which consisted of cash paid, net of cash acquired.

During the nine months ended September 30, 2018 and 2017, the Company invested \$9.1 million and \$44.9 million, respectively, in joint ventures accounted under the equity method of accounting. In addition, the Company received distributions from these joint ventures totaling \$1.4 million and \$4.3 million for the nine months ended September 30, 2018 and 2017, respectively. The Company's investment in these joint ventures primarily relate to ventures that support the Company's efforts to promote growth of our emerging brands. The Company expects to make additional capital contributions totaling \$12.2 million to existing unconsolidated and consolidated joint ventures supporting these efforts.

During the third quarter of 2018, a partner in a VIE previously accounted for under the equity method of accounting exercised a put option to the Company for its membership interest. As a result, the Company paid \$3.2 million for the remaining interest and the purchase was accounted for as an asset acquisition. The financial results of the 100% owned entity have been consolidated in the Company's financial statements since August 9, 2018.

During the nine months ended September 30, 2018 and 2017, capital expenditures in property and equipment totaled \$34.1 million and \$17.5 million, respectively. The increase in capital expenditures primarily reflects the Company's acquisition of an aircraft, including avionics and interior upgrades, as well as improvements to an office building that is converting to a hotel.

The Company provides financing to franchisees for hotel development efforts and other purposes in the form of notes receivable. These loans bear interest and are expected to be repaid in accordance with the terms of the loan arrangements. During the nine months ended September 30, 2018, the Company advanced and received repayments totaling \$28.9 million and \$4.7 million for these purposes, respectively. For the nine months ended September 30, 2017, the Company advanced and received repayments totaling \$18.6 million and \$0.6 million for these purposes, respectively. At September 30, 2018, the Company had commitments to extend an additional \$7.7 million for these purposes provided certain conditions are met by its franchisees.

From time to time, our board of directors authorizes specific transactions and general programs which permit us to provide financing, investment and guarantees and similar credit support to qualified franchisees, as well as to acquire and resell real estate to incent franchise development. Since 2006, we have engaged in these financial support activities to encourage acceleration of the growth of our Cambria Hotels brand, primarily in strategic markets and locations. Over the next three to five years, depending on market and other conditions, we expect to continue to deploy capital in support of this brand and expect our investment to total approximately \$725 million over that time period. The annual pace of future financial support activities will depend upon market and other conditions including among others, our franchise sales results, the environment for new construction hotel development and the hotel lending environment. Our support of the Cambria Hotels brand's growth is expected to be primarily in the form of joint venture investments, forgivable key money loans, senior mortgage loans, development loans, mezzanine lending, and through the operation of a land-banking program. With respect to our lending and joint venture investments, we generally expect to recycle these loans and investments within a five year period. At September 30, 2018, the Company had approximately \$317.4 million outstanding pursuant to these financial support activities.

### Financing Activities

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

#### Debt

##### Senior Unsecured Notes due 2022

On June 27, 2012, the Company issued unsecured senior notes with a principal amount of \$400 million (the "2012 Senior Notes") at par, bearing a coupon of 5.75% with an effective rate of 6.00%. The 2012 Senior Notes will mature on July 1, 2022, with interest to be paid semi-annually on January 1<sup>st</sup> and July 1<sup>st</sup>. The Company utilized the net

proceeds of this offering, after deducting underwriting discounts and commissions and other offering expenses, together with borrowings under the Company's senior credit facility, to pay a special cash dividend totaling approximately \$600.7 million paid to stockholders on August 23, 2012. The Company's 2012 Senior Notes are guaranteed jointly, severally, fully and unconditionally, subject to certain customary limitations by certain of the Company's domestic subsidiaries.

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

## Table of Contents

### Senior Unsecured Notes due 2020

On August 25, 2010, the Company issued unsecured senior notes with a principal amount of \$250 million (the "2010 Senior Notes") at a discount of \$0.6 million, bearing a coupon of 5.70% with an effective rate of 6.19%. The 2010 Senior Notes will mature on August 28, 2020, with interest on the 2010 Senior Notes to be paid semi-annually on February 28<sup>th</sup> and August 28<sup>th</sup>. The Company used the net proceeds from the offering, after deducting underwriting discounts and other offering expenses, to repay outstanding borrowings and other general corporate purposes. The Company's 2010 Senior Notes are guaranteed jointly, severally, fully and unconditionally, subject to certain customary limitations, by certain of the Company's domestic subsidiaries.

