CHOICE HOTELS INTERNATIONAL INC /DE
Form 10-Q
November 09, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2010

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.)**

10750 COLUMBIA PIKE

SILVER SPRING, MD. 20901

(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 x No ¨

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

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

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

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

CLASS	**SHARES OUTSTANDING AT SEPTEMBER 30, 2010**
Common Stock, Par Value $0.01 per share	59,554,040

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

INDEX

	PAGE NO.
PART I. FINANCIAL INFORMATION:	
Item 1 Financial Statements (Unaudited)	3
Consolidated Statements of Income For the three and nine months ended September 30, 2010 and September 30, 2009	3
Consolidated Balance Sheets As of September 30, 2010 and December 31, 2009	4
Consolidated Statements of Cash Flows For the nine months ended September 30, 2010 and September 30, 2009	5
Notes to Consolidated Financial Statements	6
Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations	28
Item 3 Quantitative and Qualitative Disclosures About Market Risk	51
Item 4 Controls and Procedures	51
PART II. OTHER INFORMATION:	
Item 1 Legal Proceedings	52
Item 1A Risk Factors	52
Item 2 Unregistered Sales of Equity Securities and Use of Proceeds	52
Item 3 Defaults Upon Senior Securities	52
Item 4 (Removed and Reserved)	52
Item 5 Other Information	52
Item 6 Exhibits	53
SIGNATURES	54

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED, IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
REVENUES:				
Royalty fees	**$ 72,565**	$ 66,401	**$ 171,029**	$ 164,771
Initial franchise and relicensing fees	**1,970**	2,957	**6,537**	9,599
Procurement services	**3,756**	3,922	**13,612**	14,084
Marketing and reservation	**102,867**	90,465	**242,096**	227,803
Hotel operations	**1,068**	934	**3,044**	3,231
Other	**1,575**	1,297	**4,752**	3,989
Total revenues	**183,801**	165,976	**441,070**	423,477
OPERATING EXPENSES:				
Selling, general and administrative	**23,156**	24,517	**67,796**	73,054
Depreciation and amortization	**2,078**	2,105	**6,470**	6,252
Marketing and reservation	**102,867**	90,465	**242,096**	227,803
Hotel operations	**823**	764	**2,387**	2,378
Total operating expenses	**128,924**	117,851	**318,749**	309,487
Operating income	**54,877**	48,125	**122,321**	113,990
OTHER INCOME AND EXPENSES, NET:				
Interest expense	**1,864**	926	**3,160**	3,731
Interest and other investment income	**(1,671)**	(2,961)	**(1,645)**	(5,302)
Equity in net income of affiliates	**(342)**	(336)	**(890)**	(779)
Total other income and expenses, net	**(149)**	(2,371)	**625**	(2,350)
Income before income taxes	**55,026**	50,496	**121,696**	116,340
Income taxes	**14,532**	17,688	**38,398**	41,721
Net income	**$ 40,494**	$ 32,808	**$ 83,298**	$ 74,619
Basic earnings per share	**$ 0.68**	$ 0.55	**$ 1.40**	$ 1.24
Diluted earnings per share	**$ 0.68**	$ 0.55	**$ 1.40**	$ 1.24

Cash dividends declared per share	**$ 0.185**	$ 0.185	**$ 0.555**	$ 0.555

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

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED, IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	September 30, 2010	December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	**$ 79,548**	$ 67,870
Receivables (net of allowance for doubtful accounts of $8,638 and $6,886, respectively)	**53,682**	41,898
Deferred income taxes	**7,980**	7,980
Other current assets	**23,980**	10,114
Total current assets	**165,190**	127,862
Property and equipment, at cost, net	**52,976**	43,627
Goodwill	**66,040**	65,813
Franchise rights and other identifiable intangibles, net	**21,641**	24,559
Receivable marketing and reservation fees	**46,127**	33,872
Investments, employee benefit plans, at fair value	**22,370**	20,931
Deferred income taxes	**16,905**	14,143
Other assets	**12,058**	9,230
Total assets	**$ 403,307**	$ 340,037
LIABILITIES AND SHAREHOLDERS DEFICIT		
Current liabilities		
Accounts payable	**$ 40,304**	$ 33,859
Accrued expenses	**35,936**	37,074
Deferred revenue	**71,296**	51,765
Revolving credit facility	**6,600**	0
Current portion of long-term debt	**294**	0
Income taxes payable	**19,775**	6,310
Deferred compensation and retirement plan obligations	**2,510**	2,798
Total current liabilities	**176,715**	131,806
Long-term debt	**251,613**	277,700
Deferred compensation and retirement plan obligations	**34,579**	34,956
Other liabilities	**15,894**	9,787
Total liabilities	**478,801**	454,249
Commitments and Contingencies		
SHAREHOLDERS DEFICIT		
Common stock, $0.01 par value, 160,000,000 shares authorized; 95,345,362 shares issued at September 30, 2010 and December 31, 2009 and 59,554,040 and 59,541,106 shares outstanding at	**596**	595

September 30, 2010 and December 31, 2009, respectively		
Additional paid-in capital	**89,611**	90,731
Accumulated other comprehensive income (loss)	**(7,545)**	333
Treasury stock (35,791,322 and 35,804,256 shares at September 30, 2010 and December 31, 2009, respectively), at cost	**(872,999)**	(870,302)
Retained earnings	**714,843**	664,431
Total shareholders deficit	**(75,494)**	(114,212)
Total liabilities and shareholders deficit	**$ 403,307**	$ 340,037

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

4

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED, IN THOUSANDS)

	Nine Months Ended September 30,	
	2010	**2009**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 83,298**	$ 74,619
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**6,470**	6,252
Provision for bad debts	**2,421**	1,643
Non-cash stock compensation and other charges	**6,969**	8,796
Non-cash interest and other income	**(987)**	(4,953)
Dividends received from equity method investments	**618**	819
Equity in net income of affiliates	**(890)**	(779)
Changes in assets and liabilities, net of acquisitions:		
Receivables	**(14,511)**	(9,409)
Receivable marketing and reservation fees, net	**(2,594)**	(13,742)
Accounts payable	**6,274**	(2,061)
Accrued expenses	**(1,210)**	(5,754)
Income taxes payable/receivable	**11,940**	22,314
Deferred income taxes	**(2,704)**	0
Deferred revenue	**19,443**	5,349
Other assets	**(11,755)**	2,087
Other liabilities	**5,457**	(5,215)
Net cash provided by operating activities	**108,239**	79,966
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in property and equipment	**(17,673)**	(7,539)
Acquisitions, net of cash acquired	**(466)**	0
Issuance of notes receivable	**(8,901)**	(1,731)
Collections of notes receivable	**5,055**	190
Purchases of investments, employee benefit plans	**(1,396)**	(3,239)
Proceeds from sale of investments, employee benefit plans	**1,018**	13,839
Other items, net	**(296)**	(447)
Net cash provided (used) in investing activities	**(22,659)**	1,073
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings (repayments) pursuant to revolving credit facility	**(271,100)**	7,900
Proceeds from the issuance of long-term debt	**247,733**	0
Principal payments on long-term debt	**(20)**	0
Settlement of forward starting interest rate swap agreement	**(8,663)**	0
Debt issuance costs	**(804)**	0
Purchase of treasury stock	**(11,171)**	(57,042)
Excess tax benefits from stock-based compensation	**331**	4,374
Dividends paid	**(32,884)**	(33,335)

Proceeds from exercise of stock options		**1,321**		6,744
Net cash used in financing activities		**(75,257)**		(71,359)
Net change in cash and cash equivalents		**10,323**		9,680
Effect of foreign exchange rate changes on cash and cash equivalents		**1,355**		1,285
Cash and cash equivalents at beginning of period		**67,870**		52,680
Cash and cash equivalents at end of period	**$**	**79,548**	$	63,645
Supplemental disclosure of cash flow information:				
Cash payments during the period for:				
Income taxes, net of refunds	**$**	**26,561**	$	16,726
Interest	**$**	**1,924**	$	4,268
Non-cash investing and financing activities:				
Declaration of dividends	**$**	**32,886**	$	33,117
Capital lease obligation	**$**	**2,483**	$	0
Issuance of restricted shares of common stock	**$**	**9,233**	$	7,150
Issuance of performance vested restricted stock units	**$**	**256**	$	461
Issuance of treasury stock to employee stock purchase plan	**$**	**454**	$	465

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

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Company Information and Significant Accounting Policies

The accompanying unaudited consolidated financial statements of Choice Hotels International, Inc. and subsidiaries (together the Company) have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In the opinion of management, all adjustments (which include any normal recurring adjustments) considered necessary for a fair presentation have been included. Certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States of America (GAAP) have been omitted. The year end balance sheet information was derived from audited financial statements, but does not include all disclosures required by GAAP. The Company believes the disclosures made are adequate to make the information presented not misleading. The consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2009 and notes thereto included in the Company s Form 8-K, filed with the SEC on August 18, 2010 (the 8-K). Interim results are not necessarily indicative of the entire year results because of seasonal variations. All intercompany transactions and balances between Choice Hotels International, Inc. and its subsidiaries have been eliminated in consolidation.

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

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with a maturity of three months or less at the date of purchase to be cash equivalents. As of September 30, 2010 and December 31, 2009, $3.9 million and $6.4 million, respectively, of book overdrafts representing outstanding checks in excess of funds on deposit are included in accounts payable in the accompanying consolidated balance sheets.

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

Derivatives

The Company uses derivative instruments as part of its overall strategy to manage exposure to market risks associated with fluctuations in interest rates. All outstanding derivative financial instruments are recognized at their fair values as assets or liabilities. The impact on earnings from recognizing the fair values of these instruments depends on their intended use, their hedge designation and their effectiveness in offsetting changes in the fair values of the exposures they are hedging. The Company does not use derivatives for trading purposes.

The effective portion of changes in fair value of derivatives designated as cash flow hedging instruments are recorded as a component of accumulated other comprehensive income (loss) and the ineffective portion is reported currently in earnings. The amounts included in accumulated other comprehensive income are reclassified into earnings in the same period during which the hedged item affects earnings. Amounts reported in earnings are classified consistent with the item being hedged.

The Company formally documents all relationships between its hedging instruments and hedged items at inception, including its risk management objective and strategy for establishing various hedge relationships. Cash flows from hedging instruments are classified in the Consolidated Statements of Cash Flows consistent with the items being hedged.

Hedge accounting is discontinued prospectively when (i) the derivative instrument is no longer effective in offsetting changes in fair value or cash flows of the underlying hedged item, (ii) the derivative instrument expires, is sold, terminated or exercised, or (iii) designating the derivative instrument as a hedge is no longer appropriate. The effectiveness of derivative instruments is assessed at inception and on an ongoing basis.

Variable Interest Entities

In accordance with the guidance for the consolidation of variable interest entities (VIE), we analyze our variable interests, including loans, guarantees, and equity investments, to determine if the entity in which we have a variable interest is a variable interest entity. Our analysis includes both quantitative and qualitative reviews. We base our analysis on our consideration of who has the power to direct those activities that most significantly impact the economic performance of the entity and who has the obligation to absorb the majority of losses or rights to receive benefits that could potentially be significant to the VIE. We also use our quantitative and qualitative analyses to determine if we must consolidate a variable interest entity as the primary beneficiary.

Recently Adopted Accounting Guidance

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements, (ASU 2010-06) to require new disclosures and clarify existing disclosures relating to fair value measurements. The new

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of this standard did not have and is not expected to have an effect on the Company s consolidated balance sheets, results of operations, or cash flows.

In September 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 167, Amendments to FASB Interpretation No. 46(R) , or ASU No. 2009-17, now included in FASB Accounting Standards Codification (ASC) 810-10, Consolidation , which amends FASB Interpretation No. 46 (revised December 2003) to address the elimination of the concept of a qualifying special purpose entity. This guidance replaces the quantitative-based risks and rewards calculation for determining which enterprise has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity. Additionally, this guidance provides more timely and useful information about an enterprise s involvement with a variable interest entity. The Company adopted this guidance on January 1, 2010. The adoption of these provisions did not have an impact on our consolidated financial statements.

In April 2010, the FASB issued authoritative guidance related to the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate. A vendor can recognize consideration that is contingent upon achievement of a milestone in its entirety as revenue in the period in which the milestone is achieved if the milestone is: (a) commensurate with either the vendor s performance to achieve the milestone or the enhancement of the value of the item delivered; (b) relates solely to past performance; and (c) is reasonable relative to all deliverables and payment terms in the arrangement. This guidance is effective on a prospective basis for financial statements issued for interim and annual periods ending after June 15, 2010 with early adoption permitted. The adoption of this guidance did not have a material impact on the Company s results of operations or financial position.

In October 2009, the FASB issued ASU 2009-13, Revenue Recognition: Multiple-Deliverable Arrangements now included in ASC 605-25, Revenue Recognition . This guidance modifies the fair value requirements of revenue recognition on multiple element arrangements by allowing the use of the best estimate of selling price in addition to vendor specific objective evidence and third-party evidence for determining the selling price of a deliverable. ASU 2009-13 also establishes a selling price hierarchy for determining the selling price of a deliverable. In addition, this guidance eliminates the residual method allocation and expands the disclosure requirements for such arrangements. This guidance is effective for contracts entered into during fiscal periods beginning on or after June 15, 2010. The adoption of this guidance did not have a material impact on the Company s results of operations or financial position.

2. Other Current Assets

Other current assets consist of the following:

	September 30, 2010	December 31, 2009
	(In thousands)	
Prepaid expenses	**$ 7,693**	$ 7,014
Land held for sale	**11,006**	
Notes receivable (See Note 3)	**3,975**	2,378
Income taxes receivable	**470**	
Other	**836**	722
Total	**$ 23,980**	$ 10,114

Land held for sale represents the Company s purchase of various parcels of real estate as part of its program to incent franchise development in top markets for certain brands. The Company has acquired this real estate with the intent to resell it to third-party developers for the construction

of hotels operated under the Company s brands.

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

3. Notes Receivable

	September 30, 2010	December 31, 2009
	(In thousands)	
Forgivable notes receivable	**$ 6,768**	$ 7,432
Mezzanine and other notes receivables	**15,571**	12,345
	22,339	19,777
Loan reserves	**(9,716)**	(9,531)
Total	**$ 12,623**	$ 10,246
Current portion, net	**$ 3,975**	$ 2,378
Long-term portion, net	**8,648**	7,868
Total	**$ 12,623**	$ 10,246

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

Forgivable Notes Receivable

From time to time, the Company provides financing to franchisees for property improvements and other purposes in the form of forgivable promissory notes. The terms of the notes typically range from 3 to 10 years, bearing market interest rates, and are forgiven and amortized over that time period if the franchisee remains in the system in good standing. As of September 30, 2010 and December 31, 2009, the unamortized balance of these notes totaled $6.8 million and $7.4 million, respectively. The Company recorded an allowance for credit losses on these forgivable notes receivable of $0.7 million at both September 30, 2010 and December 31, 2009. Amortization expense included in the accompanying consolidated statements of income related to the notes was $0.5 million and $1.4 million for the three and nine months ended September 30, 2010, respectively. Amortization expense for the three and nine months ended September 30, 2009 relating to the notes was $0.5 million and $1.5 million, respectively. At September 30, 2010, the Company had commitments to extend an additional $4.4 million in forgivable notes receivable provided certain commitments are met by its franchisees.

Mezzanine and Other Notes Receivable

The Company has provided financing to franchisees in support of the development of properties in key markets. These notes include non-interest bearing receivables as well as notes bearing market interest and are due upon maturity. Interest income associated with these notes receivable is reflected in the accompanying consolidated statements of income under the caption interest and other investment (income) loss. The Company does not accrue interest on notes receivable that are impaired. At September 30, 2010, notes receivable advanced and related interest totaled $15.6 million of which $10.8 million was determined to be impaired at September 30, 2010. The Company has recorded an $8.6 million allowance for credit losses on these impaired loans at both September 30, 2010 and December 31, 2009. In addition, at September 30, 2010 and December 31, 2009, the Company had provided loan reserves on non-impaired loans totaling $0.4 million and $0.2 million, respectively. The Company records bad debt expense in selling, general & administrative (SG&A) expenses in the accompanying consolidated statements of income. At September 30, 2010, the Company had a commitment to extend an additional $1.5 million in mezzanine and other notes receivables

provided certain conditions are met.

4. Receivable Marketing and Reservation Fees

As of September 30, 2010 and December 31, 2009, the Company s balance sheet includes a receivable of $23.6 million and $19.2 million, respectively from cumulative marketing expenses incurred in excess of cumulative marketing fee revenues earned. The reservation fees receivable related to cumulative reservation expenses incurred in excess of cumulative reservation fee revenues earned was $22.5 million and $14.7 million at September 30, 2010 and December 31, 2009, respectively. Depreciation and amortization expense attributable to marketing and reservation activities was $3.0 million for both the three months ended September 30, 2010 and 2009. Depreciation and amortization expense attributable to marketing and reservation activities was $9.1 million and $7.9 million for the nine months ended September 30, 2010 and 2009, respectively. Interest expense attributable to marketing and reservation activities was approximately $0.3 million and $0.06 million for the three months ended September 30, 2010 and 2009, while interest expense attributable to marketing and reservation activities was approximately $0.5 million and $0.2 million for the nine months ended September 30, 2010 and 2009, respectively.

