CHOICE HOTELS INTERNATIONAL INC /DE
Form 10-Q
November 07, 2014
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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, 2014
OR
o 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 incorporation or organization)	(I.R.S. Employer Identification No.)

1 CHOICE HOTELS CIRCLE, SUITE 400
ROCKVILLE, MD 20850
(Address of principal executive offices)
(Zip Code)
(301) 592-5000
(Registrant's telephone number, including area code)

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

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

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

CLASS	SHARES OUTSTANDING AT SEPTEMBER 30, 2014
Common Stock, Par Value $0.01 per share	58,182,157

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
REVENUES:				
Royalty fees	$86,091	$79,460	$222,301	$208,206
Initial franchise and relicensing fees	4,299	4,650	12,761	12,843
Procurement services	5,495	4,708	18,293	16,204
Marketing and reservation	115,653	124,809	309,025	311,204
Other	3,630	3,091	10,188	7,362
Total revenues	215,168	216,718	572,568	555,819
OPERATING EXPENSES:				
Selling, general and administrative	30,236	26,409	88,329	82,808
Depreciation and amortization	2,293	2,272	6,903	6,701
Marketing and reservation	115,653	124,809	309,025	311,204
Total operating expenses	148,182	153,490	404,257	400,713
Operating income	66,986	63,228	168,311	155,106
OTHER INCOME AND EXPENSES, NET:				
Interest expense	10,495	10,757	31,376	32,334
Interest income	(355)	(676)	(1,205)	(1,979)
Other (gains) and losses	375	(703)	(158)	(1,266)
Equity in net (income) loss of affiliates	513	(421)	578	(340)
Total other income and expenses, net	11,028	8,957	30,591	28,749
Income from continuing operations before income taxes	55,958	54,271	137,720	126,357
Income taxes	16,542	15,698	41,556	36,384
Income from continuing operations, net of income taxes	39,416	38,573	96,164	89,973
Income (loss) from discontinued operations, net of income taxes	(51)	143	1,711	293
Net income	$39,365	$38,716	$97,875	$90,266
Basic earnings per share				
Continuing operations	$0.67	$0.66	$1.65	$1.54
Discontinued operations	—	—	0.03	—
	$0.67	$0.66	$1.68	$1.54
Diluted earnings per share				
Continuing operations	$0.67	$0.65	$1.63	$1.53
Discontinued operations	—	0.01	0.03	—
	$0.67	$0.66	$1.66	$1.53

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	$39,365	$38,716	$97,875	$90,266
Other comprehensive income (loss), net of tax:				
Amortization of loss on cash flow hedge	215	215	646	646
Foreign currency translation adjustment	(1,387)	524	(357)	(1,803)
Other comprehensive income (loss), net of tax	(1,172)	739	289	(1,157)
Comprehensive income	$38,193	$39,455	$98,164	$89,109

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

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

	September 30, 2014	December 31, 2013
ASSETS		
Current assets		
Cash and cash equivalents	$244,392	$167,795
Receivables (net of allowance for doubtful accounts of $11,443 and $12,187, respectively)	109,748	82,385
Deferred income taxes	26,258	26,684
Investments, employee benefit plans, at fair value	211	400
Other current assets	24,817	29,710
Total current assets	405,426	306,974
Property and equipment, at cost, net	58,381	67,852
Goodwill	65,813	65,813
Franchise rights and other identifiable intangibles, net	7,516	9,953
Advances, marketing and reservation activities	—	5,844
Notes receivable, net of allowances	35,045	31,872
Investments, employee benefit plans, at fair value	16,845	15,950
Deferred income taxes	14,498	—
Other assets	60,663	52,164
Total assets	$664,187	$556,422
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities		
Accounts payable	$64,110	$41,663
Accrued expenses	46,781	56,625
Deferred revenue	65,839	61,188
Current portion of long-term debt	11,967	10,088
Deferred compensation and retirement plan obligations	620	2,492
Income taxes payable	10,140	2,282
Total current liabilities	199,457	174,338
Long-term debt	774,756	783,471
Deferred compensation and retirement plan obligations	23,118	22,527
Deferred income taxes	—	5,149
Other liabilities	63,871	23,808
Total liabilities	1,061,202	1,009,293
Commitments and Contingencies		
Common stock, $0.01 par value, 160,000,000 shares authorized; 95,065,638 shares issued at September 30, 2014 and December 31, 2013 and 58,182,157 and 58,638,863 shares outstanding at September 30, 2014 and December 31, 2013, respectively	582	586
Additional paid-in-capital	123,251	117,768
Accumulated other comprehensive loss	(5,928)	(6,217)
Treasury stock (36,883,481 and 36,426,775 shares at September 30, 2014 and December 31, 2013, respectively), at cost	(933,180)	(918,031)
Retained earnings	418,260	353,023
Total shareholders' deficit	(397,015)	(452,871)
Total liabilities and shareholders' deficit	$664,187	$556,422