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

### Restated Senior Unsecured Credit Facility

On August 20, 2018, the Company entered into the Restated Credit Agreement, which amended and restated the Company's existing senior unsecured revolving credit agreement, dated July 21, 2015 (the "Former Credit Agreement"). The Former Credit Agreement provided for a \$450 million unsecured revolving credit facility (the "Revolver") with a final maturity date of July 21, 2021.

The Restated Credit Agreement increases the commitments under the Revolver to \$600 million and extends the final maturity date of the Revolver to August 20, 2023, subject to optional one-year extensions that can be requested by the Company prior to each of the first, second and third anniversaries of the closing date of the Restated Credit Agreement. The effectiveness of such extensions are subject to the consent of the lenders under the Restated Credit Agreement and certain customary conditions. The Restated Credit Agreement also provides that up to \$35 million of borrowings under the Revolver may be used for alternative currency loans and up to \$25 million of borrowings under the Revolver may be used for swingline loans. The Company may from time to time designate one or more wholly owned subsidiaries of the Company as additional borrowers under the Restated Credit Agreement, subject to the consent of the lenders and certain customary conditions.

Pursuant to the Restated Credit Agreement, the previous guarantee by certain of the Company's subsidiaries of its obligations under the Revolver (as increased by the Restated Credit Agreement) was released. As a result, as of August 20, 2018, there are no subsidiary guarantors under the Revolver. However, if certain subsidiaries of the Company subsequently incur certain recourse debt or become obligors in respect of certain recourse debt of the Company or certain of its other subsidiaries, the Restated Credit Agreement requires such obligated subsidiaries to guarantee the Company's obligations under the Revolver. In the event that these subsidiary guarantees are triggered under the Revolver, the same subsidiary guarantees would be required under the Company's 5.75% Senior Notes due 2022 and 5.70% Senior Notes due 2020 and certain hedging and bank product arrangements, if any, with lenders that are parties to the Restated Credit Agreement.

The Company may at any time prior to the final maturity date increase the amount of the Revolver or add one or more term loan facilities under the Restated Credit Agreement by up to an additional \$250 million in the aggregate to the extent that any one or more lenders commit to being a lender for the additional amount of such term loan facility and certain other customary conditions are met.

The Restated Credit Agreement provides that the Company may elect to have borrowings under the Revolver bear interest at a rate equal to (i) LIBOR plus a margin ranging from 90 to 150 basis points or (ii) a base rate plus a margin ranging from 0 to 50 basis points, in each case, with the margin determined according to the Company's senior unsecured long-term debt rating or under circumstances as set forth in the Restated Credit Agreement, the Company's total leverage ratio in the event that such total leverage ratio is less than 2.5 to 1.0.

A total of \$3.2 million in debt issuance costs were capitalized as part of the Restated Credit Facility, including \$1.7 million in costs incurred on the Restated Credit Facility and remaining unamortized costs of \$1.5 million attributable to the Former Credit Facility. The capitalized debt issuance costs are amortized on a straight-line basis, which is not materially different than the effective interest method, through the maturity. Amortization of these costs is included in

interest expense in the consolidated statements of income. Additionally, the Restated Credit Agreement requires the Company to pay a fee on the total commitments under the Revolver, calculated on the basis of the actual daily amount of the commitments under the Revolver (regardless of usage) times a percentage per annum ranging from 0.075% to 0.25% (depending on the Company's senior unsecured long-term debt rating or under circumstances as set forth in the Restated Credit Agreement, the Company's total leverage ratio in the event that such total leverage ratio is less than 2.5 to 1.0).

32

---

## Table of Contents

The Restated Credit Agreement requires that the Company and its restricted subsidiaries comply with various covenants, including with respect to restrictions on liens, incurring indebtedness, making investments and effecting mergers and/or asset sales. With respect to dividends, the Company may not declare or make any payment if there is an existing event of default or if the payment would create an event of default.