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

The Company evaluates the receivable for marketing and reservation costs in excess of cumulative marketing and reservation fees earned on a periodic basis for collectability. The Company will record an allowance when, based on current information and events, it is probable that we will be unable to collect all amounts due for marketing and reservation activities according to the contractual terms of the franchise agreements. The receivables are considered to be uncollectible if the expected net, undiscounted cash flows from marketing and reservation activities are less than the carrying amount of the asset.

5. Deferred Revenue

Deferred revenue consists of the following:

	September 30, 2010	December 31, 2009
	(In thousands)	
Loyalty programs	**$ 66,798**	$ 48,686
Initial, relicensing and franchise fees	**3,106**	2,160
Procurement service fees	**1,169**	884
Other	**223**	35
Total	**$ 71,296**	$ 51,765

6. Debt

Debt consists of the following at:

	September 30, 2010	December 31, 2009
	(In thousands)	
$350 million senior unsecured revolving credit facility with an effective interest rate of 0.68% and 0.65% at September 30, 2010 and December 31, 2009, respectively	**$ 6,600**	$ 277,700
$250 million senior notes with an effective interest rate of 6.19% at September 30, 2010, less discount of $637	**249,363**	
Capital lease obligation due 2016 with an effective interest rate of 4.66%	**2,483**	
Other notes payable	**61**	
Total debt	**$ 258,507**	$ 277,700
Less current portion	**6,894**	
Total long-term debt	**$ 251,613**	$ 277,700

On June 16, 2006, the Company entered into a $350 million senior unsecured revolving credit agreement (the Revolver), with a syndicate of lenders. The Revolver allows the Company to borrow, repay and reborrow revolving loans up to $350 million (which includes swingline loans for up to $20 million and standby letters of credit of up to $30 million) until the scheduled maturity date of June 16, 2011. The Company has the

ability to request an increase in available borrowings under the Revolver by an additional amount of up to $150 million by obtaining the agreement of the existing lenders to increase their lending commitments or by adding additional lenders. The rate of interest generally applicable for revolving loans under the Revolver is, at the Company s option, equal to either (i) the greater of the prime rate or the federal funds effective rate plus 50 basis points, or (ii) an adjusted LIBOR rate plus a margin between 22 and 70 basis points based on the Company s credit rating. The Revolver requires the Company to pay a quarterly facility fee, based upon the credit rating of the Company, at a rate between 8 and 17 1/2 basis points, on the full amount of the commitment (regardless of usage). The Revolver also requires the payment of a quarterly usage fee, based upon the credit rating of the Company, at a rate between 10 and 12 1/2 basis points, on the amount outstanding under the commitment, excluding swingline loans, at all times when the amount borrowed under the Revolver exceeds 50% of the total commitment. The Revolver includes customary financial and other covenants that require the maintenance of certain ratios including maximum leverage and interest coverage. The Revolver also restricts the Company s ability to make certain investments, incur certain debt, and dispose of assets, among other restrictions. As of September 30, 2010, the Company was in compliance with all covenants.

On August 25, 2010, the Company completed a $250 million senior unsecured note offering (the Senior Notes) at a discount of $0.6 million, bearing a coupon of 5.7% with an effective rate of 6.19%. The Senior Notes will mature on

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

August 28, 2020, with interest on the Senior Notes to be paid semi-annually on February 28th and August 28th. The Company used the net proceeds from the offering, after deducting underwriting discounts and other offering expenses, to repay outstanding borrowings under the Revolver and for other general corporate purposes.

Debt issuance costs and bond discounts incurred in connection with the Senior Notes are amortized, on a straight-line basis, which is not materially different than the effective interest method, through the maturity of the Senior Notes. Amortization of these costs is included in interest expense in the Consolidated Statements of Income.

The Company may redeem the 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.

The Company s line of credit providing up to an aggregate of $5 million of borrowings matured on August 31, 2010 and was not renewed. Prior to maturity, borrowings under the line of credit bore interest at the lender s sole option at either of the following rates (i) prime rate or (ii) LIBOR rate plus 0.80% per annum; due monthly and upon demand for final payment.

7. Acquisition of Choice Hospitality (India) Ltd.

In the first quarter of 2010, the Company acquired the remaining 60% ownership interest in one of the Company s master franchisees, Choice Hospitality (India) Ltd. (CHN), which conducts franchising operations in the Republics of India, Sri Lanka, Maldives and the Kingdom of Nepal for $0.6 million and began including the results of its operations in the Company s financial statements on January 8, 2010. Prior to the acquisition, the Company owned 40% of the outstanding common stock of CHN with the remaining 60% of the outstanding stock owned by unrelated parties. The Company allocated the purchase price based on management s assessment of the fair value of assets acquired and liabilities assumed as of January 8, 2010. The Company allocated $0.3 million of the excess of the total purchase price over net tangible assets to franchise rights and the remaining $0.2 million to goodwill. The franchise rights are being amortized over their estimated useful life of 8 years. The pro forma results of operations as if this entity had been combined at the beginning of 2010 and 2009 would not be materially different from the Company s reported results for those periods.

8. Pension Plan

The Company sponsors an unfunded non-qualified defined benefit plan (SERP) for certain senior executives. No assets are held with respect to the plan; therefore benefits are funded as paid to participants. For the three months ended September 30, 2010 and September 30, 2009, the Company recorded $0.1 million and $0.3 million, respectively, for the expenses related to the SERP which are included in SG&A expense in the accompanying consolidated statements of income. The expenses related to the SERP for the nine month periods ended September 30, 2010 and 2009 are $0.4 million and $0.9 million, respectively. Benefit payments totaling $0.4 million are currently scheduled to be remitted within the next twelve months.

The following table presents the components of net periodic benefit costs for the three and nine months ended September 30, 2010 and 2009:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	**2010**	**2009**	**2010**	**2009**
Components of net periodic pension cost:				
Service cost	**$**	$ 101	**$**	$ 303
Interest cost	**135**	147	**404**	443
Amortization:				

Prior service cost		58		173
Net periodic pension cost	**$ 135**	$ 306	**$ 404**	$ 919

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

The net periodic pension costs for the year ended December 31, 2010 are projected to decline from the prior year due to the amendment of the SERP, effective December 31, 2009, which froze participant benefits. As a result of freezing the benefits, future service costs and unrecognized prior service cost amortizations have been eliminated. The 2010 monthly net periodic pension costs are approximately $45,000. The components of projected pension costs for the year ended December 31, 2010 are as follows:

(in thousands)	
Components of net periodic pension cost:	
Service cost	**$**
Interest cost	**538**
Amortizations:	
(Gain)/Loss	
Prior service cost	
Net periodic pension cost	**$ 538**

The following is a reconciliation of the changes in the projected benefit obligation for the nine months ended September 30, 2010:

(in thousands)	
Projected benefit obligation, December 31, 2009	**$ 9,176**
Service cost	
Interest cost	**404**
Benefit payments	**(310)**
Projected benefit obligation, September 30, 2010	**$ 9,270**

The amounts in accumulated other comprehensive income (loss) that have not yet been recognized as components of net periodic benefit costs at September 30, 2010 are as follows:

(in thousands)	
Transition asset (obligation)	**$**
Prior service cost	
Accumulated gain	**93**
Total	**$ 93**

9. Non-Qualified Retirement, Savings and Investment Plans

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

In 2002, the Company adopted the Choice Hotels International, Inc. Executive Deferred Compensation Plan (EDCP) which became effective January 1, 2003. Under the EDCP, certain executive officers may defer a portion of their salary into an irrevocable trust. Prior to January 1, 2010, participants could elect an investment return of either the annual yield of the Moody s Average Corporate Bond Yield Index plus 300 basis points or a return based on a selection of available diversified investment options. Effective January 1, 2010, the Moody s Average Corporate Bond Rate Yield Index plus 300 basis points is no longer an investment option for salary deferrals made on compensation earned after December 31, 2009. As of September 30, 2010 and December 31, 2009, the Company recorded a deferred compensation liability of $17.1 million and $17.6 million, respectively related to these deferrals and credited investment returns. Compensation expense is recorded in SG&A expense on the Company s consolidated statements of income based on the change in the deferred compensation obligation related to earnings credited to participants as well as changes in the fair value of diversified investments. Compensation expense recorded in SG&A for the three months ended September 30, 2010 and 2009 were $0.3 million and $0.4 million, respectively. Compensation expense recorded in SG&A for the nine months ended September 30, 2010 and 2009 was $0.7 million and $0.9 million, respectively.

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

The Company has invested the employee salary deferrals in diversified long-term investments which are intended to provide investment returns that partially offset the earnings credited to the participants. The diversified investments held in the trusts totaled $12.6 million and $10.9 million as of September 30, 2010 and December 31, 2009, respectively, and are recorded at their fair value, based on quoted market prices. These investments are considered trading securities and therefore, the changes in the fair value of the diversified assets is included in other income and expenses, net in the accompanying statements of income. The Company recorded investment gains during the three months ended September 30, 2010 and 2009 totaling $0.8 million and $1.9 million, respectively. The Company recorded investment gains during the nine months ended September 30, 2010 and 2009 totaling $0.6 million and $3.3 million, respectively.

In 1997, the Company adopted the Choice Hotels International, Inc. Nonqualified Retirement Savings and Investment Plan (Non-Qualified Plan). The Non-Qualified Plan allows certain employees who do not participate in the EDCP to defer a portion of their salary and invest these amounts in a selection of available diversified investment options. As of September 30, 2010 and December 31, 2009, the Company had recorded a deferred compensation liability of $10.7 million and $11.0 million, respectively related to these deferrals. Compensation expense is recorded in SG&A expense on the Company s consolidated statements of income based on the change in the deferred compensation obligation related to earnings credited to participants as well as changes in the fair value of diversified investments. The net increase in compensation expense recorded in SG&A for the three months ended September 30, 2010 and 2009 was $0.8 million and $1.1 million, respectively. The net increase in compensation expense recorded in SG&A for the nine months ended September 30, 2010 and 2009 was $0.5 million and $1.8 million, respectively.

The diversified investments held in the trusts were $9.8 million and $10.1 million as of September 30, 2010 and December 31, 2009, respectively, and are recorded at their fair value, based on quoted market prices. These investments are considered trading securities and therefore the changes in the fair value of the diversified assets is included in other income and expenses, net in the accompanying statements of income. The Company recorded investment gains during the three months ended September 30, 2010 and 2009 of $0.7 million and $1.0 million, respectively. The Company recorded investment gains during the nine months ended September 30, 2010 and 2009 of $0.5 million and $1.8 million, respectively. In addition, the Non-Qualified Plan held shares of the Company s common stock with a market value of $0.9 million at both September 30, 2010 and December 31, 2009, respectively.

10. Fair Value of Financial Instruments

The Company believes that the fair values 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 on the Company s Revolver adjust frequently based on current market rates; accordingly its carrying amount approximates fair value.

The Company estimates the fair value of its long-term debt, excluding leases, using quoted market prices. At September 30, 2010, the long-term debt, excluding leases, had an approximate fair value of $251.9 million.

11. Fair Value Measurements

The Company estimates the fair value of our financial instruments utilizing a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. There have been no significant transfers into or out of Level 1 or Level 2 inputs during the three and nine months ended September 30, 2010. The following summarizes the three levels of inputs, as well as the assets that the Company values using those levels of inputs:

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

Level 2: Observable inputs, other than quoted prices in active markets for identical assets and liabilities, such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable. The Company s Level 2 assets consist of money

market funds held in the Company s EDCP and Non-Qualified Plan deferred compensation plans and those recorded in cash and cash equivalents.

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

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Assets (in thousands)	Total	Fair Value Measurements at Reporting Date Using Level 1	Level 2	Level 3
As of September 30, 2010				
Money market funds, included in cash and cash equivalents	$ 10,000	$	$ 10,000	$
Investments, employee benefit plans, at fair value	22,370	20,215	2,155	
	$ 32,370	$ 20,215	$ 12,155	$
As of December 31, 2009				
Investments, employee benefit plans, at fair value	$ 20,931	$ 18,505	$ 2,426	$
	$ 20,931	$ 18,505	$ 2,426	$

12. Income Taxes

The effective income tax rate was 26.4% and 35.0% for the three months ended September 30, 2010 and September 30, 2009, respectively. The effective income tax rate was 31.6% and 35.9% for the nine months ended September 30, 2010 and September 30, 2009, respectively.

The effective income tax rates for the three months and nine months ended September 30, 2010 differed from the U.S. federal statutory rate of 35% primarily due to a prior period adjustment of $3.3 million to our deferred tax assets, partially offset by an increase of $1.6 million related to identification of prior period unrecognized tax positions. The Company believes that these adjustments are not material to its financial statements for prior annual or interim periods, the nine months ended September 30, 2010 or the Company s expected annual results for the year ended December 31, 2010. Also in the quarter, we identified $1.7 million of additional federal income tax benefits. These rates were also impacted by state income taxes, partially offset by the effect of foreign operations. The effective income tax rates for the three and nine months ended September 30, 2009 were impacted by state income taxes, offset by the effect of foreign operations and the resolution of certain income tax contingencies.

The effective income tax rates for the three and nine months ended September 30, 2009 were impacted by state income taxes, offset by the effect of foreign operations and the resolution of certain income tax contingencies.

As of September 30, 2010, the Company had $5.7 million of total unrecognized tax benefits, of which approximately $3.9 million would impact the effective tax rate if recognized. The Company believes it is reasonably possible that it will recognize tax benefits of up to $1.3 million within the next twelve months related to the anticipated lapse of applicable statutes of limitations.

13. Share-Based Compensation and Capital Stock

Stock Options

No stock options were granted by the Company in the three month period ended September 30, 2010. The Company granted 20,735 options to certain employees of the Company at a fair value of $0.2 million for the three month period ended September 30, 2009. The Company granted 0.3 million and 0.5 million options to certain employees of the Company at a fair value of $2.6 million and $4.0 million during the nine months ended September 30, 2010 and 2009, respectively. The stock options granted by the Company had an exercise price equal to the market price of the Company s common stock on the date of grant. The fair value of the options granted was estimated on the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2010 Grants	2009 Grants
Risk-free interest rate	**2.19%**	1.83%
Expected volatility	**41.92%**	39.71%
Expected life of stock option	**4.4 years**	4.4 years
Dividend yield	**2.26%**	2.74%
Requisite service period	**4 years**	4 years
Contractual life	**7 years**	7 years
Weighted average fair value of options granted	**$ 10.07**	$ 7.41

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

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

The aggregate intrinsic value of the stock options outstanding and exercisable at September 30, 2010 was $11.7 million and $6.3 million, respectively. The total intrinsic value of options exercised during the three months ended September 30, 2010 and 2009 was approximately $16,000 and $3.7 million, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2010 and 2009 was $1.0 million and $12.3 million, respectively.

The Company received approximately $6,000 and $2.1 million in proceeds from the exercise of approximately 600 and 0.2 million employee stock options during the three month periods ended September 30, 2010 and 2009, respectively. The Company received $1.3 million and $6.7 million in proceeds from the exercise of approximately 66,000 and 0.7 million employee stock options during the nine month periods ended September 30, 2010 and 2009, respectively.

Restricted Stock

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Restricted share grants	**4,203**	7,399	**279,157**	262,128
Weighted average grant date fair value per share	**$ 35.69**	$ 29.56	**$ 33.07**	$ 27.28
Aggregate grant date fair value ($000)	**$ 150**	$ 219	**$ 9,233**	$ 7,150
Restricted shares forfeited	**2,354**	23,935	**11,183**	35,072
Vesting service period of shares granted	**4 years**	4 years	**3-4 years**	3-4 years
Grant date fair value of shares vested ($000)	**$ 200**	$ 212	**$ 5,948**	$ 5,469

Compensation expense related to the fair value of these awards is recognized straight-line over the requisite service period based on those restricted stock grants that ultimately vest. The fair value of grants is measured by the market price of the Company s stock on the date of grant. Restricted stock awards generally vest ratably over the service period beginning with the first anniversary of the grant date.

Performance Vested Restricted Stock Units

The Company has granted performance vested restricted stock units (PVRSU) to certain employees. The vesting of these stock awards is contingent upon the Company achieving performance targets at the end of specified performance periods and the employees continued employment. The performance conditions affect the number of shares that will ultimately vest. The range of possible stock-based award vesting is between 0% and 200% of the initial target. If a minimum of 50% of the performance target is not attained then no awards will vest under the terms of the PVRSU agreements. Compensation expense related to these awards will be recognized over the requisite service period regardless of whether the performance targets have been met based on the Company s estimate of the achievement of the various performance targets. The Company has currently estimated that between 0% and 100% of the various award targets will be achieved. The fair value is measured by the market price of the Company s common stock on the date of grant. Compensation expense is recognized ratably over the requisite service period based on those PVRSUs that ultimately vest.

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Performance vested restricted stock units granted at target			**33,517**	9,588
Weighted average grant date fair value per share	**$**	$	**$ 32.60**	$ 26.88
Aggregate grant date fair value ($000)	**$**	$	**$ 1,093**	$ 258
Stock units forfeited		2,035	**9,650**	6,046
Requisite service period			**3 years**	2 years

During the nine months ended September 30, 2010, PVRSU grants totaling 10,880 vested at a fair value of $0.3 million. These PVRSU grants were initially granted at a target of 15,541 units, however, since the Company achieved only 70% of the targeted performance conditions contained in the stock awards granted in prior periods, 4,661 shares out of the initial grant were forfeited. In addition, during the nine months ended September 30, 2010, 4,989 units were forfeited since the performance targets of the applicable PVRSU grant were not achieved. During the nine months ended September 30, 2009, PVRSU grants totaling 19,761 vested at a fair value of $0.5 million. These PVRSU grants were initially granted at a target of 14,638 units, however, since the Company exceeded targeted performance conditions contained in the stock awards granted in prior periods by 35%, an additional 5,123 shares were earned and issued. No PVRSU grants vested during the three month periods ended September 30, 2010 and 2009.