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

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

	Nine Months Ended September 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$97,875	$90,266
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,903	7,094
Gain on sale of assets	(2,809)	—
Provision for bad debts, net	1,676	2,264
Non-cash stock compensation and other charges	8,093	8,635
Non-cash interest and other (income) loss	1,836	1,057
Deferred income taxes	(19,216)	(351)
Dividends received from equity method investments	1,101	1,109
Equity in net (income) loss of affiliates	578	(340)
Changes in assets and liabilities:		
Receivables	(30,497)	(26,635)
Advances to/from marketing and reservation activities, net	60,187	29,712
Forgivable notes receivable, net	(8,776)	(5,722)
Accounts payable	21,845	1,280
Accrued expenses	(11,082)	(22,757)
Income taxes payable/receivable	7,981	24,107
Deferred revenue	4,751	(9,686)
Other assets	(1,125)	(2,395)
Other liabilities	(943)	8,851
Net cash provided by operating activities	138,378	106,489
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in property and equipment	(11,886)	(27,922)
Proceeds from sales of assets	15,612	—
Equity method investments	(14,362)	(3,761)
Purchases of investments, employee benefit plans	(1,520)	(1,845)
Proceeds from sales of investments, employee benefit plans	966	4,052
Issuance of mezzanine and other notes receivable	(3,340)	—
Collections of mezzanine and other notes receivable	9,832	224
Other items, net	(592)	(578)
Net cash used in investing activities	(5,290)	(29,830)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net repayments pursuant to revolving credit facility	—	(27,500)
Principal payments on long-term debt	(7,110)	(6,158)
Proceeds from the issuance of long-term debt	226	3,360
Purchases of treasury stock	(23,757)	(3,684)
Dividends paid	(32,767)	(22,026)
Excess tax benefits from stock-based compensation	2,297	1,216
Proceeds from exercise of stock options	4,984	6,677
Net cash used in financing activities	(56,127)	(48,115)
Net change in cash and cash equivalents	76,961	28,544

Effect of foreign exchange rate changes on cash and cash equivalents	(364)	(1,583)
Cash and cash equivalents at beginning of period	167,795	134,177
Cash and cash equivalents at end of period	$244,392	$161,138
Supplemental disclosure of cash flow information:		
Cash payments during the period for:		
Income taxes, net of refunds	$51,600	$12,990
Interest	$40,126	$42,244
Non-cash investing and financing activities:		
Dividends declared but not paid	$10,764	$10,773
Issuance of common stock pursuant to share based compensation plans	$8,173	$9,695
Equity method investments	$2,797	$—
Investment in property and equipment acquired in accounts payable	$890	$763

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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"). These unaudited consolidated financial statements include all adjustments that are necessary, in the opinion of management, to fairly present our financial position and results of operations. Except as otherwise disclosed, all adjustments are of a normal recurring nature.

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

The consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2013 and notes thereto included in the Company's Amended Form 10-K, filed with the SEC on November 3, 2014 (the "10-K"). Interim results are not necessarily indicative of the entire year results. All inter-company transactions and balances between Choice Hotels International, Inc. and its subsidiaries have been eliminated in consolidation.

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

Discontinued Operations

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

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with a maturity of three months or less at the date of purchase to be cash equivalents. As of September 30, 2014 and December 31, 2013, $8.4 million and $5.0 million, respectively, of book overdrafts representing outstanding checks in excess of funds on deposit are included in accounts payable in the accompanying consolidated balance sheets.

The Company maintains cash balances in domestic banks, which at times, may exceed the limits of amounts insured by the Federal Deposit Insurance Corporation. In addition, as of September 30, 2014, the Company maintains cash balances of $180.6 million in international banks which do not provide deposit insurance.

Recently Adopted Accounting Guidance

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

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

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

Future Adoption of Recently Announced Accounting Guidance

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

In May 2014, the FASB issued ASU No. 2014-09, "Revenue From Contracts with Customers" ("ASU 2014-09"), which impacts virtually all aspects of an entity's revenue recognition. ASU No. 2014-09 supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, as well as most industry-specific guidance, and significantly enhances comparability of revenue recognition practices across entities and industries by providing a principles-based, comprehensive framework for addressing revenue recognition issues. In order for a provider of promised goods or services to recognize as revenue the consideration that it expects to receive in exchange for the promised goods or services, the provider should apply the following five steps: (1) identify the contract with a customer(s); (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. ASU No. 2014-09 also specifies the accounting for some costs to obtain or fulfill a contract with a customer and provides enhanced disclosure requirements. ASU No. 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The guidance permits the retrospective or modified retrospective method when adopting ASU No. 2014-09. The Company is still assessing the impact that ASU No. 2014-09 will have on its financial statements and disclosures.

2. Other Current Assets

Other current assets consist of the following:

	September 30, 2014	December 31, 2013
	(in thousands)	
Notes receivable, net of allowances (See Note 3)	$7,287	$12,816
Prepaid expenses	14,329	13,746
Other current assets	3,201	3,148

Total	$24,817	$29,710

3. Notes Receivable and Allowance for Losses

The Company segregates its notes receivable for the purposes of evaluating allowances for credit losses between two categories: Mezzanine and Other Notes Receivable and Forgivable Notes Receivable. The Company utilizes the level of

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security it has in the various notes receivable as its primary credit quality indicator (i.e. senior, subordinated or unsecured) when determining the appropriate allowances for uncollectible loans within these categories.