The Restated Credit Agreement imposes financial maintenance covenants requiring the Company to maintain a consolidated fixed charge coverage ratio of at least 2.5 to 1.0 and a total leverage ratio of not more than 4.5 to 1.0 or, on up to two nonconsecutive occasions, 5.5 to 1.0 for up to three consecutive quarters following a material acquisition commencing with the fiscal quarter in which such material acquisition occurred. If the Company achieves and maintains an Investment Grade Rating, as defined in the Restated Credit Agreement, then the Company will not need to comply with the consolidated fixed charge coverage ratio covenant.

The Restated Credit Agreement includes customary events of default, the occurrence of which, following any applicable cure period, would permit the lenders to, among other things, declare the principal, accrued interest and other obligations of the Company under the Restated Credit Agreement to be immediately due and payable. At September 30, 2018, the Company maintained a consolidated fixed charge ratio of 8.46x and a total leverage ratio of 2.16x and was in compliance with all financial covenants under the Restated Credit Agreement.

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

### Fixed Rate Collateralized Mortgage

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

### Economic Development Loans

The Company entered into economic development agreements with various governmental entities in conjunction with the relocation of its corporate headquarters in April 2013. In accordance with these agreements, the governmental entities agreed to advance approximately \$4.4 million to the Company to offset a portion of the corporate headquarters relocation and tenant improvement costs in consideration of the employment of permanent, full-time employees within the jurisdictions. At September 30, 2018, the Company had been advanced approximately \$4.2 million pursuant to these agreements and expects to receive the remaining \$0.2 million over the next several years, subject to annual appropriations by the governmental entities. These advances bear interest at a rate of 3% per annum.

Repayment of the advances is contingent upon the Company achieving certain performance conditions. Performance conditions are measured annually on December 31<sup>st</sup> and primarily relate to maintaining certain levels of employment within the various jurisdictions. If the Company fails to meet an annual performance condition, the Company may be required to repay a portion or all of the advances including accrued interest by April 30<sup>th</sup> following the measurement date. Any outstanding advances at the expiration of the Company's 10 year corporate headquarters lease in 2023 will be forgiven in full. The advances will be included in long-term debt in the Company's consolidated balance sheets until the Company determines that the future performance conditions will be met over the entire term of the agreement and the Company will not be required to repay the advances. The Company accrues interest on the portion of the advances that it expects to repay. The Company was in compliance with all current performance conditions as of September 30, 2018.

### Construction Loan Commitment

In March 2018, the Company entered into a construction loan agreement for the rehabilitation and development of a former office building into a hotel through a consolidating joint venture with a commercial lender, which is secured by the building. The construction loan can be drawn up to \$34.9 million. The Company has a carve-out guaranty and the unaffiliated joint venture partner has a completion guaranty in relation to the loan, in which both parties are required to meet certain financial covenants relating to liquidity and net worth. The rehabilitation of the building is considered a qualified asset in which requires a significant amount of time to prepare for its intended use. Therefore, any interest costs incurred during the development

## Table of Contents

period of the building is considered an element of the historical cost of the qualifying asset. At September 30, 2018, the Company has not drawn on the construction loan or recorded any capitalized interest costs.

### Transfer of Interest

The Company has transferred \$24.4 million of a \$49.1 million outstanding note receivable with a maturity date of November 30, 2019 to a third party. The transaction did not qualify as a sale and therefore the outstanding notes receivable was not de-recognized on the balance sheet. The one-time cash proceeds were recorded as unrestricted cash and the future obligation to transfer principal and interest received under the note has been recorded within Other Long-Term liabilities. The Company retains responsibility for collecting and distributing cash received on the note and interest paid to the participant is reflected as interest expense in the Company's consolidated statements of income. At September 30, 2018, Other Long-Term liabilities includes \$24.4 million pursuant to this transaction.

### Dividends

The Company currently maintains the payment of a quarterly dividend on its common shares outstanding of \$0.215 per share; however, the declaration of future dividends is subject to the discretion of our board of directors. The Company's quarterly dividend rate declared during the three and nine months ended September 30, 2018 remained unchanged from the previous quarterly declaration.

During the nine months ended September 30, 2018, the Company paid cash dividends totaling \$36.6 million. We expect to continue to pay dividends in the future, subject to the declaration of our board of directors as well as to future business performance, economic conditions, changes in income tax regulations and other factors including limitations in the Company's credit facility. Based on the present dividend rate and outstanding share count, we expect that aggregate annual regular dividends for 2018 would be approximately \$48.7 million.