A summary of stock-based award activity as of September 30, 2010 and changes during the nine months ended are presented below:

	Nine Months Ended September 30, 2010						
	Stock Options			Restricted Stock		Performance Vested Restricted Stock Units	
	Shares	Weighted Average Exercise Price	Weighted Average Contractual Term	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2010	1,658,844	$ 30.05		539,341	$ 31.68	118,385	$ 34.58
Granted	261,137	32.84		279,157	33.07	33,517	32.60
Exercised/Vested	(66,160)	19.97		(181,671)	33.68	(10,880)	40.65
Forfeited/Expired	(19,661)	8.57		(11,183)	30.83	(9,650)	36.74
Outstanding at September 30, 2010	1,834,160	$ 31.04	4.6 years	625,644	$ 31.75	131,372	$ 33.42
Options exercisable at September 30, 2010	839,448	$ 30.88	3.8 years				

The components of the Company s pretax stock-based compensation expense and associated income tax benefits are as follows for the three and nine months ended September 30, 2010 and 2009:

(in millions)	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Stock options	**$ 0.7**	$ 0.8	**$ 1.9**	$ 1.9
Restricted stock	**1.8**	1.6	**5.3**	4.9
Performance vested restricted stock units	**(0.7)**	(0.7)	**(0.4)**	(0.3)
Total	**$ 1.8**	$ 1.7	**$ 6.8**	$ 6.5
Income tax benefits	**$ 0.7**	$ 0.6	**$ 2.5**	$ 2.4

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

During the three months ended September 30, 2010 and 2009, the Company revised its estimate of the projected achievement of various performance conditions that affect the number of PVRSUs that will ultimately vest. As a result, previously recognized stock-based compensation costs related to these PVRSUs has been reduced by $0.8 million for both the three and nine months ended September 30, 2010 and $0.9 million for both the three and nine months ended September 30, 2009.

Dividends

On September 17, 2010, the Company s board of directors declared a quarterly cash dividend of $0.185 per share (or approximately $11.0 million in the aggregate), which was paid on October 15, 2010 to shareholders of record as of October 1, 2010. On April 29, 2010, the Company s board of directors declared a quarterly cash dividend of $0.185 per share (or approximately $11.0 million in the aggregate), which was paid on July 16, 2010 to shareholders of record as of July 2, 2010. On February 16, 2010, the Company s board of directors declared a cash dividend of $0.185 per share (or approximately $11.0 million in the aggregate), which was paid on April 16, 2010 to shareholders of record on April 5, 2010.

On September 10, 2009, the Company declared a cash dividend of $0.185 per share (or approximately $10.9 million in the aggregate), which was paid on October 16, 2009 to shareholders of record on October 2, 2009. On May 4, 2009, the Company s board of directors declared a quarterly cash dividend of $0.185 per share (or approximately $11.0 million in the aggregate), which was paid on July 17, 2009 to shareholders of record on July 2, 2009. On February 9, 2009, the Company s board of directors declared a cash dividend of $0.185 per share (or approximately $11.1 million in the aggregate), which was paid on April 17, 2009 to shareholders of record on April 3, 2009.

Stock Repurchase Program

During the three months ended September 30, 2010, the Company purchased approximately 50,000 shares of common stock under the share repurchase program at a total cost of $1.9 million. During the nine months ended September 30, 2010, the Company purchased 0.3 million shares of common stock under the share repurchase program at a total cost of $8.7 million. During the three and nine months ended September 30, 2009, the Company purchased 0.7 million and 2.1 million shares of common stock under the share repurchase program at a total cost of $20.5 million and $55.3 million, respectively.

During the three and nine months ended September 30, 2010, the Company redeemed 1,736 and 75,432 shares of common stock at a total cost of approximately $60,000 and $2.4 million, respectively, from employees to satisfy statutory minimum tax requirements from the vesting of restricted stock and PVRSU grants.

During the three and nine months ended September 30, 2009, the Company redeemed 8,771 and 64,643 shares of common stock at a total cost of $0.2 million and $1.7 million, respectively, from employees to satisfy statutory minimum tax requirements from the vesting of restricted stock and PVRSU grants.

These redemptions were outside the share repurchase program initiated in September 1998.

14. Comprehensive Income

The components of accumulated other comprehensive income (loss) is as follows:

	September 30, 2010	December 31, 2009
	(In thousands)	

Foreign currency translation adjustments	**$ 943**	$ 275
Deferred loss on cash flow hedge	**(8,546)**	
Changes in pension benefit obligation recognized in other comprehensive income (loss)	**58**	58
Total accumulated other comprehensive income (loss)	**$ (7,545)**	$ 333

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

The differences between net income and comprehensive income are described in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	**2010**	**2009**	**2010**	**2009**
Net income	**$ 40,494**	$ 32,808	**$ 83,298**	$ 74,619
Other comprehensive income (loss), net of tax:				
Amortization of pension related costs, net of tax				
Prior service costs		36		108
Settlement of forward starting interest rate swap agreement	**(8,663)**		**(8,663)**	
Amortization of loss on cash flow hedge	**117**		**117**	
Foreign currency translation adjustment, net	**1,851**	719	**668**	2,046
Other comprehensive income (loss), net of tax	**(6,695)**	755	**(7,878)**	2,154
Comprehensive income	**$ 33,799**	$ 33,563	**$ 75,420**	$ 76,773

Cash Flow Hedge

In July 2010, the Company entered into an interest rate swap agreement to protect itself from an increase in the market interest rate on $250 million of 10-year, fixed rate debt with the coupon to be set at market interest rates. The interest rate swap agreement was designated as a cash flow hedge under the guidance for derivatives and hedging. In August 2010, upon issuance of the related fixed-rate debt, the Company terminated and settled the interest rate swap agreement for a cash payment of $8.7 million. The Company recorded the effective portion of this deferred loss as a component of accumulated other comprehensive income (loss). The ineffective portion was calculated at less than $0.1 million and was recognized immediately as a component of earnings under interest expense in the Company s consolidated statements of income during the three months ended September 30, 2010. The effective portion of the deferred loss is being amortized over the term of the related debt as interest expense in the Company s consolidated statements of income.

15. Earnings Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share amounts)	**2010**	**2009**	**2010**	**2009**
Computation of Basic Earnings Per Share:				
Net income	**$ 40,494**	$ 32,808	**$ 83,298**	$ 74,619
Income allocated to participating securities	**(426)**	(303)	**(865)**	(688)
Net income available to common shareholders	**$ 40,068**	$ 32,505	**$ 82,433**	$ 73,931
Weighted average common shares outstanding basic	**58,965**	59,182	**58,948**	59,686

Basic earnings per share	**$ 0.68**	$ 0.55	**$ 1.40**	$ 1.24
Computation of Diluted Earnings Per Share:				
Net income	**$ 40,494**	$ 32,808	**$ 83,298**	$ 74,619
Income allocated to participating securities	**(425)**	(302)	**(864)**	(687)
Net income available to common shareholders	**$ 40,069**	$ 32,506	**$ 82,434**	$ 73,932
Weighted average common shares outstanding basic	**58,965**	59,182	**58,948**	59,686
Dilutive effect of stock options and PVRSUs	**66**	85	**80**	171
Weighted average shares outstanding-diluted	**59,031**	59,267	**59,028**	59,857
Diluted earnings per share	**$ 0.68**	$ 0.55	**$ 1.40**	$ 1.24

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

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, 2010 and 2009, the Company had 1.8 million and 1.7 million outstanding stock options, respectively. Stock options are included in the diluted earnings per share calculation using the treasury stock method and average market prices during the period, unless the stock options would be anti-dilutive. For both the three and nine months ended September 30, 2010, the Company excluded 0.6 million of anti-dilutive stock options from the diluted earnings per share calculation. For both the three and nine months ended September 30, 2009, the Company excluded 1.0 million of anti-dilutive stock options from the diluted earnings per share calculation.

PVRSUs are also included in the diluted earnings per share calculation assuming the performance conditions have been met at the reporting date. However, at September 30, 2010 and 2009, PVRSUs totaling 131,372 and 118,385, respectively were excluded from the computation since the performance conditions had not been met.

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

16. Condensed Consolidating Financial Statements

Effective August 2010, the Company s Senior Notes are guaranteed jointly, severally, fully and unconditionally by eight 100%-owned domestic subsidiaries. There are no legal or regulatory restrictions on the payment of dividends to Choice Hotels International, Inc. from subsidiaries that do not guarantee the Senior Notes. As a result of the guarantee arrangements, the following condensed consolidating financial statements are presented. Investments in subsidiaries are accounted for under the equity method of accounting.

The condensed consolidating balance sheet as of December 31, 2009 has been revised to reflect the reclassification of certain intercompany balances and transactions from prior filings between subsidiaries within the combined financial statements to which they related. These revisions are not material to our financial statements taken as a whole.

Choice Hotels International, Inc.

Condensed Consolidating Statement of Income

For the Three Months Ended September 30, 2010

(Unaudited, In Thousands)

	Choice Hotels International, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUES:					
Royalty fees	$ 66,259	$ 21,727	$ 7,507	$ (22,928)	**$ 72,565**
Initial franchise and relicensing fees	1,970				**1,970**
Procurement services	3,756				**3,756**
Marketing and reservation	90,518	86,315	4,386	(78,352)	**102,867**
Other items, net	1,568	1,069	6		**2,643**
Total revenues	164,071	109,111	11,899	(101,280)	**183,801**
OPERATING EXPENSES:					
Selling, general and administrative	23,243	19,622	3,219	(22,928)	**23,156**
Marketing and reservation	95,355	82,306	3,558	(78,352)	**102,867**
Other items, net	880	1,820	201		**2,901**
Total operating expenses	119,478	103,748	6,978	(101,280)	**128,924**
Operating income	44,593	5,363	4,921		**54,877**
OTHER INCOME AND EXPENSES, NET:					
Interest expense	2,134	(272)	2		**1,864**
Other items, net	(147)	(1,492)	(374)		**(2,013)**
Equity in earnings of consolidated subsidiaries	(9,756)			9,756	

Total other income and expenses, net		(7,769)		(1,764)		(372)		9,756		**(149)**
Income before income taxes		52,362		7,127		5,293		(9,756)		**55,026**
Income taxes		11,868		2,137		527				**14,532**
Net income	**$**	**40,494**	**$**	4,990	**$**	**4,766**	**$**	**(9,756)**	**$**	**40,494**

19

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Choice Hotels International, Inc.

Condensed Consolidating Statement of Income

For the Three Months Ended September 30, 2009

(Unaudited, In Thousands)

	Choice Hotels International, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUES:					
Royalty fees	$ 57,468	$ 26,943	$ 8,732	$ (26,742)	**$ 66,401**
Initial franchise and relicensing fees	2,957				**2,957**
Procurement services	3,922				**3,922**
Marketing and reservation	79,108	83,011	3,636	(75,290)	**90,465**
Other items, net	1,278	934	19		**2,231**
Total revenues	144,733	110,888	12,387	(102,032)	**165,976**
OPERATING EXPENSES:					
Selling, general and administrative	30,186	20,786	287	(26,742)	**24,517**
Marketing and reservation	83,386	79,104	3,265	(75,290)	**90,465**
Other items, net	816	1,876	177		**2,869**
Total operating expenses	114,388	101,766	3,729	(102,032)	**117,851**
Operating income	30,345	9,122	8,658		**48,125**
OTHER INCOME AND EXPENSES, NET:					
Interest expense	982	(55)	(1)		**926**
Other items, net	(60)	(2,901)	(336)		**(3,297)**
Equity in earnings of consolidated subsidiaries	(12,514)			12,514	
Total other income and expenses, net	(11,592)	(2,956)	(337)	12,514	**(2,371)**
Income before income taxes	41,937	12,078	8,995	(12,514)	**50,496**
Income taxes	9,129	7,990	569		**17,688**
Net income	**$ 32,808**	**$** 4,088	**$ 8,426**	**$ (12,514)**	**$ 32,808**

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Choice Hotels International, Inc.

Condensed Consolidating Statement of Income

For the Nine Months Ended September 30, 2010

(Unaudited, In Thousands)

	Choice Hotels International, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUES:					
Royalty fees	$ 153,597	$ 68,596	$ 21,137	$ (72,301)	**$ 171,029**
Initial franchise and relicensing fees	6,537				**6,537**
Procurement services	13,612				**13,612**
Marketing and reservation	209,543	233,654	11,554	(212,655)	**242,096**
Other items, net	4,606	3,045	145		**7,796**
Total revenues	387,895	305,295	32,836	(284,956)	**441,070**
OPERATING EXPENSES:					
Selling, general and administrative	68,450	61,119	10,528	(72,301)	**67,796**
Marketing and reservation	219,945	224,359	10,447	(212,655)	**242,096**
Other items, net	2,848	5,411	598		**8,857**
Total operating expenses	291,243	290,889	21,573	(284,956)	**318,749**
Operating income	96,652	14,406	11,263		**122,321**
OTHER INCOME AND EXPENSES, NET:					
Interest expense	3,597	(441)	4		**3,160**
Other items, net	(328)	(1,043)	(1,164)		**(2,535)**
Equity in earnings of consolidated subsidiaries	(20,718)			20,718	
Total other income and expenses, net	(17,449)	(1,484)	(1,160)	20,718	**625**
Income before income taxes	114,101	15,890	12,423	(20,718)	**121,696**
Income taxes	30,803	6,242	1,353		**38,398**
Net income	**$ 83,298**	**$ 9,648**	**$ 11,070**	**$ (20,718)**	**$ 83,298**

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Choice Hotels International, Inc.

Condensed Consolidating Statement of Income

For the Nine Months Ended September 30, 2009

(Unaudited, In Thousands)

	Choice Hotels International, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUES:					
Royalty fees	$ 148,909	$ 68,873	$ 18,236	$ (71,247)	**$ 164,771**
Initial franchise and relicensing fees	9,599				**9,599**
Procurement services	14,084				**14,084**
Marketing and reservation	194,600	239,657	10,229	(216,683)	**227,803**
Other items, net	3,961	3,231	28		**7,220**
Total revenues	371,153	311,761	28,493	(287,930)	**423,477**
OPERATING EXPENSES:					
Selling, general and administrative	67,221	67,490	9,590	(71,247)	**73,054**
Marketing and reservation	205,823	229,119	9,544	(216,683)	**227,803**
Other items, net	2,402	5,713	515		**8,630**
Total operating expenses	275,446	302,322	19,649	(287,930)	**309,487**
Operating income	95,707	9,439	8,844		**113,990**
OTHER INCOME AND EXPENSES, NET:					
Interest expense	4,001	(221)	(6)	(43)	**3,731**
Other items, net	(200)	(5,102)	(822)	43	**(6,081)**
Equity in earnings of consolidated subsidiaries	(13,724)			13,724	
Total other income and expenses, net	(9,923)	(5,323)	(828)	13,724	**(2,350)**
Income before income taxes	105,630	14,762	9,672	(13,724)	**116,340**
Income taxes	31,011	9,460	1,250		**41,721**
Net income	**$ 74,619**	**$** 5,302	**$ 8,422**	**$ (13,724)**	**$ 74,619**

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Choice Hotels International, Inc.

Condensed Consolidating Balance Sheet

As of September 30, 2010

(Unaudited, In thousands)

	Choice Hotels International, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Cash and cash equivalents	$ 3,198	$ 352	$ 75,998	$	**$ 79,548**
Receivables	46,756	1,548	5,378		**53,682**
Other current assets	15,472	13,238	5,810	(2,560)	**31,960**
Total current assets	65,426	15,138	87,186	(2,560)	**165,190**
Property and equipment, at cost, net	13,281	38,269	1,426		**52,976**
Goodwill	60,620	5,193	227		**66,040**
Franchise rights and other identifiable intangibles, net	13,953	4,107	3,581		**21,641**
Investments, employee benefit plans, at fair value		22,370			**22,370**
Investment in and advances to affiliates	321,100	190,704	162	(511,966)	
Receivable, marketing and reservation fees	46,127				**46,127**
Deferred income taxes		41,695	275	(25,065)	**16,905**
Other assets	4,842	6,420	796		**12,058**
Total assets	$ 525,349	$ 323,896	$ 93,653	(539,591)	**$ 403,307**
LIABILITIES AND SHAREHOLDERS DEFICIT					
Accounts payable	$ 10,746	$ 25,895	$ 3,663	$	**$ 40,304**
Accrued expenses	14,866	19,523	1,547		**35,936**
Deferred revenue	17,454	52,989	853		**71,296**
Revolving credit facility	6,600				**6,600**
Current portion of long-term debt		267	27		**294**
Deferred compensation & retirement plan obligations		2,510			**2,510**
Income taxes payable	6,331	14,189	1,815	(2,560)	**19,775**
Total current liabilities	55,997	115,373	7,905	(2,560)	**176,715**
Long-term debt	249,363	2,216	34		**251,613**
Deferred compensation & retirement plan obligations		34,573	6		**34,579**
Advances from affiliates	262,229	7,208	29,221	(298,658)	
Deferred income taxes	25,065			(25,065)	
Other liabilities	8,189	7,685	20		**15,894**
Total liabilities	600,843	167,055	37,186	(326,283)	**478,801**

Total shareholders (deficit) equity	(75,494)	156,841	56,467	(213,308)	**(75,494)**
Total liabilities and shareholders deficit	**$ 525,349**	**$ 323,896**	**$ 93,653**	**$ (539,591)**	**$ 403,307**

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Choice Hotels International, Inc.