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

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

	September 30, 2014 (in thousands)			December 31, 2013 (in thousands)		
Credit Quality Indicator	Forgivable Notes Receivable	Mezzanine & Other Notes Receivable	Total	Forgivable Notes Receivable	Mezzanine & Other Notes Receivable	Total
Senior	$—	$10,150	$10,150	$—	$18,052	$18,052
Subordinated	—	14,867	14,867	—	14,152	14,152
Unsecured	25,660	4,071	29,731	20,625	3,405	24,030
Total notes receivable	25,660	29,088	54,748	20,625	35,609	56,234
Allowance for losses on non-impaired loans	1,951	1,570	3,521	1,650	1,607	3,257
Allowance for losses on receivables specifically evaluated for impairment	547	8,348	8,895	—	8,289	8,289
Total loan reserves	2,498	9,918	12,416	1,650	9,896	11,546
Net carrying value	$23,162	$19,170	$42,332	$18,975	$25,713	$44,688
Current portion, net	$65	$7,222	$7,287	$361	$12,455	$12,816
Long-term portion, net	23,097	11,948	35,045	18,614	13,258	31,872
Total	$23,162	$19,170	$42,332	$18,975	$25,713	$44,688

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

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

	Forgivable Notes Receivable (in thousands)	Mezzanine & Other Notes Receivable
Beginning balance	$1,650	$9,896
Provisions	1,253	102
Recoveries	(208)	(80)
Write-offs	(217)	—

Other[1]	20	—
Ending balance	$2,498	$9,918

(1) Consists of default rate assumption changes

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Forgivable Notes Receivable

As of September 30, 2014 and December 31, 2013, the unamortized balance of the Company's forgivable notes receivable totaled $25.7 million and $20.6 million, respectively. The Company recorded an allowance for credit losses on these forgivable notes receivable of $2.5 million and $1.7 million at September 30, 2014 and December 31, 2013, respectively. Amortization expense included in the accompanying consolidated statements of income related to the notes for the three months ended September 30, 2014 and 2013 was $1.2 million and $1.1 million, respectively. Amortization expense for the nine months ended September 30, 2014 and 2013 was $3.6 million and $3.0 million, respectively.

Past due balances of forgivable notes receivable are as follows:

	30-89 days Past Due	> 90 days Past Due	Total Past Due	Current	Total Notes Receivable
	(in thousands)				
As of September 30, 2014					
Forgivable Notes	$—	$1,277	$1,277	$24,383	$25,660
	$—	$1,277	$1,277	$24,383	$25,660
As of December 31, 2013					
Forgivable Notes	$—	$—	$—	$20,625	$20,625
	$—	$—	$—	$20,625	$20,625

Mezzanine and Other Notes Receivable

The Company determined that approximately $11.8 million and $12.5 million of its mezzanine and other notes receivable were impaired at September 30, 2014 and December 31, 2013, respectively. The Company recorded allowance for credit losses on these impaired loans at September 30, 2014 and December 31, 2013 totaling $8.3 million and $8.3 million, respectively, resulting in a carrying value of impaired loans of $3.4 million and $4.2 million, respectively. For the nine months ended September 30, 2014 and 2013, the average mezzanine and other notes receivable on non-accrual status was approximately $12.2 million and $13.2 million, respectively. The Company recognized approximately $11 thousand and $87 thousand of interest income on impaired loans during the three and nine months ended September 30, 2014, respectively, on the cash basis. The Company recognized approximately $81 thousand and $0.2 million of interest on impaired loans during the three and nine months ended September 30, 2013. The Company provided loan reserves on non-impaired loans totaling $1.6 million at both September 30, 2014 and December 31, 2013.

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

	30-89 days Past Due	> 90 days Past Due	Total Past Due	Current	Total Notes Receivable
	(in thousands)				
As of September 30, 2014					
Senior	$—	$—	$—	$10,150	$10,150
Subordinated	—	10,986	10,986	3,881	14,867
Unsecured	—	47	47	4,024	4,071
	$—	$11,033	$11,033	$18,055	$29,088
As of December 31, 2013					
Senior	$—	$—	$—	$18,052	$18,052
Subordinated	—	9,629	9,629	4,523	14,152
Unsecured	—	47	47	3,358	3,405
	$—	$9,676	$9,676	$25,933	$35,609

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Loans Acquired with Deteriorated Credit Quality

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

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

4. Marketing and Reservation Activities

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

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

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

At September 30, 2014, cumulative marketing and reservation system fees collected exceeded expenses by $39.9 million with the excess reflected as an other long-term liabilities in the accompanying consolidated balance sheets. Depreciation and amortization expense attributable to marketing and reservation activities for the three and nine months ended September 30, 2014 was $4.4 million and $12.4 million, respectively. Depreciation and amortization expense attributable to marketing and reservation activities for the three and nine months ended September 30, 2013 was $3.9 million and $12.0 million, respectively. Interest expense attributable to marketing and reservation activities for the three and nine months ended September 30, 2014

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was $0.5 million and $1.5 million, respectively. Interest expense attributable to marketing and reservation activities for the three and nine months ended September 30, 2013 was $0.9 million and $2.8 million, respectively.