### Share Repurchases

The Company purchased 1.3 million shares of common stock at a total cost of \$101.9 million under the share repurchase program during the nine months ended September 30, 2018. Since the program's inception through September 30, 2018, we have repurchased 50.0 million shares (including 33.0 million prior to the two-for-one stock split effected in October 2005) of common stock at a total cost of \$1.4 billion. Considering the effect of the two-for-one stock split, the Company has repurchased 83.0 million shares at an average price of \$16.37 per share. As of September 30, 2018, the Company had approximately 2.7 million shares remaining under the current share repurchase authorization.

During the nine months ended September 30, 2018, the Company redeemed 90,872 shares of common stock at a total cost of approximately \$7.3 million from employees to satisfy the option exercise price and statutory minimum tax-withholding requirements related to the exercising of stock options and vesting of performance vested restricted stock units and restricted stock grants. These redemptions were outside the share repurchase program.

### Off Balance Sheet Arrangements

The Company entered in to various limited payment guaranties with regards to the Company's VIEs supporting the VIE's efforts to develop and own hotels franchised under the Company's brands. Under these limited payment guaranties, the Company has agreed to guarantee a portion of the outstanding debt until certain conditions are met, such as (a) the loan matures, (b) certain debt covenants are achieved, (c) the maximum amount guaranteed by the Company is paid in full or (d) the Company, through its affiliates, ceases to be a member of the VIE. The maximum exposure of principal incidental to these limited payment guaranties is \$13.0 million, plus unpaid expenses and accrued unpaid interest. The Company believes the likelihood of having to perform under the aforementioned limited payment guarantees is remote as of September 30, 2018 and December 31, 2017. In the event of performance, the Company has recourse for two of the transactions in the form of a membership interest pledge as collateral for our guaranty. See Note 13 for further discussion of our off-balance sheet arrangements.

### Critical Accounting Policies

Our accounting policies comply with principles generally accepted in the United States. We have described below those policies that we believe are critical and require the use of complex judgment or significant estimates in their application. Additional discussion of these policies is included in Note 1 to our consolidated financial statements as of and for the year ended December 31, 2017 included in our Annual Report on Form 10-K.

## Table of Contents

### Revenue Recognition

Revenues are primarily derived from franchise agreements with third-party hotel owners. Franchise fees include the following:

**Royalty fees.** Royalty fees are earned in exchange for a license to brand intellectual property typically based on a percentage of gross room revenues. These fees are billed and collected monthly and revenues are recognized in the same period that the underlying gross room revenues are earned by the Company's franchisees.

**Initial franchise and relicensing fees.** Initial and relicensing fees are charged when (i) new hotels enter the franchise system; (ii) there is a change of ownership; or (iii) existing franchise agreements are extended. These revenues are recognized as revenue ratably as services are provided over the enforceable period of the franchise agreement. The enforceable period is the period from hotel opening to the first point the franchisee or the Company can terminate the franchise agreement without incurring a significant penalty. Deferred revenues from initial and relicensing fees will typically be recognized over a five to ten-year period, unless the franchise agreement is terminated and the hotel exits the franchise system whereby remaining deferred amounts will be recognized to revenue in the period of termination.

**Other revenue.** Other revenue is a combination of miscellaneous non-marketing and reservation system fees, inclusive of quality assurance non-compliance and franchisee training fees, and is recognized in the period the designated transaction or event has occurred.

**Marketing and reservation system revenues.** The Company's franchise agreements require the payment of marketing and reservation system fees. The Company is obligated to use these marketing and reservation system fees to provide marketing and reservation services such as advertising, providing a centralized reservation and property management system, providing reservation and revenue management services, and performing certain franchise services to support the operation of the overall franchise system. These services are comprised of multiple fees including the following:

Fees based on a percentage of gross room revenues are recognized in the period the gross room revenue was earned, based on the underlying hotel's sales or usage.

Fees based on the occurrence of a designated transaction or event are recognized in the period the transaction or event occurred.

System implementation fees charged to franchisees are deferred and recognized as revenue over the term of the franchise agreement.

Marketing and reservation system activities also include revenues generated from the Company's guest loyalty program. The revenue recognition of this program is discussed in Choice Privileges Loyalty Program below.