Condensed Consolidating Balance Sheet

As of December 31, 2009

(In Thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Cash and cash equivalents	$ 4,281	$ 303	$ 63,286		**$ 67,870**
Receivables	33,911	2,947	5,040		**41,898**
Other current assets	21,110	7,484	330	(10,830)	**18,094**
Total current assets	59,302	10,734	68,656	(10,830)	**127,862**
Property and equipment, at cost, net	17,660	24,604	1,363		**43,627**
Goodwill	60,620	5,193			**65,813**
Franchise rights and other identifiable intangibles, net	16,448	4,571	3,540		**24,559**
Investments, employee benefit plans, at fair value		20,931			**20,931**
Investment in and advances to affiliates	292,455	190,007	146	(482,608)	
Receivable, marketing and reservation fees	33,872				**33,872**
Deferred income taxes		41,695	111	(27,663)	**14,143**
Other assets	1,680	6,958	592		**9,230**
Total assets	$ 482,037	$ 304,693	$ 74,408	$ (521,101)	**$ 340,037**
LIABILITIES AND SHAREHOLDERS DEFICIT					
Accounts payable	$ 5,516	$ 24,952	$ 3,391		**$ 33,859**
Accrued expenses	12,629	23,266	1,179		**37,074**
Deferred revenue	3,854	47,331	580		**51,765**
Deferred compensation and retirement plan obligations		2,798			**2,798**
Income taxes payable		14,272	2,868	(10,830)	**6,310**
Total current liabilities	21,999	112,619	8,018	(10,830)	**131,806**
Long-term debt	277,700				**277,700**
Deferred compensation & retirement plan obligations		34,951	5		**34,956**
Advances from affiliates	262,628	6,663	22,708	(291,999)	
Deferred income taxes	27,663			(27,663)	
Other liabilities	6,259	3,528			**9,787**
Total liabilities	596,249	157,761	30,731	(330,492)	**454,249**

Total shareholders deficit	(114,212)	146,932	43,677	(190,609)	**(114,212)**
Total liabilities and shareholders deficit	$ 482,037	$ 304,693	$ 74,408	$ (521,101)	**$ 340,037**

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Choice Hotels International, Inc.

Condensed Consolidating Statement of Cash Flows

For the Nine Months Ended September 30, 2010

(Unaudited, in thousands)

	Choice Hotels International, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided from operating activities	$ 79,156	$ 17,001	$ 12,082		**$ 108,239**
CASH FLOWS FROM INVESTING ACTIVITIES:					
Investment in property and equipment	(1,409)	(15,993)	(271)		**(17,673)**
Acquisitions, net of cash acquired			(466)		**(466)**
Issuance of notes receivable	(7,906)	(995)			**(8,901)**
Collection of notes receivable	5,000	55			**5,055**
Purchases of investments, employee benefit plans		(1,396)			**(1,396)**
Proceeds from the sales of investments, employee benefit plans		1,018			**1,018**
Other items, net	(351)	23	32		**(296)**
Net cash used in investing activities	(4,666)	(17,288)	(705)		**(22,659)**
CASH FLOWS FROM FINANCING ACTIVITIES:					
Net repayments pursuant to revolving credit facility	(271,100)				**(271,100)**
Proceeds from the issuance of long-term debt	247,733				**247,733**
Principal payments on long term debt			(20)		**(20)**
Settlement of forward starting interest rate swap agreement	(8,663)				**(8,663)**
Purchase of treasury stock	(11,171)				**(11,171)**
Dividends paid	(32,884)				**(32,884)**
Other items, net	512	336			**848**
Net cash provided (used) in financing activities	(75,573)	336	(20)		**(75,257)**
Net change in cash and cash equivalents	(1,083)	49	11,357		**10,323**
Effect of foreign exchange rate changes on cash and cash equivalents			1,355		**1,355**
Cash and cash equivalents at beginning of period	4,281	303	63,286		**67,870**
Cash and cash equivalents at end of period	**$ 3,198**	**$ 352**	**$ 75,998**		**$ 79,548**

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Choice Hotels International, Inc.

Condensed Consolidating Statement of Cash Flows

For the Nine Months Ended September 30, 2009

(Unaudited, In thousands)

	Choice Hotels International, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided (used) from operating activities	$ 37,862	$ (5,382)	$ 47,486		**$ 79,966**
CASH FLOWS FROM INVESTING ACTIVITIES:					
Investment in property and equipment	(3,077)	(3,627)	(835)		**(7,539)**
Issuance of notes receivable	(162)	(1,569)			**(1,731)**
Collection of notes receivable		190			**190**
Purchases of investments, employee benefit plans		(3,239)			**(3,239)**
Proceeds from the sales of investments, employee benefit plans		13,839			**13,839**
Other items, net	(450)	(187)	190		**(447)**
Net cash provided (used) in investing activities	(3,689)	5,407	(645)		**1,073**
CASH FLOWS FROM FINANCING ACTIVITIES:					
Net borrowings pursuant to revolving credit facility	7,900				**7,900**
Purchase of treasury stock	(57,042)				**(57,042)**
Excess tax benefits from stock-based compensation	4,374				**4,374**
Dividends paid	(33,335)				**(33,335)**
Proceeds from exercise of stock options	6,744				**6,744**
Net cash used in financing activities	(71,359)				**(71,359)**
Net change in cash and cash equivalents	(37,186)	25	46,841		**9,680**
Effect of foreign exchange rate changes on cash and cash equivalents			1,285		**1,285**
Cash and cash equivalents at beginning of period	42,734	225	9,721		**52,680**
Cash and cash equivalents at end of period	**$ 5,548**	**$ 250**	**$ 57,847**		**$ 63,645**

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

17. Reportable Segment Information

The Company has a single reportable segment encompassing its franchising business. Revenues from the franchising business include royalty fees, initial franchise and relicensing fees, marketing and reservation fees, procurement services revenue and other revenue. The Company is obligated under its 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 franchising business. The revenues received from franchisees that are used to pay for part of the Company s ongoing operations are included in franchising revenues and are offset by the related expenses paid for marketing and reservation activities to calculate franchising operating income. Corporate and other revenue consists of hotel operations. Except as described in Note 4, the Company does not allocate interest income, interest expense or income taxes to its franchising segment.

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

(In thousands)	Three Months Ended September 30, 2010			Three Months Ended September 30, 2009		
	Franchising	Corporate & Other	Consolidated	Franchising	Corporate & Other	Consolidated
Revenues	**$ 182,733**	**$ 1,068**	**$ 183,801**	$ 165,042	$ 934	$ 165,976
Operating income (loss)	**$ 64,424**	**$ (9,547)**	**$ 54,877**	$ 59,438	$ (11,313)	$ 48,125

(In thousands)	Nine Months Ended September 30, 2010			Nine Months Ended September 30, 2009		
	Franchising	Corporate & Other	Consolidated	Franchising	Corporate & Other	Consolidated
Revenues	**$ 438,026**	**$ 3,044**	**$ 441,070**	$ 420,246	$ 3,231	$ 423,477
Operating income (loss)	**$ 150,056**	**$ (27,735)**	**$ 122,321**	$ 146,798	$ (32,808)	$ 113,990

18. Commitments and Contingencies

The Company is a defendant in a number of lawsuits arising in the ordinary course of business. In the opinion of management and the Company s legal counsel, the ultimate outcome of any such lawsuit individually will not have a material adverse effect on the Company s business, financial position, results of operations or cash flows.

In June 2008, the Company guaranteed $1 million of a bank loan funding a franchisee s construction of a Cambria Suites in Columbus, Ohio. The guaranty will terminate on the earlier of (i) the repayment of all outstanding obligations under the bank loan that it supports (the current initial loan term runs through June 2013), or (ii) when the franchisee achieves certain debt service coverage ratios outlined in the underlying bank loan agreement. The Company has received a pledge of an equity interest in the entity constructing the property as well as personal guarantees from several of the franchisee s principal owners related to the repayment of any amounts the Company may be required to pay under this guaranty.

In July 2008, the Company guaranteed $1 million of a bank loan funding a franchisee s construction of a Cambria Suites in Noblesville, Indiana. The guaranty will terminate on the earlier of (i) the repayment of all outstanding obligations under the bank loan that it supports (the current initial loan term runs through September 2011), or (ii) when the franchisee achieves certain debt service coverage ratios outlined in the underlying bank loan agreement. The Company has received a pledge of an equity interest in the entity constructing the property as well as personal guarantees from several of the franchisee s principal owners related to the repayment of any amounts the Company may be required to pay under this guaranty.

The Company has made a commitment to purchase a parcel of real estate to support the development of its brands. Providing certain conditions are met by the seller, the Company expects to acquire this parcel of land for a total price of approximately $3.5 million during the year ended December 31, 2010.

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. Such indemnifications are granted under various agreements, including those governing (i) purchases or sales of assets 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

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

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.

19. Termination Charges

During nine months ended September 30, 2010, the Company recorded one-time employee termination charges totaling $1.6 million in SG&A and marketing and reservation expenses. These charges related to salary and benefits continuation payments for employees separating from service with the Company. At September 30, 2010, the Company had approximately $0.9 million of these salary and benefits continuation payments remaining to be remitted. The Company recorded a $2.8 million charge in SG&A and marketing and reservations expenses related to salary and benefits continuation for terminated employees during the nine months ended September 30, 2009. At September 30, 2010 the Company had approximately $2.3 million of benefits remaining to be paid on these termination benefits as well as those incurred prior to January 1, 2009.

At September 30, 2010 and December 31, 2009, approximately $3.2 million and $5.5 million, respectively, of termination benefits remained unpaid and are included as current and non-current liabilities in the Company s consolidated financial statements. At September 30, 2010, the Company expects $2.6 million of these benefits to be paid within the next twelve months.

20. Future Adoption of Accounting Standards

In July 2010, the FASB issued ASU No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, (ASU 2010-20), which is included in the codification under ASC 815, Derivatives and Hedging (ASC 815). ASU 2010-20 sets forth requirements to improve financial reporting by companies with financial receivables (as defined in ASU 2010-20) and to provide more relevant and reliable information to the users of the financial statements. A significant change in ASU 2010-20 is that companies will be required to provide information for both the financing receivable and the related allowance on credit losses at disaggregated levels. ASU 2010-20 will be effective for both interim and annual reporting periods ending after December 15, 2010. The Company is currently evaluating the impact of this guidance on its consolidated financial statements, if any.

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

The following Management s Discussion and Analysis (MD&A) is intended to help the reader understand Choice Hotels International, Inc. and subsidiaries (together the Company). MD&A is provided as a supplement to and should be read in conjunction with our consolidated financial statements and the accompanying notes.

Overview

We are a hotel franchisor with franchise agreements representing 6,091 hotels open and 638 hotels under construction, awaiting conversion or approved for development as of September 30, 2010, with 492,152 rooms and 52,723 rooms, respectively, in 49 states, the District of Columbia and over 40 countries and territories outside the United States. Our brand names include Comfort Inn®, Comfort Suites®, Quality®, Clarion®, Ascend Collection®, Sleep Inn®, Econo Lodge®, Rodeway Inn®, MainStay Suites®, Suburban Extended Stay Hotel®, and Cambria Suites® (collectively, the Choice brands).

The Company conducts its international franchise operations through a combination of direct franchising and master franchising relationships. Master franchising relationships allow the use of our brands by third parties in foreign countries. The Company has made equity investments in

certain non-domestic lodging franchise companies that conduct franchise operations for the Choice brands under master franchising relationships. As a result of our use of master franchising relationships and international market conditions, total revenues from international franchising operations comprised only 7% of our total revenues for both the three and nine months ended September 30, 2010, while representing approximately 19% of hotels open at September 30, 2010.

The Company previously had a 40% equity interest in Choice Hospitality (India) Ltd. (CHN) which it accounted for under the equity method of accounting. On January 8, 2010, the Company purchased the remaining 60% of CHN at which time it became a wholly-owned subsidiary. The pro forma results of operations as if CHN had been combined at the beginning of 2010 and 2009, would not be materially different from the Company s reported results for those periods. This transaction enabled Choice to continue its strategy of more closely directing the growth of our international franchise 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 procurement services vendor arrangements, hotel operations and other sources. The hotel industry is seasonal in nature. For most hotels, demand is lower in December through March than during the remainder of the year. Our principal source of revenues is franchise fees based on the gross room revenues of our franchised properties. The Company s franchise fee revenues and operating income reflect the industry s seasonality and historically have been lower in the first quarter than in the second, third or fourth quarters.

The lodging industry has historically experienced economic cycles reflected in positive and negative operating performance for various periods of time. Positive cycles are characterized as periods of sustained occupancy growth. These cycles usually continue until the economy sustains a prolonged downturn, excess supply conditions exist or some external factor occurs such as war, terrorism or natural resource shortages. Industry recovery usually begins with an increase in occupancy followed by hoteliers increasing room rates. As demand begins to exceed room supply, occupancies and rates continue to improve. These factors result in increased hotel development.

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 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 that 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 annual domestic royalty revenues by approximately $2.1 million and a 1 basis point change in the Company s effective royalty rate would increase or decrease annual domestic royalties by approximately $0.5 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. As a lodging franchisor, the Company currently has relatively low capital expenditure requirements.

The principal factors that affect the Company s results are: the number and relative mix of franchised hotel rooms; 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 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 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 contractually 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 system, help to enhance awareness and increase consumer preference for our brands. Greater awareness and preference promotes long-term growth in business delivery to our franchisees, which ultimately increases franchise fees earned by the Company.

Our Company articulates its mission as a commitment to our franchisees profitability by providing them with hotel franchises that 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. Our Company focuses on two key value drivers:

Profitable Growth. We believe 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, a central

reservation system, property and yield management systems, quality assurance standards and procurement services 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 established 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.

Table of Contents

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. Currently, our business does not require significant capital to operate and grow. Therefore, we can maintain a capital structure that generates high financial returns and use our excess cash flow to increase returns to our shareholders. Historically, we have returned value to our shareholders in two primary ways: share repurchases and dividends. In 1998, we instituted a share repurchase program which has generated substantial value for our shareholders. During the nine months ended September 30, 2010, the Company repurchased 0.3 million shares of its common stock under the share repurchase program at a total cost of $8.8 million. Since the program s inception through September 30, 2010, we have repurchased 43.2 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 $1.0 billion. Considering the effect of the two-for-one stock split, the Company has repurchased 76.2 million shares at an average price of $13.35 per share. We currently believe that our cash flows from operations will support our ability to complete the current board of directors repurchase authorization of approximately 3.6 million shares remaining as of September 30, 2010. Upon completion of the current authorization, our board of directors will evaluate the advisability of additional share repurchases. During the nine months ended September 30, 2010, we paid cash dividends totaling approximately $32.9 million and we presently expect to continue to pay dividends in the future, subject to future business performance, economic conditions and changes in income tax regulations. Based on our present dividend rate and outstanding share count, aggregate annual dividends for 2010 would be approximately $43.8 million.

Our Board previously authorized us to enter into programs which permit us to offer financing, investment and guaranty support to qualified franchisees as well as to acquire and resell real estate to incent franchise development for certain brands in top markets. Recent market conditions have resulted in an increase in opportunities to incentivize development under these programs. As a result, during the nine months ended September 30, 2010, the Company has invested approximately $18.9 million pursuant to these programs, of which $5 million has subsequently been repaid.

Over the next several years, we expect to continue to deploy capital opportunistically pursuant to these programs to promote growth of our emerging brands. The amount and timing of the investment in these programs will be dependent on market and other conditions. Our current expectation is that our annual investment in these programs will range from $20 million to $40 million. Notwithstanding these programs, the company expects to continue to return value to its shareholders through a combination of share repurchases and dividends, subject to market and other conditions.

We believe these value drivers, 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 Operation: Royalty fees, operating income, net income and diluted earnings per share (EPS) represent key measurements of these value drivers. In the three months ended September 30, 2010, royalty fees revenue totaled $72.6 million, a 9% increase from the same period in 2009. Operating income totaled $54.9 million for the three months ended September 30, 2010, a $6.8 million or 14% increase from the same period in 2009. Net income increased $7.7 million or 23% from the same period of the prior year to $40.5 million. Diluted earnings per share for the quarter ended September 30, 2010 were $0.68 compared to $0.55 for the three months ended September 30, 2009. These measurements will continue to be a key management focus in 2010 and beyond.

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. In the nine months ended September 30, 2010 and 2009, net cash provided by operating activities was $108.2 million and $80.0 million, respectively. Since our business does not currently require significant reinvestment of capital, we utilize cash in ways that management believes provide the greatest returns to our shareholders, which include share repurchases and dividends. 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.

Operations Review

Comparison of Operating Results for the Three-Month Periods Ended September 30, 2010 and 2009

The Company recorded net income of $40.5 million for the three months ended September 30, 2010, a $7.7 million, or 23% increase from the $32.8 million for the quarter ended September 30, 2009. The increase in net income for the three months ended September 30, 2010, is primarily attributable to a $6.8 million or 14% increase in operating income and a lower effective income tax rate, partially offset by an increase in effective borrowing rates due to the issuance of new debt and lower appreciation in the fair value of investments held in the Company s non-qualified employee benefit plans compared to the prior year period.