5. Other Assets

Other assets consist of the following:

	September 30, 2014 (in thousands)	December 31, 2013
Equity method investments	$47,703	$32,257
Deferred financing fees, net	7,763	8,954
Land	4,011	10,097
Other assets	1,186	856
Total	$60,663	$52,164

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

Equity Method Investments - Variable Interest Entities

Equity method investments include investments in joint ventures totaling $44.2 million and $28.9 million at September 30, 2014 and December 31, 2013, respectively that the Company determined to be variable interest entities ("VIEs"). These investments relate to the Company's program to offer equity support to qualified franchisees to develop and operate Cambria Suites hotels in strategic markets. Based on an analysis of who has the power to direct the activities that most significantly impact these entities performance and who has an obligation to absorb losses of these entities or a right to receive benefits from these entities that could potentially be significant to the entity, the Company determined that it is not the primary beneficiary of any of its VIEs. The Company based its qualitative analysis on its review of the design of the entity, its organizational structure including decision-making ability and the relevant development, operating management and financial agreements. Although the Company is not the primary beneficiary of these VIEs, it does exercise significant influence through its equity ownership and as a result the Company's investment in these entities is accounted for under the equity method. For the three and nine months ended September 30, 2014, the Company recognized losses totaling $0.8 million and $0.9 million, respectively from these investments. For the three and nine months ended September 30, 2013, the Company recognized income totaling $81 thousand and $9 thousand, respectively, from these investments. The Company's maximum exposure to losses related to its investments in VIEs is limited to its equity investments as well as certain guarantees described in Note 16 "Commitments and Contingencies" of these financial statements.

6. Deferred Revenue

Deferred revenue consists of the following:

	September 30, 2014 (in thousands)	December 31, 2013
Loyalty programs	$58,711	$53,875
Initial, relicensing and franchise fees	4,899	5,354
Procurement service fees	1,419	1,504
Other	810	455

Total	$65,839	$61,188

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7. Debt

Debt consists of the following at:

	September 30, 2014	December 31, 2013
	(in thousands)	
$400 million senior unsecured notes with an effective interest rate of 5.94% at September 30, 2014 and December 31, 2013	$400,000	$400,000
$250 million senior unsecured notes with an effective interest rate of 6.19% less discount of $0.4 million at September 30, 2014 and December 31, 2013	249,620	249,572
$350 million senior secured credit facility with an effective interest rate of 2.16% and 2.17% at September 30, 2014 and December 31, 2013, respectively	132,187	138,750
Economic development loans with an effective interest rate of 3.00% at September 30, 2014 and December 31, 2013	3,536	3,360
Capital lease obligations due 2016 with an effective interest rate of 3.18% at September 30, 2014 and December 31, 2013	1,325	1,848
Other notes payable	55	29
Total debt	$786,723	$793,559
Less current portion	11,967	10,088
Total long-term debt	$774,756	$783,471

Senior Notes Due 2022

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

Senior Notes Due 2020

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

Revolving Credit Facility

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

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

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

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

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

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

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

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

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

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

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

At September 30, 2014, the Company had $132.2 million under the Term Loan and no amounts outstanding under the Revolver. At December 31, 2013, the Company had $138.8 million outstanding under the Term Loan and no amounts outstanding under the Revolver.

Economic Development Loans

The Company entered into economic development agreements with various governmental entities in conjunction with the relocation of its corporate headquarters in April 2013. In accordance with these agreements, the governmental entities agreed to advance approximately $4.4 million to the Company to offset a portion of the corporate headquarters relocation and tenant improvement costs in consideration of the employment of permanent, full-time employees within the jurisdictions. At September 30, 2014, the Company had been advanced approximately $3.5 million pursuant to these agreements and expects to receive the remaining $0.9 million over the next several years, subject to annual appropriations by the governmental entities. These advances bear interest at a rate of 3% per annum.

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

8. Accumulated Other Comprehensive Income (Loss)

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

	Loss on Cash Flow Hedge	Foreign Currency Items	Total
	(in thousands)		
Beginning balance, December 31, 2013	$(5,745)	$(472)	$(6,217)
Other comprehensive income (loss) before reclassification	—	(357)	(357)
Amounts reclassified from accumulated other comprehensive income (loss)	646	—	646
Net current period other comprehensive income (loss)	646	(357)	289
Ending balance, September 30, 2014	$(5,099)	$(829)	$(5,928)

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

Component	Amount Reclassified from Accumulated Other Comprehensive Income(Loss)		Affected Line Item in the Consolidated Statement of Net Income
	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014	
	(in thousands)		
Loss on cash flow hedge			
Interest rate contract	$215	$646	Interest expense
	—	—	Tax (expense) benefit
	$215	$646	Net of tax

9. Non-Qualified Retirement, Savings and Investment Plans

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

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

In 2002, the Company adopted the Choice Hotels International, Inc. Executive Deferred Compensation Plan ("EDCP") which became effective January 1, 2003. Under the EDCP, certain executive officers may defer a portion of their salary into an irrevocable trust. Prior to January 1, 2010, participants could elect an investment return of either the annual yield of the Moody's Average Corporate Bond Rate Yield Index plus 300 basis points, or a return based on a selection of available diversified investment options. Effective January 1, 2010, the Moody's Average Corporate Bond Rate Yield Index plus 300 basis points is no longer an investment option for salary deferrals made on compensation earned after December 31, 2009. The Company recorded current and long-term deferred compensation liabilities of $9.8 million and $11.3 million, as of

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September 30, 2014 and December 31, 2013, respectively, related to these deferrals and credited investment returns. Compensation expense is recorded in SG&A expense on the Company's consolidated statements of income based on the change in the deferred compensation obligation related to earnings credited to participants as well as changes in the fair value of diversified investments. Compensation expense recorded in SG&A related to the EDCP for the three months ended September 30, 2014 and 2013 was $48 thousand and $0.3 million, respectively. Compensation expense recorded in SG&A related to the EDCP for the nine months ended September 30, 2014 and 2013 was $0.4 million and $0.7 million, respectively.

