

CHOICE HOTELS INTERNATIONAL INC /DE

Form 10-Q

November 08, 2016

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED September 30, 2016

OR

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

COMMISSION FILE NO. 001-13393

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

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

1 CHOICE HOTELS CIRCLE, SUITE 400

ROCKVILLE, MD 20850

(Address of principal executive offices)

(Zip Code)

(301) 592-5000

(Registrant's telephone number, including area code)

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

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

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

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

Large accelerated filer 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

CLASS SHARES OUTSTANDING AT SEPTEMBER 30, 2016

Common Stock, Par Value \$0.01 per share 56,096,987

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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		Nine Months Ended	
	September 30, 2016	2015	September 30, 2016	2015
REVENUES:				
Royalty fees	\$96,114	\$89,929	\$247,168	\$233,543
Initial franchise and relicensing fees	6,284	6,170	17,146	17,703
Procurement services	7,615	6,271	23,719	19,667
Marketing and reservation system	152,018	134,463	412,193	366,298
Other	5,546	4,693	16,220	11,716
Total revenues	267,577	241,526	716,446	648,927
OPERATING EXPENSES:				
Selling, general and administrative	34,357	30,152	109,515	95,712
Depreciation and amortization	2,986	3,108	8,707	8,793
Marketing and reservation system	152,018	134,463	412,193	366,298
Total operating expenses	189,361	167,723	530,415	470,803
Gain on sale of assets, net	402	—	402	—
Operating income	78,618	73,803	186,433	178,124
OTHER INCOME AND EXPENSES, NET:				
Interest expense	11,150	10,821	33,466	32,057
Interest income	(836)	(359)	(2,502)	(982)
Other (gains) losses	(746)	1,402	(1,005)	(239)
Equity in net (income) losses of affiliates	(1,150)	(329)	286	1,107
Total other income and expenses, net	8,418	11,535	30,245	31,943
Income before income taxes	70,200	62,268	156,188	146,181
Income taxes	22,635	20,849	48,638	47,355
Net income	\$47,565	\$41,419	\$107,550	\$98,826
Basic earnings per share	\$0.85	\$0.72	\$1.91	\$1.72
Diluted earnings per share	\$0.84	\$0.72	\$1.90	\$1.71
Cash dividends declared per share	\$0.205	\$0.195	\$0.615	\$0.585

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,	
	2016	2015	2016	2015
Net income	\$47,565	\$41,419	\$107,550	\$98,826
Other comprehensive income (loss), net of tax:				
Amortization of loss on cash flow hedge	215	215	646	646
Foreign currency translation adjustment	137	(951)	1,036	(2,223)
Other comprehensive income (loss), net of tax	352	(736)	1,682	(1,577)
Comprehensive income	\$47,917	\$40,683	\$109,232	\$97,249

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

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

	September 30, 2016	December 31, 2015
ASSETS		
Current assets		
Cash and cash equivalents	\$ 205,953	\$ 193,441
Receivables (net of allowance for doubtful accounts of \$8,024 and \$8,719, respectively)	129,422	89,352
Income taxes receivable	277	5,486
Notes receivable, net of allowance	7,709	5,107
Other current assets	28,568	17,567
Total current assets	371,929	310,953
Property and equipment, at cost, net	86,736	88,158
Goodwill	79,799	79,327
Franchise rights and other identifiable intangibles, net	11,543	11,948
Notes receivable, net of allowances	98,450	82,572
Investments, employee benefit plans, at fair value	16,414	17,674
Investments in unconsolidated entities	83,740	67,037
Deferred income taxes	47,002	42,434
Other assets	50,663	16,907
Total assets	\$ 846,276	\$ 717,010
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities		
Accounts payable	\$ 60,363	\$ 64,431
Accrued expenses and other current liabilities	59,577	70,648
Deferred revenue	121,592	71,587
Current portion of long-term debt	660	1,191
Income taxes payable	16,303	159
Total current liabilities	258,495	208,016
Long-term debt	866,247	812,945
Deferred compensation and retirement plan obligations	20,890	22,859
Deferred income taxes	719	506
Other liabilities	37,367	68,583
Total liabilities	1,183,718	1,112,909
Commitments and Contingencies		
Common stock, \$0.01 par value, 160,000,000 shares authorized; 95,065,638 shares issued at September 30, 2016 and December 31, 2015 and 56,096,987 and 56,336,566 shares outstanding at September 30, 2016 and December 31, 2015, respectively	951	951
Additional paid-in-capital	155,393	149,895
Accumulated other comprehensive loss	(7,096) (8,778)
Treasury stock (38,968,651 and 38,729,072 shares at September 30, 2016 and December 31, 2015, respectively), at cost	(1,074,527) (1,052,864)
Retained earnings	587,837	514,897
Total shareholders' deficit	(337,442) (395,899)
Total liabilities and shareholders' deficit	\$ 846,276	\$ 717,010