Table of Contents

Summarized financial results for the three months ended September 30, 2010 and 2009 are as follows:

(in thousands, except per share amounts)	2010	2009
REVENUES:		
Royalty fees	**$ 72,565**	$ 66,401
Initial franchise and relicensing fees	**1,970**	2,957
Procurement services	**3,756**	3,922
Marketing and reservation	**102,867**	90,465
Hotel operations	**1,068**	934
Other	**1,575**	1,297
Total revenues	**183,801**	165,976
OPERATING EXPENSES:		
Selling, general and administrative	**23,156**	24,517
Depreciation and amortization	**2,078**	2,105
Marketing and reservation	**102,867**	90,465
Hotel operations	**823**	764
Total operating expenses	**128,924**	117,851
Operating income	**54,877**	48,125
OTHER INCOME AND EXPENSES, NET:		
Interest expense	**1,864**	926
Interest and other investment income	**(1,671)**	(2,961)
Equity in net income of affiliates	**(342)**	(336)
Total other income and expenses, net	**(149)**	(2,371)
Income before income taxes	**55,026**	50,496
Income taxes	**14,532**	17,688
Net income	**$ 40,494**	$ 32,808
Diluted earnings per share	**$ 0.68**	$ 0.55

The Company utilizes certain measures such as adjusted net income, adjusted diluted EPS, adjusted SG&A, adjusted operating income and franchising revenues which do not conform to generally accepted accounting principles 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, such as net income, diluted EPS, SG&A, operating income and total revenues. 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 below a reconciliation of these measures to the comparable GAAP measurement as well as our reason for reporting these non-GAAP measures.

Franchising Revenues: The Company utilizes franchising revenues which exclude marketing and reservation revenues and hotel operations rather than total revenues when analyzing the performance of the business. Marketing and reservation activities are excluded from revenues since the Company is contractually required by its franchise agreements to use these fees collected for marketing and reservation activities; as such, no income or loss to the Company is generated. Cumulative reservation and marketing fees not expended are recorded as a payable on the Company s financial statements and are carried over to the next fiscal year and expended in accordance with the franchise agreements. Cumulative marketing and reservation expenditures in excess of fees collected for marketing and reservation activities are recorded as a

receivable on the Company s financial statements. Hotel operations are excluded since they do not reflect the most accurate measure of the Company s core franchising business. This non-GAAP measure is a commonly used measure of performance in our industry and facilitates comparisons between the Company and its competitors.

Table of Contents

Calculation of Franchising Revenues

	Three Months Ended September 30, ($ amounts in thousands)	
	2010	**2009**
Franchising Revenues:		
Total Revenues	**$ 183,801**	$ 165,976
Adjustments:		
Marketing and reservation revenues	**(102,867)**	(90,465)
Hotel operations	**(1,068)**	(934)
Franchising Revenues	**$ 79,866**	$ 74,577

Adjusted Net Income, Adjusted Diluted EPS, Adjusted SG&A and Adjusted Operating Income: We also use adjusted net income, adjusted diluted EPS, adjusted SG&A and adjusted operating income all of which exclude employee termination benefits for the three months ended September 30, 2010 and 2009. The Company utilizes these non-GAAP measures to enable investors to perform meaningful comparisons of past, present and future operating results and as a means to emphasize the results of on-going operations.

Calculation of Adjusted Operating Income

	Three Months Ended September 30, ($ amounts in thousands)	
	2010	**2009**
Operating Income	**$ 54,877**	$ 48,125
Adjustments:		
Employee termination benefits	**263**	1,496
Adjusted Operating Income	**$ 55,140**	$ 49,621

Calculation of Adjusted SG&A

	Three Months Ended September 30, ($ amounts in thousands)	
	2010	**2009**
SG&A	**$ 23,156**	$ 24,517
Adjustments:		
Employee termination benefits	**(263)**	(1,496)
Adjusted SG&A	**$ 22,893**	$ 23,021

Table of Contents

Calculation of Adjusted Net Income and Adjusted Diluted EPS

	Three Months Ended September 30, (In thousands, except per share amounts)	
	2010	**2009**
Net Income	**$ 40,494**	$ 32,808
Adjustments:		
Employee termination benefits	**165**	936
Adjusted Net Income	**$ 40,659**	$ 33,744
Weighted average shares outstanding diluted	**59,658**	59,818
Diluted EPS	**$ 0.68**	$ 0.55
Adjustments:		
Employee termination benefits		0.01
Adjusted Diluted EPS	**$ 0.68**	$ 0.56

The Company recorded adjusted net income of $40.7 million for the three months ended September 30, 2010 a $7.0 million increase compared to an adjusted net income of $33.7 million for the three months ended September 30, 2009. The increase in adjusted net income for the three months ended September 30, 2010 is primarily attributable to a $5.5 million increase in adjusted operating income and a lower effective income tax rate, partially offset by lower appreciation in the fair value of investments held in the Company s non-qualified employee benefit plans compared to the same period in 2009. Adjusted operating income increased $5.5 million as the Company s franchising revenues for the three months ended September 30, 2010 increased $5.3 million or 7% from the same period of the prior year and adjusted SG&A expenses declined $0.1 million.

Franchising Revenues: Franchising revenues were $79.9 million for the three months ended September 30, 2010 compared to $74.6 million for the three months ended September 30, 2009. The increase in franchising revenues is primarily due to a 9% increase in royalty revenues partially offset by a 33% decline in initial franchise and relicensing fees.

Domestic royalty fees for the three months ended September 30, 2010 increased $5.7 million to $66.4 million from $60.7 million in the three months ended September 30, 2009, an increase of 9%. The increase in royalties is attributable to a combination of factors including a 7.4% increase in RevPAR, a 0.7% increase in the number of domestic franchised hotel rooms and an increase in the effective royalty rate of the domestic hotel system from 4.23% to 4.30%. System-wide RevPAR increased due to a 420 basis point increase in occupancy while average daily rates approximated the prior year period.

Table of Contents

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

	For the Three Months Ended September 30, 2010*			For the Three Months Ended September 30, 2009*			Change		
	Average Daily Rate	Occupancy	RevPAR	Average Daily Rate	Occupancy	RevPAR	Average Daily Rate	Occupancy	RevPAR
Comfort Inn	**$ 82.46**	**66.7%**	**$ 54.99**	$ 81.35	62.7%	$ 51.04	1.4%	400 bps	7.7%
Comfort Suites	**85.78**	**64.2%**	**55.03**	86.67	60.0%	52.02	(1.0%)	420 bps	5.8%
Sleep	**72.03**	**60.4%**	**43.52**	72.14	57.9%	41.74	(0.2%)	250 bps	4.3%
Midscale without Food & Beverage	**81.84**	**65.1%**	**53.28**	81.32	61.4%	49.89	0.6%	370 bps	6.8%
Quality	**71.76**	**58.3%**	**41.84**	72.71	53.7%	39.02	(1.3%)	460 bps	7.2%
Clarion	**80.18**	**51.5%**	**41.27**	81.07	47.8%	38.75	(1.1%)	370 bps	6.5%
Midscale with Food & Beverage	**73.44**	**56.8%**	**41.72**	74.33	52.4%	38.97	(1.2%)	440 bps	7.1%
Econo Lodge	**58.62**	**55.4%**	**32.47**	58.54	51.2%	29.94	0.1%	420 bps	8.5%
Rodeway	**57.40**	**56.0%**	**32.15**	57.37	51.1%	29.30	0.1%	490 bps	9.7%
Economy	**58.24**	**55.6%**	**32.37**	58.19	51.1%	29.75	0.1%	450 bps	8.8%
MainStay	**68.96**	**72.5%**	**49.98**	73.01	63.6%	46.44	(5.5%)	890 bps	7.6%
Suburban	**40.61**	**67.8%**	**27.52**	41.68	60.1%	25.06	(2.6%)	770 bps	9.8%
Extended Stay	**49.01**	**69.1%**	**33.87**	50.88	61.1%	31.10	(3.7%)	800 bps	8.9%
Total	**$ 74.79**	**61.1%**	**$ 45.71**	$ 74.77	56.9%	$ 42.56	0.0%	420 bps	7.4%

* Operating statistics represent hotel operations from June through August

The number of domestic rooms on-line increased to 390,515 as of September 30, 2010 from 387,630 as of September 30, 2009, an increase of 0.7%. The total number of domestic hotels on-line grew 1.2% to 4,951 as of September 30, 2010 from 4,890 as of September 30, 2009.

Table of Contents

A summary of domestic hotels and rooms on-line at September 30, 2010 and 2009 by brand is as follows:

	September 30, 2010		September 30, 2009		Variance			
	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms	%	%
Comfort Inn	**1,450**	**113,952**	1,457	114,377	(7)	(425)	(0.5%)	(0.4%)
Comfort Suites	**624**	**48,411**	601	46,853	23	1,558	3.8%	3.3%
Sleep	**394**	**28,714**	389	28,459	5	255	1.3%	0.9%
Midscale without Food & Beverage	**2,468**	**191,077**	2,447	189,689	21	1,388	0.9%	0.7%
Quality	**990**	**88,831**	963	88,129	27	702	2.8%	0.8%
Clarion	**176**	**25,208**	167	24,063	9	1,145	5.4%	4.8%
Midscale with Food & Beverage	**1,166**	**114,039**	1,130	112,192	36	1,847	3.2%	1.6%
Econo Lodge	**774**	**48,022**	795	49,504	(21)	(1,482)	(2.6%)	(3.0%)
Rodeway	**387**	**21,522**	374	21,834	13	(312)	3.5%	(1.4%)
Economy	**1,161**	**69,544**	1,169	71,338	(8)	(1,794)	(0.7%)	(2.5%)
MainStay	**37**	**2,868**	37	2,866		2	0.0%	0.1%
Suburban	**63**	**7,608**	63	7,531		77	0.0%	1.0%
Extended Stay	**100**	**10,476**	100	10,397		79	0.0%	0.8%
Ascend Collection	**34**	**2,821**	26	1,941	8	880	30.8%	45.3%
Cambria Suites	**22**	**2,558**	18	2,073	4	485	22.2%	23.4%
Total Domestic Franchises	**4,951**	**390,515**	4,890	387,630	61	2,885	1.2%	0.7%

International available rooms increased 2.1% to 101,637 as of September 30, 2010 from 99,582 as of September 30, 2009. The total number of international hotels increased 2.2% from 1,116 as of September 30, 2009 to 1,140 as of September 30, 2010.

As of September 30, 2010, the Company had 545 franchised hotels with 44,627 rooms under construction, awaiting conversion or approved for development in its domestic system as compared to 744 hotels and 59,121 rooms at September 30, 2009. The number of new construction franchised hotels in the Company s domestic pipeline decreased 29% to 394 at September 30, 2010 from 558 at September 30, 2009. The number of conversion franchised hotels in the Company s domestic pipeline declined by 35 units or 19% from September 30, 2009 to 151 hotels at September 30, 2010. The domestic system hotels under construction, awaiting conversion or approved for development declined 27% from the prior year primarily due to the decline in new executed franchise agreements over the trailing twelve months due to the current economic environment coupled with the opening of 301 franchised units over the twelve months ending September 30, 2010. The Company had an additional 93 franchised hotels with 8,096 rooms under construction, awaiting conversion or approved for development in its international system as of September 30, 2010 compared to 116 hotels and 9,420 rooms at September 30, 2009. 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.

Table of Contents

A summary of the domestic franchised hotels under construction, awaiting conversion or approved for development at September 30, 2010 and 2009 by brand is as follows:

	September 30, 2010 Units			September 30, 2009 Units			Variance					
							Conversion		New Construction		Total	
	Conversion	New Construction	Total	Conversion	New Construction	Total	Units	%	Units	%	Units	%
Comfort Inn	**35**	**64**	**99**	37	97	134	(2)	(5%)	(33)	(34%)	(35)	(26%)
Comfort Suites	**1**	**126**	**127**		194	194	1	NM	(68)	(35%)	(67)	(35%)
Sleep Inn	**1**	**81**	**82**	1	129	130		0%	(48)	(37%)	(48)	(37%)
Midscale without Food & Beverage	**37**	**271**	**308**	38	420	458	(1)	(3%)	(149)	(35%)	(150)	(33%)
Quality	**38**	**9**	**47**	49	16	65	(11)	(22%)	(7)	(44%)	(18)	(28%)
Clarion	**20**	**4**	**24**	23	6	29	(3)	(13%)	(2)	(33%)	(5)	(17%)
Midscale with Food & Beverage	**58**	**13**	**71**	72	22	94	(14)	(19%)	(9)	(41%)	(23)	(24%)
Econo Lodge	**37**	**2**	**39**	40	4	44	(3)	(8%)	(2)	(50%)	(5)	(11%)
Rodeway	**16**	**2**	**18**	35	2	37	(19)	(54%)		0%	(19)	(51%)
Economy	**53**	**4**	**57**	75	6	81	(22)	(29%)	(2)	(33%)	(24)	(30%)
MainStay		**40**	**40**		34	34		NM	6	18%	6	18%
Suburban		**26**	**26**		31	31		NM	(5)	(16%)	(5)	(16%)
Extended Stay		**66**	**66**		65	65		NM	1	2%	1	2%
Ascend Collection	**3**	**5**	**8**	1	2	3	2	200%	3	150%	5	167%
Cambria Suites		**35**	**35**		43	43		NM	(8)	(19%)	(8)	(19%)
Total	**151**	**394**	**545**	186	558	744	(35)	(19%)	(164)	(29%)	(199)	(27%)

There were 15 net domestic franchise additions during the three months ended September 30, 2010, compared to 78 net domestic franchise additions during the three months ended September 30, 2009. Gross domestic franchise additions declined from 127 for the three months ended September 30, 2009 to 62 for the same period of 2010. New construction hotels represented 14 of the gross domestic additions during the three months ended September 30, 2010 compared to 49 hotels in the same period of the prior year. Gross domestic additions for conversion hotels during the three months ended September 30, 2010 declined by 30 to 48 hotels compared to the same period of the prior year. The decline in new construction and conversion hotel openings reflects the decline in new executed franchise agreements due to the challenging economic and hotel financing environment which has had a negative effective on the level of hotel transactions.

Domestic franchise terminations declined slightly from 49 in the three months ended September 30, 2009 to 47 for the three months ended September 30, 2010.

International royalties increased by $0.4 million or 7% from $5.7 million in the third quarter of 2009 to $6.1 million for the same period of 2010 primarily due to the acquisition of CHN and RevPAR increases.

New domestic franchise agreements executed in the three months ended September 30, 2010 totaled 79 representing 6,943 rooms compared to 79 agreements representing 7,041 rooms executed in the third quarter of 2009. During the third quarter of 2010, 11 of the executed agreements were for new construction hotel franchises representing 917 rooms compared to 13 contracts representing 919 rooms for the same period a year ago. Conversion hotel executed franchise agreements totaled 68 representing 6,026 rooms for the three months ended September 30, 2010 compared to 66 agreements representing 6,122

rooms for the same period a year ago. Domestic initial fee revenue, included in the initial franchise and relicensing fees caption above, generated from executed franchise agreements decreased 22% to $1.4 million for the three months ended September 30, 2010 from $1.8 million for the three months ended September 30, 2009. Initial fee revenue declined 22% from the same period of the prior year despite executing the same number of new franchise agreements in both periods due to an increase in the number of franchise agreements that include incentives. Revenues associated with agreements including incentives are deferred and recognized when the incentive criteria are met or the agreement is terminated, whichever occurs first.

A summary of executed domestic franchise agreements by brand for the three months ended September 30, 2010 and 2009 is as follows:

	For the Three Months Ended September 30, 2010			For the Three Months Ended September 30, 2009			% Change		
	New Construction	Conversion	Total	New Construction	Conversion	Total	New Construction	Conversion	Total
Comfort Inn	**1**	**9**	**10**	3	7	10	(67%)	29%	0%
Comfort Suites	**5**		**5**	3		3	67%	NM	67%
Sleep	**1**		**1**	4		4	(75%)	NM	(75%)
Midscale without Food & Beverage	**7**	**9**	**16**	10	7	17	(30%)	29%	(6%)
Quality		**23**	**23**	1	23	24	(100%)	0%	(4%)
Clarion		**11**	**11**	1	9	10	(100%)	22%	10%
Midscale with Food & Beverage		**34**	**34**	2	32	34	(100%)	6%	0%
Econo Lodge		**16**	**16**		16	16	NM	0%	0%
Rodeway		**7**	**7**		8	8	NM	(13%)	(13%)
Economy		**23**	**23**		24	24	NM	(4%)	(4%)
MainStay	**1**		**1**				NM	NM	NM
Suburban							NM	NM	NM
Extended Stay	**1**		**1**				NM	NM	NM
Ascend Collection	**1**	**2**	**3**	1	3	4	0%	(33%)	(25%)
Cambria Suites	**2**		**2**				NM	NM	NM
Total Domestic System	**11**	**68**	**79**	13	66	79	(15%)	3%	0%

Relicensing fees include fees charged to the 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 expiring franchise contracts. Relicensing and renewal contracts declined 26% from 31 in the third quarter of 2009 to 23 for the three months ended September 30, 2010. As a result of the decline in contracts, relicensing revenues declined $0.5 million from $1.1 million for the three months ended September 30, 2009 to $0.6 million for the three months ended September 30, 2010. The Company s relicensing activity in 2010 and beyond is dependent on the availability and cost of capital as well as the presence of an active real estate market for hotel transactions.