The Company has invested the employee salary deferrals in diversified long-term investments which are intended to provide investment returns that partially offset the earnings credited to the participants. The diversified investments held in the trusts totaled $4.4 million and $4.1 million as of September 30, 2014 and December 31, 2013, respectively, and are recorded at their fair value, based on quoted market prices. At September 30, 2014, the Company expects $0.2 million of the assets held in the trusts to be distributed to participants during the next twelve months. These investments are considered trading securities and therefore the changes in the fair value of the diversified assets is included in other gains and losses in the accompanying consolidated statements of income. The Company recorded investment gains (losses) related to the EDCP during the three months ended September 30, 2014 and 2013 of approximately ($98) thousand and $165 thousand, respectively. The Company recorded investment gains related to the EDCP during the nine months ended September 30, 2014 and 2013 of approximately $41 thousand and $252 thousand, respectively. In addition, the EDCP Plan held shares of the Company's common stock with a market value of $0.2 million at both September 30, 2014 and December 31, 2013, which were recorded as a component of shareholders' deficit.

In 1997, the Company adopted the Choice Hotels International, Inc. Non-Qualified Retirement Savings and Investment Plan ("Non-Qualified Plan"). The Non-Qualified Plan allows certain employees who do not participate in the EDCP to defer a portion of their salary and invest these amounts in a selection of available diversified investment options. As of September 30, 2014 and December 31, 2013, the Company had recorded a deferred compensation liability of $13.9 million and $13.7 million, respectively, related to these deferrals. Compensation expense is recorded in SG&A expense on the Company's consolidated statements of income based on the change in the deferred compensation obligation related to earnings credited to participants as well as changes in the fair value of diversified investments. The net increase (decrease) in compensation expense recorded in SG&A related to the Non-Qualified Plan for the three months ended September 30, 2014 and 2013 was $(0.1) million and $0.6 million, respectively. The net increase in compensation expense recorded in SG&A related to the Non-Qualified Plan for the nine months ended September 30, 2014 and 2013 was $0.1 million and $1.3 million, respectively.

The diversified investments held in the trusts were $12.6 million and $12.3 million as of September 30, 2014 and December 31, 2013, respectively, and are recorded at their fair value, based on quoted market prices. These investments are considered trading securities and therefore the changes in the fair value of the diversified assets is included in other gains and losses in the accompanying consolidated statements of income. The Company recorded investment gains (losses) related to the Non-Qualified Plan during the three months ended September 30, 2014 and 2013 of approximately ($0.3) million and $0.5 million, respectively. The Company recorded investment gains related to the Non-Qualified Plan during the nine months ended September 30, 2014 and 2013 of approximately $0.1 million and $1.1 million, respectively. In addition, the Non-Qualified Plan held shares of the Company's common stock with a market value of $1.3 million and $1.4 million at September 30, 2014 and December 31, 2013, respectively, which are recorded as a component of shareholders' deficit.

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10. Fair Value Measurements

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

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

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

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

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

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

	Fair Value Measurements at Reporting Date Using			
	Total	Level 1	Level 2	Level 3
Assets	(in thousands)			
As of September 30, 2014				
Money market funds, included in cash and cash equivalents	$50,001	$—	$50,001	$—
Mutual funds(1)	15,641	15,641	—	—
Money market funds(1)	1,415	—	1,415	—
	$67,057	$15,641	$51,416	$—
As of December 31, 2013				
Money market funds, included in cash and cash equivalents	$50,001	$—	$50,001	$—
Mutual funds(1)	14,564	14,564	—	—
Money market funds(1)	1,786	—	1,786	—
	$66,351	$14,564	$51,787	$—

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

Other Financial Instruments

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

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

The fair value of the Company's 2010 and 2012 Senior Notes are classified as Level 2 as the significant inputs are observable in an active market. At September 30, 2014 and December 31, 2013, the 2010 Senior Notes had an approximate fair value of

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$271.9 million and $261.3 million, respectively. At September 30, 2014 and December 31, 2013, the 2012 Senior Notes had an approximate fair value of $427.0 million and $416.0 million, respectively.

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

11. Income Taxes

The effective income tax rates for income from continuing operations were 29.6% and 28.9% for the three months ended September 30, 2014 and 2013, respectively. The effective income tax rates for income from continuing operations were 30.2% and 28.8% for the nine months ended September 30, 2014 and 2013, respectively. The effective income tax rate for discontinued operations was 37.1% for the three and nine months ended September 30, 2014 and 2013.

The effective income tax rate for continuing operations for the three and nine months ended September 30, 2014 and 2013 were lower than the U.S federal income tax rate of 35% due to the recurring impact of foreign operations, partially offset by state income taxes. The effective income tax rates for the three and nine months ended September 30, 2014 were further reduced by the settlement of unrecognized tax positions. Additionally, the effective income tax rate for the nine months ended September 30, 2013 was also reduced by settlements of unrecognized tax positions and legislation retroactively extending the U.S. controlled foreign corporation look-through rules.