Marketing and reservation system expenses are those expenses incurred to facilitate the delivery of marketing and reservation system services, including direct expenses and an allocation of costs for certain administrative activities required to carry out marketing and reservation services. Marketing and reservation system expenses are recognized as services are incurred or goods are received, and as such may not equal marketing and reservation system revenues in a specific period but are expected to equal revenues earned from franchisees over time. The Company's 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 and recover such advances in future periods through additional fee assessments or reduced spending.

We make certain payments to customers as an incentive to enter in to new franchise agreements ("Franchise agreement acquisition cost"). We capitalize such payments as an intangible asset. These intangibles are amortized on a straight-line basis over the estimated benefit period of the arrangement as an offset to royalty fees and marketing and reservation system fees. Impairments from hotel terminations are recorded within the selling, general and administrative expenses and marketing and reservations expenses.

The Company generates procurement services revenues from qualified vendors. Procurement services revenues are generally based on marketing services provided by the Company on behalf of the qualified vendors to hotel owners and guests. The Company provides these services in exchange for either fixed consideration or a percentage of revenues earned by the qualified vendor pertaining to purchases by the Company's franchisees or guests. Fixed consideration is allocated and recognized ratably to each period over the term of the agreement. Variable

consideration is recognized in the period when sales to franchisees or guests from vendors are known or cash payment has been remitted. Qualified vendor revenues are recognized within Procurement services revenue.

The Company is party to SaaS arrangements. SaaS agreements typically include fixed consideration for installment and other initiation fees paid at contract onset, and variable consideration for recurring subscription revenue paid monthly. Fixed consideration is allocated and recognized ratably to each period over the term of the agreement. Variable consideration is determined at the conclusion of each period, and recognized in the current period.

35

---

## Table of Contents

### Choice Privileges Loyalty Program

Choice Privileges is the Company's frequent guest loyalty program, which enables members to earn points based on their spending levels with the Company's franchises. The points, which the Company accumulates and tracks on the members' behalf, may be redeemed for free accommodations or other benefits (e.g., gift cards to participating retailers). The Company collects from franchisees a percentage of program members' gross room revenue from completed stays to operate the program. At such time points are redeemed for free accommodations or other benefits, the Company reimburses franchisees or third parties based on a rate derived in accordance with the franchise or vendor agreement.

Loyalty point revenues are recognized at the point in time when the loyalty points are redeemed by members for benefits. No loyalty program revenues are recognized at the time the loyalty points are issued.

The Company is an agent in coordinating delivery of the services between the loyalty program member and franchisee or third party, and as a result, revenues are recognized net of the cost of redemptions. The estimated fair value of future redemptions is reflected in current and non-current Liability for guest loyalty program in our consolidated balance sheet. The liability for guest loyalty program is developed based on an estimate of the eventual redemption rates and point values using various actuarial methods. These significant judgments determine the required point liability attributable to outstanding points, which is relieved as redemption costs are processed. The amount of the loyalty program fees in excess of the point liability, represents current and non-current Deferred revenue, which is recognized to revenue as points are redeemed including an estimate of future forfeitures ("breakage"). The anticipated redemption pattern of the points is the basis for current and non-current designation of each liability. Loyalty program point redemption revenues are recognized within marketing and reservation system revenue in the consolidated statements of income.

The Company maintains various agreements with third-party partners, including the co-branding of the Choice Privileges credit card. Choice Privileges members can earn points through participation in the partner's program. Partner agreements include multiple performance obligations. The primary performance obligations are brand intellectual property and material rights for free or discounted goods or services to hotel guests. Allocation of fixed and variable consideration to the performance obligations is based on standalone selling price as estimated based on market and income methods, which represent significant judgments. The amounts allocated to brand intellectual property are recognized on a gross basis over time using the output measure of time elapsed, primarily within Procurement services revenue. The amounts allocated to material rights for free or discounted goods or services to hotel guests are recognized to revenue as points are redeemed including an estimate of breakage, primarily within Marketing and reservation system revenue.