Selling, General and Administrative Expenses: The cost to operate the franchising business is reflected in SG&A on the consolidated statements of income. SG&A expenses were $23.2 million for the three months ended September 30, 2010, a $1.4 million or 6% decline from the three months ended September 30, 2009. Adjusted SG&A costs, which exclude certain items described above, declined $0.1 million to $22.9 million for the three months ended September 30, 2010 from $23.0 million for the same period of 2009. Adjusted SG&A declined from 30.9% of

franchising revenues for the third quarter of 2009 to 28.7% for the third quarter of 2010 primarily due to cost containment initiatives.

Table of Contents

Marketing and Reservations: The Company s franchise agreements require the payment of franchise fees, which include marketing and reservation system fees. The fees, which are primarily based on a percentage of the franchisees gross room revenues, are used exclusively by the Company for expenses associated with providing franchise services such as central reservation systems, national marketing and media advertising. The Company is contractually obligated to expend the marketing and reservation system fees it collects from franchisees in accordance with the franchise agreements; as such, no income or loss to the Company is generated.

Combined marketing and reservation fees were $102.9 million and $90.5 million for the three months ended September 30, 2010 and 2009, respectively. Depreciation and amortization attributable to marketing and reservation activities was $3.0 million for both three month periods ended September 30, 2010 and 2009. Interest expense attributable to marketing and reservation activities was approximately $0.3 million and $0.06 million for the three month periods ended September 30, 2010 and 2009, respectively. As of September 30, 2010 and December 31, 2009, the Company s balance sheet includes a receivable of $23.6 million and $19.2 million, respectively from cumulative marketing expenses incurred in excess of cumulative marketing fee revenues earned. As of September 30, 2010 and December 31, 2009, the Company s balance sheet includes a receivable from cumulative reservation expenses incurred in excess of cumulative reservation fee revenues earned totaling $22.5 million and $14.7 million, respectively. These receivables are recorded as an asset in the financial statements as the Company has the contractual authority to require that the franchisees in the system at any given point repay the Company for any deficits related to marketing and reservation activities. The Company s current franchisees are legally obligated to pay any assessment the Company imposes on its franchisees to obtain reimbursement of such deficit regardless of whether those constituents continue to generate gross room revenue. The Company has no present intention to accelerate repayment of the deficit from current franchisees. Conversely, cumulative reservation and marketing fees not expended are recorded as a payable in the financial statements and are carried over to the next fiscal year and expended in accordance with the franchise agreements.

Our ability to recover these receivables may be adversely impacted by certain factors, including, among others, declines in the ability of our franchisees to generate revenues at properties they franchise from us, lower than expected franchise system growth of certain brands and/or lower than expected international franchise system growth. An extended period of occupancy or room rate declines or a decline in the number of hotel rooms in our franchise system could result in the generation of insufficient funds to recover marketing and reservation advances as well as meet the ongoing marketing and reservation needs of the overall system.

Other Income and Expenses, Net: Other income and expenses, net, decreased $2.2 million to $0.2 million for the three months ended September 30, 2010 compared to $2.4 million in the same period of the prior year primarily due to the following items.

Interest expense increased from $0.9 million for the three months ended September 30, 2009 to $1.9 million for the same period of 2010 due to the issuance of the Company s $250 million senior notes with an effective rate of 6.19% on August 25, 2010. The proceeds were utilized to repay outstanding borrowings under the Company s revolving line of credit which had an effective interest rate of approximately 0.7%.

Interest and other investment income decreased $1.3 million primarily due to fluctuations in the fair value of investments held in the Company s non-qualified employee benefit plans. As discussed in the accompanying critical accounting policies, the Company sponsors two non-qualified retirement and savings plans: the Non-Qualified Plan and the EDCP plan. The fair value of the Non-Qualified Plan investments increased $0.7 million during the three months ended September 30, 2010 compared to a $1.0 million appreciation in fair value during the three months ended September 30, 2009. The fair value of the Company s investments held in the EDCP plan increased $0.8 million during the three months ended September 30, 2010 compared to an increase in fair value of $1.9 million during the same period of the prior year.

The Company accounts for the Non-Qualified Plan in accordance with accounting for deferred compensation arrangements when investments are held in a rabbi trust and invested. As a result, the Company also recognizes compensation expense in SG&A related to changes in the fair value of investments held in the Non-Qualified Plan, excluding investments in the Company s stock. Therefore, during the three months ended September 30, 2010, the Company s SG&A expense was increased by $0.8 million due to the increase in the fair value of these investments. During the three months ended September 30, 2009, the Company recognized additional SG&A expense totaling $1.1 million due to the appreciation in the fair value of these investments.

Income Taxes: The effective income tax rates were 26.4% and 35.0% for the three months ended September 30, 2010 and September 30, 2009, respectively. The effective income tax rate for the three months ended September 30, 2010 differed from the U.S. federal statutory rate of 35% primarily due to a prior period adjustment of $3.3 million to our deferred tax assets, partially offset by an increase of $1.6 million related to identification of prior period unrecognized tax positions. The

Table of Contents

Company believes that these adjustments are not material to its financial statements for prior annual or interim periods, the three months ended September 30, 2010 or the Company s expected annual results for the year ended December 31, 2010. Also in the quarter, we identified $1.7 million of additional federal income tax benefits. The rate was also impacted by state income taxes, partially offset by the effect of foreign operations. The effective income tax rate for the three months ended September 30, 2009 was impacted by state income taxes, offset by the effect of foreign operations and the resolution of certain income tax contingencies.

Net income: Net income for the three months ended September 30, 2010 increased by 23% to $40.5 million from $32.8 million in the same period of the prior year. Adjusted net income, as adjusted for certain items described above, increased by $7.0 million to $40.7 million for the three months ended September 30, 2010 from $33.7 million for the same period of the prior year.

Diluted EPS: Diluted EPS increased $0.13 per share from $0.55 for the three months ended September 30, 2009 to $0.68 for the three months ended September 30, 2010. Adjusted diluted EPS, which excludes certain items described above, totaled $0.68 for the three months ended September 30, 2010 compared to $0.56 for the same period of the prior year.

Comparison of Operating Results for the Nine-Month Periods Ended September 30, 2010 and 2009

The Company recorded net income of $83.3 million for the nine months ended September 30, 2010, an $8.7 million, or 12% increase from the $74.6 million for the nine months ended September 30, 2009. The increase in net income for the nine months ended September 30, 2010, is primarily attributable to an $8.3 million or 7% increase in operating income, an effective tax rate of 31.6% compared to an effective rate of 35.9% in the prior year, offset by a lower appreciation of the fair value of investments held in the Company s non-qualified employee benefit plans compared to the same period of the prior year.

Summarized financial results for the nine months ended September 30, 2010 and 2009 are as follows:

(in thousands, except per share amounts)	2010	2009
REVENUES:		
Royalty fees	**$ 171,029**	$ 164,771
Initial franchise and relicensing fees	**6,537**	9,599
Procurement services	**13,612**	14,084
Marketing and reservation	**242,096**	227,803
Hotel operations	**3,044**	3,231
Other	**4,752**	3,989
Total revenues	**441,070**	423,477
OPERATING EXPENSES:		
Selling, general and administrative	**67,796**	73,054
Depreciation and amortization	**6,470**	6,252
Marketing and reservation	**242,096**	227,803
Hotel operations	**2,387**	2,378
Total operating expenses	**318,749**	309,487
Operating income	**122,321**	113,990
OTHER INCOME AND EXPENSES, NET:		
Interest expense	**3,160**	3,731
Interest and other investment income	**(1,645)**	(5,302)
Equity in net income of affiliates	**(890)**	(779)
Total other income and expenses, net	**625**	(2,350)

Income before income taxes	**121,696**	116,340
Income taxes	**38,398**	41,721
Net income	**$ 83,298**	$ 74,619
Diluted earnings per share	**$ 1.40**	$ 1.24

Table of Contents

The Company utilizes certain measures such as adjusted net income, adjusted diluted EPS, adjusted SG&A, adjusted operating income and franchising revenues which do not conform to generally accepted accounting principles 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, such as net income, diluted EPS, SG&A, operating income and total revenues. 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 below a reconciliation of these measures to the comparable GAAP measurement as well as our reason for reporting these non-GAAP measures.

Franchising Revenues: The Company utilizes franchising revenues which exclude marketing and reservation revenues and hotel operations rather than total revenues when analyzing the performance of the business. Marketing and reservation activities are excluded from revenues since the Company is contractually required by its franchise agreements to use these fees collected for marketing and reservation activities; as such, no income or loss to the Company is generated. Cumulative reservation and marketing fees not expended are recorded as a payable on the Company s financial statements and are carried over to the next fiscal year and expended in accordance with the franchise agreements. Cumulative marketing and reservation expenditures in excess of fees collected for marketing and reservation activities are recorded as a receivable on the Company s financial statements. Hotel operations are excluded since they do not reflect the most accurate measure of the Company s core franchising 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 Franchising Revenues

	Nine Months Ended September 30, ($ amounts in thousands)	
	2010	**2009**
Franchising Revenues:		
Total Revenues	**$ 441,070**	$ 423,477
Adjustments:		
Marketing and reservation revenues	**(242,096)**	(227,803)
Hotel operations	**(3,044)**	(3,231)
Franchising Revenues	**$ 195,930**	$ 192,443

Adjusted Net Income, Adjusted Diluted EPS, Adjusted SG&A and Adjusted Operating Income: We also use adjusted net income, adjusted diluted EPS, adjusted SG&A and adjusted operating income all of which exclude employee termination benefits for the nine months ended September 30, 2010 and 2009 as well as a loss on sublease of office space for the nine months ended September 30, 2009. The loss on the sublease of office space represents a $1.0 million charge resulting from the fair value of the Company s operating lease rental payments exceeding the anticipated revenue from the operating sublease and a $0.5 million impairment charge related to the office leasehold improvements. The Company utilizes these non-GAAP measures to enable investors to perform meaningful comparisons of past, present and future operating results and as a means to emphasize the results of on-going operations.

Calculation of Adjusted Operating Income

	Nine Months Ended September 30, ($ amounts in thousands)	
	2010	**2009**
Operating Income	**$ 122,321**	$ 113,990
Adjustments:		
Employee termination benefits	**497**	2,270
Loss on sublease of office space		1,503
Adjusted Operating Income	**$ 122,818**	$ 117,763

Table of Contents

Calculation of Adjusted SG&A

	Nine Months Ended September 30, ($ amounts in thousands)	
	2010	2009
SG&A	**$ 67,796**	$ 73,054
Adjustments:		
Employee termination benefits	**(497)**	(2,270)
Loss on sublease of office space		(1,503)
Adjusted SG&A	**$ 67,299**	$ 69,281

Calculation of Adjusted Net Income and Adjusted Diluted EPS

	Nine Months Ended September 30, (In thousands, except per share amounts)	
	2010	2009
Net Income	**$ 83,298**	$ 74,619
Adjustments:		
Employee termination benefits	**311**	1,421
Loss on sublease of office space		941
Adjusted Net Income	**$ 83,609**	$ 76,981
Weighted average shares outstanding-diluted	**59,646**	60,412
Diluted EPS	**$ 1.40**	$ 1.24
Adjustments:		
Employee termination benefits		0.02
Loss on sublease of office space		0.01
Adjusted Diluted EPS	**$ 1.40**	$ 1.27

The Company recorded adjusted net income of $83.6 million for the nine months ended September 30, 2010 an increase of $6.6 million compared to an adjusted net income of $77.0 million for the nine months ended September 30, 2009. The increase in adjusted net income for the nine months ended September 30, 2010 is primarily attributable to a $5.1 million increase in adjusted operating income and a decline in the effective income tax rate from 35.9% to 31.6% for the nine months ended September 30, 2010. These items were partially offset by a $3.7 million decline in interest and other income resulting from a lower appreciation in the fair value of investments held in the Company s non-qualified employee benefit plans compared to the prior year. Adjusted operating income increased $5.1 million as the Company s franchising revenues for the nine months ended September 30, 2010 increased $3.5 million or 2% from the same period of the prior year as well as a decline in adjusted SG&A expenses of $2.0 million or 3%.

Franchising Revenues: Franchising revenues were $195.9 million for the nine months ended September 30, 2010 compared to $192.4 million for the nine months ended September 30, 2009. The $3.5 million or 2% increase in franchising revenues is primarily due to a $6.3 million increase in royalty fees partially offset by a $3.1 million decline in initial franchise and relicensing fees.

Domestic royalty fees for the nine months ended September 30, 2010 increased $4.3 million to $154.2 million from $149.9 million for the nine months ended September 30, 2009, an increase of 2.9%. The increase in royalties is attributable to a combination of factors including a 0.5% increase in RevPAR, a 0.7% increase in the number of domestic franchised hotel rooms and an increase in the effective royalty rate of the

domestic hotel system from 4.25% to 4.32%. System-wide RevPAR increased due to a 110 basis point increase in occupancy partially offset by a 1.7% decline in average daily rates.

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

	For the Nine Months Ended September 30, 2010*			For the Nine Months Ended September 30, 2009*			Change		
	Average Daily Rate	Occupancy	RevPAR	Average Daily Rate	Occupancy	RevPAR	Average Daily Rate	Occupancy	RevPAR
Comfort Inn	**$ 77.16**	**55.4%**	**$ 42.72**	$ 77.48	54.7%	$ 42.36	(0.4%)	70 bps	0.8%
Comfort Suites	**82.92**	**55.1%**	**45.72**	85.72	54.2%	46.50	(3.3%)	90 bps	(1.7%)
Sleep	**68.94**	**51.8%**	**35.69**	70.16	52.5%	36.80	(1.7%)	(70)bps	(3.0%)
Midscale without Food & Beverage	**77.47**	**54.8%**	**42.42**	78.41	54.2%	42.53	(1.2%)	60 bps	(0.3%)
Quality	**67.30**	**48.0%**	**32.31**	68.73	46.9%	32.20	(2.1%)	110 bps	0.3%
Clarion	**75.54**	**43.3%**	**32.73**	77.95	43.0%	33.55	(3.1%)	30 bps	(2.4%)
Midscale with Food & Beverage	**68.98**	**47.0%**	**32.40**	70.54	46.1%	32.48	(2.2%)	90 bps	(0.2%)
Econo Lodge	**54.26**	**45.7%**	**24.81**	54.96	43.9%	24.15	(1.3%)	180 bps	2.7%
Rodeway	**51.42**	**46.0%**	**23.64**	53.24	43.9%	23.35	(3.4%)	210 bps	1.2%
Economy	**53.39**	**45.8%**	**24.45**	54.46	43.9%	23.92	(2.0%)	190 bps	2.2%
MainStay	**66.03**	**63.8%**	**42.09**	71.68	58.1%	41.65	(7.9%)	570 bps	1.1%
Suburban	**39.24**	**64.2%**	**25.20**	42.37	56.0%	23.72	(7.4%)	820 bps	6.2%
Extended Stay	**46.76**	**64.1%**	**29.97**	50.76	56.6%	28.71	(7.9%)	750 bps	4.4%
Total	**$ 70.36**	**51.2%**	**$ 36.02**	$ 71.59	50.1%	$ 35.85	(1.7%)	110 bps	0.5%

* Operating statistics represent hotel operations from December through August

There were 45 net domestic franchise additions during the nine months ended September 30, 2010 compared to 174 net domestic franchise additions during the nine months ended September 30, 2009. Gross domestic franchise additions decreased from 360 for the nine months ended September 30, 2009 to 219 for the same period in 2010. New construction hotels represented 64 of the gross domestic additions during the nine months ended September 30, 2010 compared to 122 hotels in the same period of the prior year. Gross domestic additions for conversion hotels during the nine months ended September 30, 2010 declined by 83 to 155 hotels compared to the same period of the prior year. The decline in hotel openings is primarily due to a decline in new executed franchise agreements as the lack of new hotel construction financing and a decline in the real estate market for hotel sales transactions has been significantly impacted by the current economic environment. The Company expects the number of new franchise additions that will open during 2010 to decline from 442 for the year ended December 31, 2009 to approximately 325 hotels.

Domestic franchise terminations decreased to 174 for the nine months ended September 30, 2010 from 186 for the same period of the prior year. The Company has continued to execute its strategy to replace franchised hotels that do not meet our brand standards or are underperforming in their market. As the competition gets stronger and more focused on limited service franchising, the Company will continue to focus on improving its system of hotels and utilizing the domestic hotels under construction, awaiting conversion or approved for development as a strong

platform for continued system growth.

International royalties increased $2.0 million or 13% from $14.9 million in the first nine months of 2009 to $16.9 million for the same period in 2010 primarily due to foreign currency fluctuations and the acquisition of CHN.

New domestic franchise agreements executed in the nine months ended September 30, 2010 totaled 196 representing 16,932 rooms compared to 257 agreements representing 20,504 rooms executed in the first nine months of 2009. During the first nine months of 2010, 33 of the executed agreements were for new construction hotel franchises, representing 2,735 rooms, compared to 35 contracts, representing 2,597 rooms for the same period a year ago. Conversion hotel franchise executed contracts totaled 163 representing 14,197 rooms for the nine months ended September 30, 2010 compared to 222 agreements representing 17,907 rooms for the same period a year ago. Domestic initial fee revenue, included in the initial franchise and relicensing fees caption above, generated from executed franchise agreements decreased 28% to $4.3 million for the nine months ended September 30, 2010 from $6.0 million for the nine months ended September 30, 2009. The decline in revenues primarily reflects a 24% decline in executed agreements compared to the same period of the prior year.