12. Share-Based Compensation and Capital Stock

Stock Options

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

	2014 Grants		2013 Grants	
Risk-free interest rate	1.56	%	0.73	%
Expected volatility	25.01	%	38.14	%
Expected life of stock option	4.5 years		4.5 years	
Dividend yield	1.62	%	2.01	%
Requisite service period	4 years		4 years	
Contractual life	7 years		7 years	
Weighted average fair value of options granted	$8.82		$9.89	

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, 2014 was $41.4 million and $32.1 million, respectively. The total intrinsic value of options exercised during the three months ended September 30, 2014 and 2013 was approximately $3.1 million and $0.5 million, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2014 and 2013 was approximately $4.4 million and $3.4 million, respectively.

The Company received approximately $3.4 million and $0.7 million in proceeds from the exercise of 131,808 and 29,008 employee stock options during the three months ended September 30, 2014 and 2013, respectively. The

Company received approximately $5.0 million and $6.7 million in proceeds from the exercise of 190,557 and 263,073 employee stock options during the nine month periods ended September 30, 2014 and 2013, respectively.

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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,	
	2014	2013	2014	2013
Restricted share grants	2,853	7,646	149,908	223,045
Weighted average grant date fair value per share	$52.59	$39.24	$46.58	$37.65
Aggregate grant date fair value ($000)	$150	$300	$6,983	$8,397
Restricted shares forfeited	13,922	25	18,218	27,953
Vesting service period of shares granted	36 months	36 months	12 - 48 months	12 - 48 months
Grant date fair value of shares vested ($000)	$2,076	$94	$10,280	$8,569

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

Performance Vested Restricted Stock Units

The Company has granted performance vested restricted stock units ("PVRSU") to certain employees. The fair value is measured by the market price of the Company's common stock on the date of the grant. The vesting of these stock awards is contingent upon the Company achieving performance targets at the end of specified performance periods and the employees' continued employment. The performance conditions affect the number of shares that will ultimately vest. The range of possible stock-based award vesting is generally between 0% and 200% of the initial target. If minimum performance targets are not attained then no awards will vest under the terms of the various PVRSU agreements. Compensation expense related to these awards is recognized over the requisite service period based on the Company's estimate of the achievement of the various performance targets. The Company has currently estimated that between 0% and 150% of the various award targets will be achieved. Compensation expense is recognized ratably over the requisite service period only on those PVRSUs that ultimately vest.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Performance vested restricted stock units granted at target	—	—	24,678	58,902
Weighted average grant date fair value per share	$—	$—	$45.59	$36.76
Aggregate grant date fair value ($000)	$—	$—	$1,125	$2,165
Stock units forfeited	3,900	—	3,900	—
Requisite service period	—	—	36 months	22-36 months

During the three months ended September 30, 2014 and 2013, no PVRSU grants vested. During the nine months ended September 30, 2014, a total of 28,886 PVRSU grants vested at a fair value of $1.4 million. These PVRSU grants were initially granted at a target of 18,635 units. However, since the Company achieved 155% of the targeted performance conditions contained in the stock awards granted in prior periods, an additional 10,251 shares were earned and issued.

During the nine months ended September 30, 2013, a total of 39,816 PVRSU grants vested at a fair value of $1.3 million. These PVRSU grants were initially granted at a target of 30,624 units. However, since the Company achieved 130% of the targeted performance conditions contained in the stock awards granted in prior periods, an additional 9,192 shares were earned and issued.

A summary of stock-based award activity as of September 30, 2014 and changes during the nine months ended are presented below:

	Stock Options			Restricted Stock		Performance Vested Restricted Stock Units	
	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2014	1,661,952	$26.44		563,345	$36.64	216,342	$37.34
Granted	651,757	$45.59		149,908	$46.58	24,678	$45.59
Performance based leveraging [1]	—	$—		—	$—	10,251	$41.25
Exercised/Vested	(190,557)	$26.16		(214,818)	$35.91	(28,886)	$41.25
Expired	—	$—		—	$—	—	$—
Forfeited	(15,990)	$31.33		(18,218)	$38.50	(3,900)	$36.76
Outstanding at September 30, 2014	2,107,162	$32.35	3.7	480,217	$40.01	218,485	$37.95
Options exercisable at September 30, 2014	1,194,906	$25.15	2.0				

[1]PVRSU units outstanding have been increased by 10,251 units due to the Company exceeding the targeted performance conditions contained in PVRSUs granted in prior periods during the nine months ended September 30, 2014.

The components of the Company’s pretax share-based compensation expense and associated income tax benefits are as follows for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	2014	2013	2014	2013
Stock options	$0.6	$0.3	$1.7	$1.3
Restricted stock	1.7	2.1	5.5	5.7
Performance vested restricted stock units	0.8	0.5	0.7	1.7
Total	$3.1	$2.9	$7.9	$8.7
Income tax benefits	$1.1	$1.1	$2.9	$3.2

During the nine months ended September 30, 2014, 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 share-based compensation costs related to these PVRSUs has been decreased by $0.9 million for the nine months ended September 30, 2014.

Dividends

The Company currently pays a quarterly dividend on its common stock of $0.185 per share, however the declaration of future dividends are subject to the discretion of the board of directors. During the three and nine months ended September 30, 2014, the Company's board of directors declared dividends totaling $0.185 and $0.56 per share or approximately $10.8 million and $32.4 million in the aggregate, respectively.