### Notes Receivable

The Company has provided financing to franchisees in support of the development of properties in strategic markets. The Company expects the owners to repay the loans in accordance with the loan agreements, or earlier as the hotels mature and capital markets permit. The Company estimates the collectibility and records an allowance for loss on its notes receivable when recording the receivables in the Company's financial statements. These estimates are updated quarterly based on available information. The Company utilizes the level of security as its primary credit quality indicator (i.e., senior, subordinated or unsecured) when determining the appropriate allowances for uncollectible loans.

The Company considers a loan to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement. The Company measures loan impairment based on the present value of expected future cash flows discounted at the loan's original effective interest rate or the estimated fair value of the collateral. For impaired loans, the Company establishes a specific impairment reserve for the difference between the recorded investment in the loan and the present value of the expected future cash flows or the estimated fair value of the collateral. The Company applies its loan impairment policy individually to all notes receivable in the portfolio and does not aggregate loans for the purpose of applying such policy. For impaired loans, the Company recognizes interest income on a cash basis. If it is likely that a loan will not be collected

based on financial or other business indicators it is the Company's policy to charge off these loans to SG&A expenses in the accompanying consolidated statements of income in the quarter when it is deemed uncollectible. Recoveries of impaired loans are recorded as a reduction of SG&A expenses in the quarter received.

The Company assesses the collectibility of its senior notes receivable by comparing the market value of the underlying assets to the carrying value of the outstanding notes. In addition, the Company evaluates the property's operating performance, the borrower's compliance with the terms of the loan and franchise agreements, and all related personal guarantees that have been provided by the borrower. For subordinated or unsecured receivables, the Company assesses the property's operating

## Table of Contents

performance, the subordinated equity available to the Company, the borrower's compliance with the terms of the loan and franchise agreements, and the related personal guarantees that have been provided by the borrower.

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

### New Accounting Standards

See Note 1, "Recently Adopted Accounting Standards" and "Recently Issued Accounting Standards," of the Notes to our Financial Statements for information related to our adoption of new accounting standards in 2018 and for information on our anticipated adoption of recently issued accounting standards.

### FORWARD-LOOKING STATEMENTS

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

Several factors could cause actual results, performance or achievements of the Company to differ materially from those expressed in or contemplated by the forward-looking statements. Such risks include, but are not limited to, changes to general, domestic and foreign economic conditions; changes in law and regulation applicable to the lodging and franchising industries foreign currency fluctuations; operating risks common in the lodging and franchising industries; changes to the desirability of our brands as viewed by hotel operators and customers; changes to the terms or termination of our contracts with franchisees and our relationships with our franchisees; our ability to keep pace with improvements in technology utilized for marketing and reservations systems and other operating systems; the commercial acceptance of our SkyTouch division's products and services; our ability to grow our franchise system; exposure to risks related to our hotel-development and financing activities; fluctuations in the supply and demand for hotels rooms; our ability to realize anticipated benefits from acquired businesses; the level of acceptance of alternative growth strategies we may implement; cyber security and data breach risks; operating risks associated with international operations; the outcome of litigation; and our ability to effectively manage our indebtedness. These and other risk factors are discussed in detail in the Risk Factors section of the Company's Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on March 1, 2018. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by law.

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

The Company is exposed to market risk from changes in interest rates and the impact of fluctuations in foreign currencies on the Company's foreign investments and operations. The Company manages its exposure to these market risks through the monitoring of its available financing alternatives including in certain circumstances the use of derivative financial instruments. We are also subject to risk from changes in debt and equity prices from our non-qualified retirement savings plan investments in debt securities and common stock, which have a carrying value of \$23.7 million and \$22.6 million at September 30, 2018 and December 31, 2017, respectively, which we account for as trading securities. The Company will continue to monitor the exposure in these areas and make the appropriate adjustments as market conditions dictate.

At September 30, 2018, the Company had \$126.4 million of variable interest rate debt instruments outstanding at an effective rate of 3.23%. A hypothetical change of 10% in the Company's effective interest rate from September 30,

2018 levels would increase or decrease annual interest expense by \$0.4 million. The Company expects to refinance its fixed and variable long-term debt obligations prior to their scheduled maturities. The Company does not presently have any derivative financial instruments.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

Management's Evaluation of Disclosure Controls and Procedures

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

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

An evaluation was performed under the supervision and with the participation of the Company's CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of September 30, 2018.