Table of Contents

Based on the uncertainty around the current economic and credit market conditions, we expect the number of franchise applications received and therefore the number of new franchise agreements executed to remain below levels achieved in the most recent pre-economic recessionary periods. We believe this trend is likely to continue while the lodging industry recovers from the recent negative operating conditions and the availability of hotel financing continues to be limited. During prior lodging industry downturns, we experienced an increase in the number of new domestic franchise agreements from conversion hotels. While we believe that a greater percentage of new contracts will result from conversion hotel agreements, the length and breadth of the disruption of the credit markets could result in a prolonged downturn in the number of both conversion and new construction hotel contracts executed. This trend could have a material adverse affect on our financial results.

A summary of executed domestic franchise agreements by brand for the nine months ended September 30, 2010 and 2009 is as follows:

	For the Nine Months Ended September 30, 2010			For the Nine Months Ended September 30, 2009			% Change		
	New Construction	Conversion	Total	New Construction	Conversion	Total	New Construction	Conversion	Total
Comfort Inn	**4**	**22**	**26**	4	22	26	0%	0%	0%
Comfort Suites	**13**	**1**	**14**	9	1	10	44%	0%	40%
Sleep	**3**		**3**	11	2	13	(73%)	(100%)	(77%)
Midscale without Food & Beverage	**20**	**23**	**43**	24	25	49	(17%)	(8%)	(12%)
Quality	**1**	**54**	**55**	3	87	90	(67%)	(38%)	(39%)
Clarion		**17**	**17**	1	23	24	(100%)	(26%)	(29%)
Midscale with Food & Beverage	**1**	**71**	**72**	4	110	114	(75%)	(35%)	(37%)
Econo Lodge		**38**	**38**		45	45	NM	(16%)	(16%)
Rodeway	**1**	**26**	**27**	1	36	37	0%	(28%)	(27%)
Economy	**1**	**64**	**65**	1	81	82	0%	(21%)	(21%)
MainStay	**4**		**4**	1	1	2	300%	(100%)	100%
Suburban	**1**		**1**	2		2	(50%)	NM	(50%)
Extended Stay	**5**		**5**	3	1	4	67%	(100%)	25%
Ascend Collection	**1**	**5**	**6**	1	5	6	0%	0%	0%
Cambria Suites	**5**		**5**	2		2	150%	NM	150%
Total Domestic System	**33**	**163**	**196**	35	222	257	(6%)	(27%)	(24%)

Relicensing fees include fees charged to the 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 expiring franchise contracts. Relicensing and renewal contracts declined 36% from 112 during the nine months ending September 30, 2009 to 72 for the same period of 2010. As a result of the decline in contracts, relicensing revenues declined $1.4 million from $3.6 million for the nine months ended September 30, 2009 to $2.2 million for the nine months ended September 30, 2010. The Company s relicensing activity in 2010 and beyond is dependent on the availability and cost of capital as well as the presence of an active real estate market for hotel transactions.

Procurement services revenues declined $0.5 million from $14.1 million for the nine months ended September 30, 2009 to $13.6 million for the same period of the current year primarily due to a reduced volume of franchisee purchases from the Company s qualified vendors.

Table of Contents

Selling, General and Administrative Expenses: The cost to operate the franchising business is reflected in SG&A on the consolidated statements of income. SG&A expenses were $67.8 million for the nine months ended September 30, 2010, a $5.3 million or 7% decline from the nine months ended September 30, 2009. Adjusted SG&A costs, which exclude certain items described above, for the nine months ended September 30, 2010 totaled $67.3 million compared to adjusted SG&A of $69.3 million for the same period of the prior year. The $2.0 million decline in adjusted SG&A was primarily attributable to lower variable franchise sales compensation and lower compensation expense recognized on deferred compensation arrangements as described in more detail in *Other Income and Expenses, Net*.

Marketing and Reservations: The Company s franchise agreements require the payment of franchise fees, which include marketing and reservation fees. The fees, which are primarily based on a percentage of the franchisees gross room revenues, are used exclusively by the Company for expenses associated with providing franchise services such as central reservation systems, national marketing and media advertising. The Company is contractually obligated to expend the marketing and reservation fees it collects from franchisees in accordance with the franchise agreements; as such, no income or loss to the Company is generated.

Combined marketing and reservation fees were $242.1 million and $227.8 million for the nine months ended September 30, 2010 and 2009, respectively. Depreciation and amortization attributable to marketing and reservation activities was $9.1 million for the nine months ended September 30, 2010 compared to $7.9 million for the nine months ended September 30, 2009. Interest expense attributable to marketing and reservation activities was $0.5 million and $0.2 million for the nine month periods ended September 30, 2010 and 2009, respectively.

Other Income and Expenses, Net: Other income and expenses, net, which is an expense of $0.6 million in the nine months ended September 30, 2010, increased $3.0 million from income of $2.4 million for the same period in 2009. Interest and other investment income decreased $3.7 million primarily due to a decrease in the appreciation of the fair value of investments held in the Company s non-qualified employee benefit plans compared to the prior year. As discussed in the accompanying critical accounting policies, the Company sponsors two non-qualified retirement and savings plans: the Non-Qualified Plan and the EDCP plan. The fair value of the Non-Qualified Plan investments increased $0.5 million during the nine months ended September 30, 2010 compared to a $1.8 million appreciation in fair value during the nine months ended September 30, 2009. The fair value of the Company s investments held in the EDCP plan increased $0.6 million during the nine months ended September 30, 2010 compared to an increase in fair value of $3.3 million during the same period of the prior year.

The Company accounts for the Non-Qualified Plan in accordance with accounting for deferred compensation arrangements when investments are held in a rabbi trust and invested. As a result, the Company also recognizes compensation expense in SG&A related to changes in the fair value of investments held in the Non-Qualified Plan, excluding investments in the Company s stock. Therefore, during the nine months ended September 30, 2010, the Company s SG&A expense was increased by $0.5 million due to the appreciation in the fair value of these investments. During the nine months ended September 30, 2009, the Company recognized additional SG&A expense totaling $1.8 million due to the appreciation in the fair value of these investments.

Income Taxes: The effective income tax rates were 31.6% and 35.9% for the nine months ended September 30, 2010 and September 30, 2009, respectively. The effective income tax rate for the nine months ended September 30, 2010 differed from the U.S. federal statutory rate of 35% primarily due to a prior period adjustment of $3.3 million to our deferred tax assets, partially offset by an increase of $1.6 million related to identification of prior period unrecognized tax positions. The Company believes that these adjustments are not material to its financial statements for prior annual or interim periods, the nine months ended September 30, 2010 or the Company s expected annual results for the year ended December 31, 2010. Also in the quarter, we identified $1.7 million of additional federal income tax benefits. The rate was also impacted by state income taxes, partially offset by the effect of foreign operations. The effective income tax rate for the nine months ended September 30, 2009 was impacted by state income taxes, partially offset by the effect of foreign operations and the resolution of certain income tax contingencies.

Net income: Net income for the nine months ended September 30, 2010 increased by 12% to $83.3 million from $74.6 million in the same period of the prior year. Adjusted net income, as adjusted for certain items described above, increased by $6.6 million to $83.6 million for the nine months ended September 30, 2010 from $77.0 million for the same period of the prior year.

Diluted EPS: Diluted EPS increased $0.16 per share from $1.24 for the nine months ended September 30, 2009 to $1.40 for 2010. Adjusted diluted EPS, which excludes certain items described above, totaled $1.40 for the nine months ended September 30, 2010 compared to $1.27 for the same period of the prior year.

Table of Contents

Liquidity and Capital Resources

Operating Activities

Net cash provided by operating activities increased $28.2 million to $108.2 million for the nine months ended September 30, 2010 from $80.0 million for the same period of 2009. The increase in cash flows from operating activities primarily reflects lower net advances for marketing and reservation activities and increases in deferred revenue related to the Company s loyalty programs. These items were partially offset by purchases of real estate with the intent to resell to third parties as part of its program to incent franchise development in top markets for certain brands totaling approximately $11.0 million.

Net cash advanced for marketing and reservations activities totaled $2.6 million and $13.7 million during the nine months ended September 30, 2010 and 2009, respectively. Cash advances during the nine months ended September 30, 2010 related primarily due to planned advertising and promotional cost spending in excess of fees collected and investments in information technology initiatives. Based on the current economic conditions, the Company expects marketing and reservation activities to be a net use of cash ranging between $8 million and $12 million in 2010.

Investing Activities

Cash utilized for investing activities totaled $22.7 million for the nine months ended September 30, 2010 compared to a $1.1 million source of cash for the nine months ended September 30, 2009. The increase in cash utilized for investing activities was primarily due to an increase in capital expenditures, an increase in financing provided to franchisees and lower activity related to the Company s employee benefit plan investments. During the nine months ended September 30, 2010 and 2009, capital expenditures totaled $17.7 million and $7.5 million, respectively. Capital expenditures for 2010 primarily include upgrades of system-wide property and yield management systems, improvements related to newly leased office space and information systems infrastructure and the purchase of computer software and equipment.

The Company occasionally provides financing to franchisees for property improvements, hotel development efforts and other purposes. During the nine months ended September 30, 2010 and 2009, the Company advanced $8.9 million and $1.7 million and collected $5.1 million and $0.2 million, respectively for these purposes. At September 30, 2010, the Company had commitments to extend an additional $6.2 million for these purposes provided certain conditions are met by its franchisees, of which $3.3 million is expected to be advanced in the next twelve months.

Financing Activities

Financing cash flows relate primarily to the Company s borrowings, treasury stock purchases and dividends.

Debt

On June 16, 2006, the Company entered into a $350 million senior unsecured revolving credit agreement (the Revolver), with a syndicate of lenders. The Revolver allows the Company to borrow, repay and reborrow revolving loans up to $350 million (which includes swingline loans for up to $20 million and standby letters of credit of up to $30 million) until the scheduled maturity date of June 16, 2011. The Company has the ability to request an increase in available borrowings under the Revolver by an additional amount of up to $150 million by obtaining the agreement of the existing lenders to increase their lending commitments or by adding additional lenders. The rate of interest generally applicable for revolving loans under the Revolver is, at the Company s option, equal to either (i) the greater of the prime rate or the federal funds effective rate plus 50 basis points, or (ii) an adjusted LIBOR rate plus a margin between 22 and 70 basis points based on the Company s credit rating. The Revolver requires the Company to pay a quarterly facility fee, based upon the credit rating of the Company, at a rate between 8 and 17 $^{1}/2$ basis points, on the full amount of the commitment (regardless of usage). The Revolver also requires the payment of a quarterly usage fee, based upon the credit rating of the Company, at a rate between 10 and 12 $^{1}/2$ basis points, on the amount outstanding under the commitment, excluding swingline loans, at all times when the amount borrowed under the Revolver exceeds 50% of the total commitment. As of September 30, 2010, the Company had $6.6 million of revolving loans outstanding pursuant to the Revolver.

The Revolver includes customary financial and other covenants that require the maintenance of certain ratios including maximum leverage and interest coverage. The Revolver also restricts the Company s ability to make certain investments, incur certain debt, and dispose of assets, among other restrictions. The maximum leverage ratio requires the Company to maintain a consolidated indebtedness to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA) ratio, as defined in the Revolver, of less than 3.25x. At September 30, 2010, the Company maintained a ratio of approximately 1.5x. Furthermore, the Revolver requires the Company to maintain a consolidated EBITDA to

interest expense ratio of at least 3.75x. At September 30, 2010, the Company maintained a ratio of approximately 39.9x. At September 30, 2010, the Company was in compliance with all covenants under the Revolver.

The proceeds of the Revolver are used for general corporate purposes, including working capital, debt repayment, stock repurchases, dividends and investments.

On August 25, 2010, the Company completed a $250 million senior unsecured note offering (the Senior Notes) at a discount of $0.6 million, bearing a coupon of 5.7% with an effective rate of 6.19%. The Senior Notes will mature on August 28, 2020, with interest on the Senior Notes to be paid semi-annually on February 28th and August 28th. The Company used the net proceeds from the offering, after deducting underwriting discounts and other offering expenses, to repay outstanding borrowings under the Revolver and for other general corporate purposes.

The Company may redeem the 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.

In July 2010, the Company entered into an interest rate swap agreement to protect itself from an increase in the market interest rate on $250 million of 10-year, fixed rate debt with the coupon to be set at market interest rates. The interest rate swap agreement was designated as a cash flow hedge under the guidance for derivatives and hedging. In August 2010, upon issuance of the related fixed-rate debt, the Company terminated and settled the interest rate swap agreement for a cash payment of $8.7 million. The Company recorded the effective portion of this deferred loss as a component of accumulated other comprehensive income (loss). The ineffective portion was calculated at less than $0.1 million and was recognized immediately as a component of earnings under interest expense in the Company s consolidated statements of income during the three months ended September 30, 2010. The effective portion of the deferred loss is being amortized over the term of the related debt as interest expense in the Company s consolidated statements of income.

As a result of the issuance of the Senior Notes, the Company s borrowing costs have increased as the Company s Revolver carries an interest rate of LIBOR plus approximately 50 basis points which has been lower than the effective rate of the Senior Notes.

Dividends

On February 16, 2010, the Company s board of directors declared a cash dividend of $0.185 per share (or approximately $11.0 million in the aggregate), which was paid on April 16, 2010 to shareholders of record on April 5, 2010. On April 29, 2010, the Company s board of directors declared a quarterly cash dividend of $0.185 per share (or approximately $11.0 million in the aggregate), which was paid on July 16, 2010 to shareholders of record as of July 2, 2010. On September 17, 2010, the Company s board of directors declared a cash dividend of $0.185 per share (or approximately $11.0 million in the aggregate), which was paid on October 15, 2010 to shareholders of record as of October 1, 2010.

The Company currently maintains the payment of a quarterly dividend on its common shares outstanding, however, the declaration of future dividends are subject to the discretion of our board of directors. We expect that cash dividends will continue to be paid in the future, subject to future business performance, economic conditions and changes in tax regulations. Based on our present dividend rate and outstanding share count, aggregate annual dividends for 2010 would be approximately $43.8 million.

Share Repurchases

During the nine months ended September 30, 2010, the Company repurchased 0.3 million shares of its common stock under the share repurchase program at a total cost of $8.7 million for an average price of $32.36 per share. Since the program s inception through September 30, 2010, we have repurchased 43.2 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 $1.0 billion. Considering the effect of the two-for-one stock split, the Company has repurchased 76.2 million shares at an average price of $13.35 per share through September 30, 2010. At September 30, 2010, the Company had 3.6 million shares remaining under the current stock repurchase authorization. Upon completion of the current authorization, our board of directors will evaluate the advisability of additional share repurchases.

Other items

Our Board previously authorized us to enter into programs which permit us to offer financing, investment and guaranty support to qualified franchisees as well as to acquire and resell real estate to incent franchise development for certain brands in top markets. Recent market conditions have resulted in an increase in opportunities to incentivize development under these programs. As a result, during the nine months ended September 30, 2010, the Company has invested approximately $18.9 million pursuant to these programs of which $5 million has been repaid to the Company.

Over the next several years, we expect to continue to deploy capital opportunistically pursuant to these programs to promote growth of our emerging brands. The amount and timing of the investment in these programs will be dependent on market and other conditions. Our current expectation is that our annual investment in these programs will range from $20 million to $40 million. Notwithstanding these programs, the company expects to continue to return value to its shareholders through a combination of share repurchases and dividends, subject to market and other conditions.

Approximately $76.0 million of the Company s cash and cash equivalents at September 30, 2010 pertains to undistributed earnings of the Company s consolidated foreign subsidiaries. Since the Company s intent is for such earnings to be reinvested by the foreign subsidiaries, the Company has not provided additional United States income taxes on these amounts. While the Company has no intention to utilize these cash and cash equivalents in its domestic operations, any change to this policy would result in the Company incurring additional United States income taxes on any amounts utilized domestically.

During the nine months ended September 30, 2010, the Company recorded one-time employee termination charges totaling $1.6 million in SG&A and marketing and reservation expenses. These charges related to salary and benefits continuation payments for employees separating from service with the Company. At September 30, 2010, the Company had approximately $0.9 million of these salary and benefits continuation payments remaining to be remitted. In addition, the Company has approximately $2.3 million of benefits remaining to be paid on termination benefits incurred during prior years. The Company expects to remit $2.6 million of the remaining $3.2 million of benefits payable during the next twelve months. In addition, the Company expects to satisfy approximately $2.5 million of deferred compensation and retirement plan obligations during the next twelve months.

The following table summarizes our contractual obligations as of September 30, 2010:

		Payment due by period			
Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
			(in millions)		
Long-term debt[1]	$ 399.3	$ 21.0	$ 28.5	$ 28.5	$ 321.3
Capital lease obligations	4.0	0.4	1.6	1.6	0.4
Operating lease obligations	39.1	6.5	13.7	5.9	13.0
Purchase obligations	3.5	3.5			
Other long-term liabilities[2]	43.4		12.0	7.8	23.6
Total contractual cash obligations	$ 489.3	$ 31.4	$ 55.8	$ 43.8	$ 358.3

(1) Long-term debt amounts include interest on fixed rate debt obligations.

(2) Capital lease obligations include interest and related maintenance agreements on the equipment.