In addition, during the nine months ended September 30, 2014, the Company recorded dividends totaling $0.4 million related to previously declared dividends that were contingent upon the vesting of performance vested restricted stock units. No dividends on performance vested restricted units were paid during the three months ended September 30, 2014.

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Share Repurchases and Redemptions

The Company purchased 0.4 million shares of common stock under the share repurchase program at a total cost of $18.4 million during the three and nine months ended September 30, 2014. These shares were purchased from family members of the Company's largest shareholder at their fair market value.

During the three and nine months ended September 30, 2014, the Company redeemed 15,834 and 110,579 shares of common stock at a total cost of approximately $0.8 million and $5.3 million, respectively, from employees to satisfy the option exercise price and statutory minimum tax-withholding requirements related to the exercising of stock options and vesting of performance vested restricted stock units and restricted stock grants. These redemptions were outside the share repurchase program.

Other

Effective January 1, 2014, the Company reduced its reported number of common shares outstanding by 0.3 million shares to address a reconciling item with the Company's share transfer agent.

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13. 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)	2014	2013	2014	2013
Computation of Basic Earnings Per Share:				
Numerator:				
Net income from continuing operations	$39,416	$38,573	$96,164	$89,973
Net income (loss) from discontinued operations	(51)	143	1,711	293
Net income	39,365	38,716	97,875	90,266
Income allocated to participating securities	(343)	(377)	(867)	(901)
Net income available to common shareholders	$39,022	$38,339	$97,008	$89,365
Denominator:				
Weighted average common shares outstanding – basic	57,932	57,978	57,878	57,884
Basic earnings per share - Continuing operations	$0.67	$0.66	$1.65	$1.54
Basic earnings per share - Discontinued operations	—	—	0.03	—
	$0.67	$0.66	$1.68	$1.54
Computation of Diluted Earnings Per Share:				
Numerator:				
Net income from continuing operations	$39,416	$38,573	$96,164	$89,973
Net income from discontinued operations	(51)	143	1,711	293
Net income	39,365	38,716	97,875	90,266
Income allocated to participating securities	(340)	(375)	(862)	(898)
Net income available to common shareholders	$39,025	$38,341	$97,013	$89,368
Denominator:				
Weighted average common shares outstanding – basic	57,932	57,978	57,878	57,884
Diluted effect of stock options and PVRSUs	524	394	503	383
Weighted average common shares outstanding – diluted	58,456	58,372	58,381	58,267
Diluted earnings per share - Continuing operations	$0.67	$0.65	$1.63	$1.53
Diluted earnings per share - Discontinued operations	—	0.01	0.03	—
	$0.67	$0.66	$1.66	$1.53

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, 2014 and 2013, the Company had 2.1 million and 1.8 million outstanding stock options, respectively. Stock options are included in the diluted earnings per share calculation using the treasury stock method and average market prices during the period, unless the stock options would be anti-dilutive. For the three and nine months ended September 30, 2014 and 2013, the Company did not exclude any anti-dilutive stock options from the diluted EPS calculation.

PVRSUs are also included in the diluted earnings per share calculation when the performance conditions have been met at the reporting date. However, at September 30, 2014 and 2013, PVRSUs totaling 218,485 and 198,394, respectively, were excluded from the computation since the performance conditions had not been met.

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14. Condensed Consolidating Financial Statements

The Company’s 2010 and 2012 Senior Notes are guaranteed jointly, severally, fully and unconditionally, subject to certain customary limitations, by certain of the Company’s 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.

Choice Hotels International, Inc.
Condensed Consolidating Statement of Income
For the Three Months Ended September 30, 2014
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUES:					
Royalty fees	$79,326	$28,799	$10,829	$(32,863)	$86,091
Initial franchise and relicensing fees	4,125	—	174	—	4,299
Procurement services	5,215	—	280	—	5,495
Marketing and reservation	104,093	106,438	4,981	(99,859)	115,653
Other	3,500	2	128	—	3,630
Total revenues	196,259	135,239	16,392	(132,722)	215,168
OPERATING EXPENSES:					
Selling, general and administrative	33,301	26,251	3,547	(32,863)	30,236
Marketing and reservation	109,086	102,108	4,318	(99,859)	115,653
Depreciation and amortization	765	1,383	145	—	2,293
Total operating expenses	143,152	129,742	8,010	(132,722)	148,182
Operating income	53,107	5,497	8,382	—	66,986
OTHER INCOME AND EXPENSES, NET:					
Interest expense	10,485	1	9	—	10,495
Equity in earnings of consolidated subsidiaries	(10,760)	554	—	10,206	—
Other items, net	(263)	410	386	—	533
Total other income and expenses, net	(538)	965	395	10,206	11,028
Income from continuing operations before income taxes	53,645	4,532	7,987	(10,206)	55,958
Income taxes	14,280	2,562	(300)	—	16,542
Income from continuing operations, net of income taxes	39,365	1,970	8,287	(10,206)	39,416
Net income (loss) from discontinued operations, net of income taxes	—	(51)	—	—	(51)
Net income	$39,365	$1,919	$8,287	$(10,206)	$39,365