Changes in internal control over financial reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2018, that materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is not a party to any litigation other than litigation in the ordinary course of business. The Company's management and legal counsel do not expect that the ultimate outcome of any of its currently ongoing legal proceedings, individually or collectively, will have a material adverse effect on the Company's financial position, results of operations or cash flows.

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those disclosed in Part I, "Item 1A. Risk Factors" to our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed on March 1, 2018. In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Table of Contents

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

## Issuer Purchases of Equity Securities

The following table sets forth purchases and redemptions of Choice Hotels International, Inc. common stock made by the Company during the nine months ended September 30, 2018:

Month Ending	Total Number of Shares Purchased or Redeemed	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(1),(2)</sup>	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs, End of Period
January 31, 2018	22,168	\$ 71.90	—	4,016,795
February 28, 2018	44,347	80.43	—	4,016,795
March 31, 2018	451,324	81.44	432,165	3,584,630
April 30, 2018	189,696	79.71	188,284	3,396,346
May 31, 2018	10,076	79.41	10,076	3,386,270
June 30, 2018	159,918	79.65	158,815	3,227,455
July 31, 2018	234,479	76.88	233,847	2,993,608
August 31, 2018	174,613	77.53	174,149	2,819,459
September 30, 2018	89,521	79.60	87,934	2,731,525
Total	1,376,142	\$ 79.40	1,285,270	2,731,525

The Company's share repurchase program was initially approved by the board of directors on June 25, 1998. The program has no fixed dollar amount or expiration date. Since the program's inception through September 30, 2018, (1) the Company has repurchased 50.0 million shares (including 33.0 million prior to the two-for-one stock split effected in October 2005) of common stock at a total cost of \$1.4 billion. Considering the effect of the two-for-one stock split, the Company has repurchased 83.0 million shares at an average price of \$16.37 a share.

During the nine months ended September 30, 2018, the Company redeemed 90,872 shares of common stock from (2) employees to satisfy the option price and minimum tax-withholding requirements related to the exercising of options and vesting of restricted stock and performance vested restricted stock unit grants. These redemptions were not part of the board repurchase authorization.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

None.

## ITEM 5. OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

Exhibit Number and Description

Exhibit Number	Description
3.01(a)	<u>Restated Certificate of Incorporation of Choice Hotels Franchising, Inc. (renamed Choice Hotels International, Inc.)</u>
3.02(b)	<u>Amendment to the Restated Certificate of Incorporation of Choice Hotels International, Inc.</u>
3.03(c)	<u>Amended and Restated Bylaws of Choice Hotels International, Inc.</u>
3.04(d)	<u>Amendment to the Amended and Restated Bylaws of Choice Hotels International, Inc.</u>
3.05(e)	<u>Amendment to the Amended and Restated Bylaws of Choice Hotels International, Inc.</u>
10.1(f)	<u>Amended and Restated Senior Unsecured Credit Agreement dated August 20, 2018 among Choice Hotels International, Inc., Deutsche Bank AG New York Branch, as administrative agent, the other agents thereto and a syndicate of lenders</u>
31.1*	<u>Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a)</u>
31.2*	<u>Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a)</u>
32*	<u>Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350</u>
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Label Linkbase Document
101.PRE*	XBRL Taxonomy Presentation Linkbase Document

---

\*Filed herewith

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

Edgar Filing: CHOICE HOTELS INTERNATIONAL INC /DE - Form 10-Q

Incorporated by reference to the identical document filed as an exhibit to Choice Hotels International, Inc.'s Current Report on Form 8-K filed April 29, 2015.

(e) Incorporated by reference to the identical document filed as an exhibit to Choice Hotels International, Inc.'s Current Report on Form 8-K filed on January 13, 2016.

(f) Incorporated by reference to the identical document filed as an exhibit to Choice Hotels International, Inc.'s Current Report on Form 8-K filed on August 20, 2018.

Table of Contents

SIGNATURES

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

CHOICE HOTELS INTERNATIONAL,  
INC.

November 8, 2018 By: /s/ PATRICK S. PACIOUS  
Patrick S. Pacious  
President & Chief Executive Officer

CHOICE HOTELS INTERNATIONAL,  
INC.

November 8, 2018 By: /s/ DOMINIC E. DRAGISICH  
Dominic E. Dragisich  
Chief Financial Officer