(3) The total amount of unrecognized tax benefits and the related interest and penalties totaled $7.1 million at September 30, 2010 and is not reflected in the Contractual Obligations table. We have several open tax positions, and it is possible that the amount of the liability for unrecognized tax benefits could change over the next year. While it is possible that one or more of these open positions may be resolved in the next year, it is not anticipated that a significant impact to the unrecognized tax benefit balance will occur.

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.

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 or 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, 2009 included in our Annual Report on Form 8-K dated August 18, 2010.

Revenue Recognition.

We recognize continuing franchise fees, including royalty, marketing and reservations system fees, when earned and receivable from our franchisees. Franchise fees are typically based on a percentage of gross room revenues of each franchisee. Our estimate of the allowance for uncollectible royalty fees is charged to SG&A expense and to marketing and reservation expenses for uncollectible marketing and reservation system fees.

Initial franchise and relicensing fees are recognized, in most instances, in the period the related franchise agreement is executed because the initial franchise and relicensing fees are non-refundable and the Company is not required to provide initial services to the franchisee prior to hotel opening. We defer the initial franchise and relicensing fee revenue related to franchise agreements which include incentives until the incentive criteria are met or the agreement is terminated, whichever occurs first.

The Company may also enter into master development agreements (MDAs) with developers that grant limited exclusive development rights and preferential franchise agreement terms for one-time, non-refundable fees. When these fees are not contingent upon the number of agreements executed under the MDA, the Company recognizes the up-front fees over the MDA s contractual life. Fees that are contingent upon the execution of franchise agreements under the MDA are recognized upon execution of the franchise agreement.

The Company recognizes procurement services revenues from qualified vendors when the services are performed or the product delivered, evidence of an arrangement exists, the fee is fixed and determinable and collectability is probable. We defer the recognition of procurement services revenues related to certain upfront fees and recognize them over a period corresponding to the Company s estimate of the life of the arrangement.

Marketing and Reservation Revenues and Expenses.

The Company s franchise agreements require the payment of certain marketing and reservation system fees, which are used exclusively by the Company for expenses associated with providing franchise services such as national marketing, media

advertising, central reservation systems and technology services. The Company is contractually obligated to expend the marketing and reservation system fees it collects from franchisees in accordance with the franchise agreements; as such, no income or loss to the Company is generated. In accordance with our contracts, we include in marketing and reservation expenses an allocation of costs for certain activities, such as human resources, facilities, legal, accounting, etc., required to carry out marketing and reservation activities.

The Company records marketing and reservation revenues and expenses on a gross basis since the Company is the primary obligor in the arrangement, maintains the credit risk, establishes the price and nature of the marketing or reservation services and retains discretion in supplier selection. In addition, net advances to and repayments from the franchise system for marketing and reservation activities are presented as cash flows from operating activities.

Reservation fees and marketing fees not expended in the current year are carried over to the next fiscal year and expended in accordance with the franchise agreements. Shortfall amounts are similarly recovered in subsequent years. Cumulative excess or shortfall amounts from the operation of these programs are recorded as a marketing or reservation fee payable or receivable. Under the terms of the franchise agreements, the Company may advance capital as necessary for marketing and reservation activities and recover such advances through future fees. Our current assessment is that the credit risk associated with the marketing and reservation fees receivable is mitigated due to our contractual right to recover these amounts from a large geographically dispersed group of franchisees. However, our ability to recover these receivables may be adversely impacted by certain factors, including, among others, declines in the ability of our franchisees to generate revenues at properties they franchise from us, lower than expected franchise system growth of certain brands and/or lower than expected international franchise system growth. An extended period of occupancy or room rate declines or a decline in the number of hotel rooms in our franchise system could result in the generation of insufficient funds to recover marketing and reservation advances as well as meet the ongoing marketing and reservation needs of the overall system.

The Company evaluates the receivable for marketing and reservation costs in excess of cumulative marketing and reservation fees earned on a periodic basis for collectability. The Company will record an allowance when, based on current information and events, it is probable that we will be unable to collect all amounts due for marketing and reservation activities according to the contractual terms of the franchise agreements. The receivables are considered to be uncollectible if the expected net, undiscounted cash flows from marketing and reservation activities are less than the carrying amount of the asset.

Choice Privileges is our frequent guest incentive marketing program. Choice Privileges enables members to earn points based on their spending levels with our franchisees and, to a lesser degree, through participation in affiliated partners programs, such as those offered by credit card companies. The points, which we accumulate and track on the members behalf, may be redeemed for free accommodations or other benefits.

We provide Choice Privileges as a marketing program to franchised hotels and collect a percentage of program members room revenue from franchises to operate the program. Revenues are deferred in an amount equal to the estimated fair value of the future redemption obligation. A third-party actuary estimates the eventual redemption rates and point values using various actuarial methods. These judgmental factors determine the required liability attributable to outstanding points. Upon redemption of points, the Company recognizes the previously deferred revenue as well as the corresponding expense relating to the cost of the awards redeemed. Revenues in excess of the estimated future redemption obligation are recognized when earned to reimburse the Company for costs incurred to operate the program, including administrative costs, marketing, promotion and performing member services. Costs to operate the program, excluding estimated redemption values, are expensed when incurred.

Impairment Policy.

The Company evaluates the potential impairment of property and equipment and other long-lived assets, including franchise rights and other definite-lived intangibles, on an annual basis or whenever an event or other circumstances indicates that we may not be able to recover the carrying value of the asset. Recoverability is measured based on net, undiscounted expected cash flows. Assets are considered to be impaired if the net, undiscounted expected cash flows are less than the carrying amount of the assets. Impairment charges are recorded based upon the difference between the carrying value and the fair value of the asset. Significant management judgment is involved in developing these projections, and they include inherent uncertainties. If different projections are used in the current period, the balances for non-current assets could be materially impacted. Furthermore, if management uses different projections or if different conditions occur in future periods, future-operating results could be materially impacted.

The Company evaluates the impairment of goodwill and trademarks with indefinite lives on an annual basis, or during the year if an event or other circumstance indicates that we may not be able to recover the carrying amount of the asset. Since the Company has one reporting unit, the fair value of the Company s net assets is used to determine if goodwill may be impaired.

Indefinite life trademarks are considered to be impaired if the net, undiscounted expected cash flows associated with the trademark are less than their carrying amount.

The Company evaluates the collectability of notes receivable on a periodic basis. We consider that a loan is impaired when, based on current information and events, it is probable that a creditor 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 reviews outstanding notes receivable on a periodic basis to ensure that each is fully collectible. We measure 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, we establish 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. We apply our loan impairment policy individually to all loans in the portfolio and do not aggregate loans for the purpose of applying such policy. The Company records bad debt expense in SG&A expenses in the accompanying consolidated statements of income. For loans that we have determined to be impaired, we recognize interest income on a cash basis.

Stock Compensation.

The Company s policy is to recognize compensation cost related to share-based payment transactions in the financial statements based on the fair value of the equity or liability instruments issued. Compensation expense related to the fair value of share-based awards is recognized over the requisite service period based on an estimate of those awards that will ultimately vest. The Company estimates the share-based compensation expense for awards that will ultimately vest upon inception of the grant and adjusts the estimate of share-based compensation for those awards with performance and/or service requirements that will not be satisfied so that compensation cost is recognized only for awards that ultimately vest.

Income Taxes.

Our income tax expense and related balance sheet amounts involve significant management estimates and judgments. Judgments regarding realization of deferred tax assets and the ultimate outcome of tax-related contingencies represent key items involved in the determination of income tax expense and related balance sheet accounts.

Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been included in the financial statements or income tax returns. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted rates expected to apply to taxable income in the years in which those differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Deferred tax assets represent items to be used as a tax deduction or credit in future tax returns for which we have already properly recorded the tax benefit in our income statement. Realization of our deferred tax assets reflects our tax planning strategies. We establish valuation allowances for deferred tax assets that we do not believe will be realized.

The Company does not provide additional United States income taxes on undistributed earnings of consolidated foreign subsidiaries included in retained earnings. Currently it is not practical for the Company to calculate the deferred tax related to the outside basis differences. Such earnings could become taxable upon the sale or liquidation of these foreign subsidiaries or upon dividend repatriation. The Company s intent is for such earnings to be reinvested by the subsidiaries.

The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Judgment is required in determining the worldwide income tax provision. In the ordinary course of global business, there are many transactions and calculations where the ultimate tax outcome is uncertain. Some of these uncertainties arise as a consequence of cost reimbursement arrangements among related entities. Although the Company believes the estimates are reasonable, no assurance can be given that the final tax outcome of these matters will not be different than that which is reflected in the historical income tax provisions and accruals. Tax assessments and resolution of tax contingencies may arise several years after tax returns have been filed. Predicting the outcome of such tax assessments involves uncertainty; however, the Company believes that recorded tax liabilities adequately account for our analysis of probable outcomes. Resolution of these uncertainties in a manner inconsistent with the Company s expectations could have a material impact on the Company s results of operations.

The Company has established a recognition threshold a tax position is required to meet before being recognized in the financial statements. The Company s uncertain tax positions are related to tax years that remain subject to examination by the relevant tax authorities. The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions.

Table of Contents

Pension, Profit Sharing and Incentive Plans

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

In 2002, the Company adopted the Choice Hotels International, Inc. Executive Deferred Compensation Plan (EDCP) which became effective January 1, 2003. Under the EDCP, certain executive officers may defer a portion of their salary into an irrevocable trust. Prior to January 1, 2010, participants could elect an investment return of either the annual yield of the Moody s Average Corporate Bond Yield Index plus 300 basis points or a return based on a selection of available diversified investment options. Effective January 1, 2010, the Moody s Average Corporate Bond Rate Yield Index plus 300 basis points is no longer an investment option for salary deferrals made on compensation earned after December 31, 2009. As of September 30, 2010 and December 31, 2009, the Company recorded a deferred compensation liability of $17.1 million and $17.6 million, respectively related to these deferrals and credited investment returns. Compensation expense is recorded in SG&A expense on the Company s consolidated statements of income based on the change in the deferred compensation obligation related to earnings credited to participants as well as changes in the fair value of diversified investments. Compensation expense recorded in SG&A for the three months ended September 30, 2010 and 2009 were $0.3 million and $0.4 million, respectively. Compensation expense recorded in SG&A for the nine months ended September 30, 2010 and 2009 was $0.7 million and $0.9 million, respectively.

The Company has invested the employee salary deferrals in diversified long-term investments which are intended to provide investment returns that partially offset the earnings credited to the participants. The diversified investments held in the trusts totaled $12.6 million and $10.9 million as of September 30, 2010 and December 31, 2009, respectively, and are recorded at their fair value, based on quoted market prices. These investments are considered trading securities and therefore, the changes in the fair value of the diversified assets is included in other income and expenses, net in the accompanying statements of income. The Company recorded investment gains during the three months ended September 30, 2010 and 2009 totaling $0.8 million and $1.9 million, respectively. The Company recorded investment gains during the nine months ended September 30, 2010 and 2009 totaling $0.6 million and $3.3 million, respectively.

In 1997, the Company adopted the Choice Hotels International, Inc. Nonqualified Retirement Savings and Investment Plan (Non-Qualified Plan). The Non-Qualified Plan allows certain employees who do not participate in the EDCP to defer a portion of their salary and invest these amounts in a selection of available diversified investment options. As of September 30, 2010 and December 31, 2009, the Company had recorded a deferred compensation liability of $10.7 million and $11.0 million, respectively related to these deferrals. Compensation expense is recorded in SG&A expense on the Company s consolidated statements of income based on the change in the deferred compensation obligation related to earnings credited to participants as well as changes in the fair value of diversified investments. The net increase in compensation expense recorded in SG&A for the three months ended September 30, 2010 and 2009 was $0.8 million and $1.1 million, respectively. The net increase in compensation expense recorded in SG&A for the nine months ended September 30, 2010 and 2009 was $0.5 million and $1.8 million, respectively.

The diversified investments held in the trusts were $9.8 million and $10.1 million as of September 30, 2010 and December 31, 2009, respectively, and are recorded at their fair value, based on quoted market prices. These investments are considered trading securities and therefore the changes in the fair value of the diversified assets is included in other income and expenses, net in the accompanying statements of income. The Company recorded investment gains during the three months ended September 30, 2010 and 2009 of $0.7 million and $1.0 million, respectively. The Company recorded investment gains during the nine months ended September 30, 2010 and 2009 of $0.5 million and $1.8 million, respectively. In addition, the Non-Qualified Plan held shares of the Company s common stock with a market value of $0.9 million at both September 30, 2010 and December 31, 2009, respectively.

The Company is subject to risk from changes in debt and equity prices from our non-qualified retirement savings plan investments in debt securities and common stock. The diversified investments held in the Non-Qualified Plan and EDCP include investments primarily in equity and debt securities, and cash and cash equivalents.

Recently Issued Accounting Standards

In July 2010, the FASB issued ASU No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, (ASU 2010-20), which is included in the codification under ASC 815, Derivatives and Hedging (ASC 815). ASU 2010-20 sets forth requirements to improve financial reporting by companies with financial receivables (as defined in ASU 2010-20) and to provide more relevant

and reliable information to the users of the financial

statements. A significant change in ASU 2010-20 is that companies will be required to provide information for both the financing receivable and the related allowance on credit losses at disaggregated levels. ASU 2010-20 will be effective for both interim and annual reporting periods ending after December 15, 2010. The Company is currently evaluating the impact of this guidance on its consolidated financial statements, if any.

FORWARD-LOOKING STATEMENTS

Certain matters discussed in this quarterly report constitute forward-looking statements within the meaning of federal securities law. Generally, our use of words such as expect, estimate, believe, anticipate, will, forecast, plan, project, assume or similar words of futurity id that are forward-looking and that we intend to be included within the Safe Harbor protections provided by Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934. Such 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 and other financial and operational measures, Company debt levels, payment of stock dividends, and future operations or other matters. We caution you not to place undue reliance on any forward-looking statements, which are made as of the date of this quarterly report. 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; 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; our ability to keep pace with improvements in technology utilized for reservations systems and other operating systems; fluctuations in the supply and demand for hotels rooms; and our ability to manage effectively our indebtedness, among other factors. These and other risk factors are discussed in detail in Item 1A Risk Factors of the Company s Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission on March 1, 2010. 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 may be 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 had carrying values of $22.4 million and $20.9 million at September 30, 2010 and December 31, 2009, respectively. The Company will continue to monitor the exposure in these areas and make the appropriate adjustments as market conditions dictate.

At September 30, 2010 and December 31, 2009, the Company had $6.6 million and $277.7 million of debt with variable rates outstanding at a weighted average effective interest rate of 0.7% and 0.7%, respectively. A hypothetical change of 10% in the Company s effective interest rate from September 30, 2010 levels would increase or decrease interest expense by approximately $4,000. The Company expects to refinance its debt obligations prior to their scheduled maturities.

ITEM 4. 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 CEO and CFO consider the disclosure review committee s procedures in performing their evaluations of the Company s disclosure controls and procedures (as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) and in assessing the accuracy and completeness of the Company s disclosures.

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, 2010.

There has been no change in the Company s internal controls over financial reporting that occurred during the quarter ended September 30, 2010, that materially affected, or is reasonably likely to materially affect the Company s internal controls over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

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, 2009, 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.

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, 2010:

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[1],[2]	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs, End of Period
January 31, 2010	57,866	$ 32.00	45,161	3,795,473
February 28, 2010	222,432	31.64	171,400	3,624,073
March 31, 2010	1,396	34.73		3,624,073
April 30, 2010				3,624,073
May 31, 2010	8,092	35.78		3,624.073
June 30, 2010	471	31.78		3,624,073
July 31, 2010	537	32.80		3,624,073
August 31, 2010				3,624,073
September 30, 2010	54,812	34.87	53,613	3,570,460
Total	345,606	$ 32.33	270,174	3,570,460

[1] 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.

[2] During the nine months ended September 30, 2010, the Company redeemed 75,432 shares of common stock from employees to satisfy minimum tax-withholding requirements related to the 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. (REMOVED AND RESERVED)

ITEM 5. OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

Exhibit Number and Description

Exhibit Number	Description
3.01(a)	Restated Certificate of Incorporation of Choice Hotels Franchising, Inc. (renamed Choice Hotels International, Inc.)
3.02(b)	Amended and Restated Bylaws of Choice Hotels International, Inc.
4.01(c)	Indenture, dated August 25, 2010 between the Company and Wells Fargo Bank, National Association, as Trustee
4.02(c)	First Supplemental Indenture, dated August 25, 2010, between the Company, the Subsidiary Guarantors, and Wells Fargo Bank, National Association, as Trustee
10.1*	First Amendment to First Amended and Restated Employment Agreement dated September 16, 2010 between Choice Hotels International, Inc. and Stephen P. Joyce
31.1*	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a)
31.2*	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a)
32*	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350
101*	The following statements from the Company s Quarterly Report on Form 10-Q for the quarter ended September 30, 2010, filed on November 9, 2010, formatted in XBRL: (i) Consolidated Statements of Income, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Cash Flows, (iv) Notes to Financial Statements, tagged as blocks of text.

* 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 dated February 15, 2010, filed February 16, 2010.

(c) Incorporated by reference to the identical document filed as an exhibit to Choice Hotels International, Inc. s Current Report on Form 8-K dated August 25, 2010, filed August 25, 2010.

Table of Contents

SIGNATURE

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

	CHOICE HOTELS INTERNATIONAL, INC.
Date: November 9, 2010	By: /s/ DAVID L. WHITE
	David L. White
	Senior Vice President, Chief Financial Officer & Treasurer

54