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Choice Hotels International, Inc.
Condensed Consolidating Statement of Income
For the Three Months Ended September 30, 2013
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUES:					
Royalty fees	$72,915	$25,161	$11,362	$(29,978)	$79,460
Initial franchise and relicensing fees	4,419	—	231	—	4,650
Procurement services	4,375	—	333	—	4,708
Marketing and reservation	112,354	96,672	5,807	(90,024)	124,809
Other	2,778	—	313	—	3,091
Total revenues	196,841	121,833	18,046	(120,002)	216,718
OPERATING EXPENSES:					
Selling, general and administrative	30,498	22,417	3,472	(29,978)	26,409
Marketing and reservation	117,480	92,784	4,569	(90,024)	124,809
Depreciation and amortization	828	1,222	222	—	2,272
Total operating expenses	148,806	116,423	8,263	(120,002)	153,490
Operating income	48,035	5,410	9,783	—	63,228
OTHER INCOME AND EXPENSES, NET:					
Interest expense	10,691	61	5	—	10,757
Equity in earnings of consolidated subsidiaries	(13,031)	—	—	13,031	—
Other items, net	(577)	(697)	(526)	—	(1,800)
Total other income and expenses, net	(2,917)	(636)	(521)	13,031	8,957
Income from continuing operations before income taxes	50,952	6,046	10,304	(13,031)	54,271
Income taxes	12,236	3,017	445	—	15,698
Income from continuing operations, net of income taxes	38,716	3,029	9,859	(13,031)	38,573
Income from discontinued operations, net of income taxes	—	143	—	—	143
Net income	$38,716	$3,172	$9,859	$(13,031)	$38,716

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Choice Hotels International, Inc.
Condensed Consolidating Statement of Income
For the Nine Months Ended September 30, 2014
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUES:					
Royalty fees	$203,411	$89,773	$33,711	$(104,594)	$222,301
Initial franchise and relicensing fees	12,144	—	617	—	12,761
Procurement services	17,688	—	605	—	18,293
Marketing and reservation	275,203	274,638	14,150	(254,966)	309,025
Other	9,798	3	387	—	10,188
Total revenues	518,244	364,414	49,470	(359,560)	572,568
OPERATING EXPENSES:					
Selling, general and administrative	101,012	81,845	10,066	(104,594)	88,329
Marketing and reservation	286,903	263,710	13,378	(254,966)	309,025
Depreciation and amortization	2,272	4,117	514	—	6,903
Total operating expenses	390,187	349,672	23,958	(359,560)	404,257
Operating income	128,057	14,742	25,512	—	168,311
OTHER INCOME AND EXPENSES, NET:					
Interest expense	31,356	3	17	—	31,376
Equity in earnings of consolidated subsidiaries	(34,874)	604	—	34,270	—
Other items, net	(988)	(107)	310	—	(785)
Total other income and expenses, net	(4,506)	500	327	34,270	30,591
Income from continuing operations before income taxes	132,563	14,242	25,185	(34,270)	137,720
Income taxes	34,688	6,746	122	—	41,556
Income from continuing operations, net of income taxes	97,875	7,496	25,063	(34,270)	96,164
Income from discontinued operations, net of income taxes	—	1,711	—	—	1,711
Net income	$97,875	$9,207	$25,063	$(34,270)	$97,875

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Choice Hotels International, Inc.
Condensed Consolidating Statement of Income
For the Nine Months Ended September 30, 2013
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUES:					
Royalty fees	$189,559	$84,477	$31,940	$(97,770)	$208,206
Initial franchise and relicensing fees	12,074	—	769	—	12,843
Procurement services	15,559	—	645	—	16,204
Marketing and reservation	275,780	267,404	15,391	(247,371)	311,204
Other	6,581	—	781	—	7,362
Total revenues	499,553	351,881	49,526	(345,141)	555,819
OPERATING EXPENSES:					
Selling, general and administrative	94,903	75,799	9,876	(97,770)	82,808
Marketing and reservation	287,436	257,197	13,942	(247,371)	311,204
Depreciation and amortization	2,301	3,775	625	—	6,701
Total operating expenses	384,640	336,771	24,443	(345,141)	400,713
Operating income	114,913	15,110	25,083	—	155,106
OTHER INCOME AND EXPENSES, NET:					
Interest expense	32,210	111	13	—	32,334
Equity in earnings of consolidated subsidiaries	(34,691)	—	—	34,691	—
Other items, net	(1,689)	(1,261)	(635)	—	(3,585)
Total other income and expenses, net	(4,170)	(1,150)	(622)	34,691	28,749
Income from continuing operations before income taxes	119,083	16,260	25,705	(34,691)	126,357
Income taxes	28,817	7,317	250	—	36,384
Income from continuing operations, net of income taxes	90,266	8,943	25,455	(34,691)	89,973
Income from discontinued operations, net of income taxes	—	293	—	—	293
Net income	$90,266	$9,236	$25,455	$(34,691)	$90,266

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Choice Hotels International, Inc.
Condensed Consolidating Statement of Comprehensive Income
For the Three Months Ended September 30, 2014
(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income	$39,365	$1,919	$8,287	$(10,206)	$39,365
Other comprehensive income (loss), net of tax:					
Amortization of loss on cash flow hedge	215	—	—	—	215
Foreign currency translation adjustment	(1,387)	—	(1,387)	1,387	(1,387)
Other comprehensive income (loss), net of tax					