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,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$107,550	\$98,826
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,707	8,793
Gain on disposal of assets	(377)	(1,519)
Provision for bad debts, net	1,093	1,540
Non-cash stock compensation and other charges	11,037	8,929
Non-cash interest and other loss	807	3,168
Excess tax benefits from stock-based compensation	2,149	4,885
Deferred income taxes	(4,329)	(1,799)
Equity in net losses from unconsolidated joint ventures, less distributions received	1,654	2,917
Changes in assets and liabilities; net of acquisition:		
Receivables	(42,426)	(24,532)
Advances to/from marketing and reservation system activities, net	(25,783)	18,341
Forgivable notes receivable, net	(15,109)	(21,029)
Accounts payable	(3,532)	5,111
Accrued expenses and other current liabilities	(14,261)	(14,083)
Income taxes payable/receivable	19,219	11,066
Deferred revenue	49,976	2,122
Other assets	(9,958)	(4,826)
Other liabilities	1,992	5,748
Net cash provided by operating activities	88,409	103,658
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in property and equipment	(17,584)	(21,810)
Proceeds from sales of assets	8,360	6,347
Acquisitions of real estate	(25,263)	(8,767)
Business acquisition, net of cash acquired	(1,341)	(13,269)
Contributions to equity method investments	(24,179)	(3,811)
Distributions from equity method investments	3,700	270
Purchases of investments, employee benefit plans	(1,430)	(2,977)
Proceeds from sales of investments, employee benefit plans	1,395	2,920
Issuance of mezzanine and other notes receivable	(20,281)	(25,253)
Collections of mezzanine and other notes receivable	11,040	3,697
Other items, net	(422)	(445)
Net cash used by investing activities	(66,005)	(63,098)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings pursuant to revolving credit facilities	52,814	162,032
Principal payments on long-term debt	(836)	(130,194)
Proceeds from issuance of long term debt	—	176
Purchases of treasury stock	(33,958)	(56,450)
Dividends paid	(34,690)	(34,173)
Debt issuance costs	(284)	(2,169)
Proceeds from exercise of stock options	6,802	6,381

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Net cash used by financing activities	(10,152)	(54,397)
Net change in cash and cash equivalents	12,252	(13,837)
Effect of foreign exchange rate changes on cash and cash equivalents	260	(1,781)
Cash and cash equivalents at beginning of period	193,441	214,879
Cash and cash equivalents at end of period	\$205,953	\$199,261
Supplemental disclosure of cash flow information:		
Cash payments during the period for:		
Income taxes, net of refunds	\$32,085	\$32,474
Interest, net of capitalized interest	\$40,935	\$39,187
Non-cash investing and financing activities:		
Dividends declared but not paid	\$11,499	\$11,041
Investment in property and equipment acquired in accounts payable	\$554	\$1,611
Non-cash sale of investment in unconsolidated joint venture	\$2,350	\$—
The accompanying notes are an integral part of these consolidated financial statements.		

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

1. Company Information and Significant Accounting Policies

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

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

The consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2015 and notes thereto included in the Company's Form 10-K, filed with the SEC on February 29, 2016 (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.

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.

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 and money market funds which do not provide deposit insurance.

Recently Adopted Accounting Guidance

In January 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20) ("ASU No. 2015-01"). ASU No. 2015-01 changes the requirements for reporting extraordinary and unusual items in the income statement by eliminating the concept of extraordinary items. The presentation and disclosure guidance for items that are unusual in nature or occur infrequently is retained and expanded to include items that are both unusual in nature and infrequently occurring. ASU No. 2015-01 is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. The Company adopted this ASU on January 1, 2016 and it did not have an impact on our consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810) ("ASU No. 2015-02"). ASU No. 2015-02 changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. This guidance must be applied using one of two retrospective application methods and is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. The Company adopted this ASU on January 1, 2016 and it did not have an impact on our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles-Goodwill - Internal Use Software (Subtopic 350-40) ("ASU No. 2015-05"). ASU No. 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license or should be accounted for as a service contract. The standard is effective for annual reporting periods, including interim periods within those annual periods beginning after December 15, 2015.

The Company adopted this ASU on January 1, 2016, and elected to apply the revised standard prospectively to all new or materially altered agreements signed by the Company. The adoption did not have a material impact on our consolidated financial statements as of the date of adoption.

In March 2016, the FASB issued ASU No. 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU No. 2016-09"). ASU No. 2016-09 requires that excess tax benefits and tax deficiencies should be recognized as income tax expense or benefit to the income statement. The Company must also make an

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accounting policy election of whether to account for forfeitures based on an estimate of the number of awards that are expected to vest or to account for forfeitures when they occur. In addition, excess tax benefits are required to be classified along with other income tax cash flows as an operating activity on the statement of cash flows and cash paid by an employer when directly withholding shares for tax-withholding purposes should be classified as a financing activity. ASU No. 2016-09 is effective for fiscal years, and interim periods for those years, beginning after December 15, 2016. Early adoption is permitted, but if elected, a Company must adopt all of the amendments in the same period.

The Company adopted the new guidance in the second quarter of 2016 and, in accordance with the provisions of ASU 2016-09 applied the required adjustments as of January 1, 2016, the beginning of the annual period that includes the interim period of adoption. The primary impact of adoption was the recognition of excess tax benefits in the Company's provision for income taxes rather than additional paid-in-capital during the nine months ended September 30, 2016. Additional amendments to the accounting for income taxes and minimum statutory withholding tax requirements had no impact to retained earnings as of January 1, 2016, where the cumulative effect of these changes are required to be recorded. The Company has elected to continue to estimate forfeitures based on an estimate of the number of awards that are expected to vest.

The Company also elected to apply the presentation requirements for cash flows related to excess tax benefits retrospectively which resulted in an increase to net cash provided by operating activities and an increase in net cash used by financing activities of \$4.9 million for the nine months ended September 30, 2015.

Adoption of the new standard resulted in the recognition of tax benefits of \$0.7 million and \$2.1 million in our provision for income taxes rather than additional paid-in-capital for the three and nine months ended September 30, 2016, respectively.

The impact of the adoption to our previously reported first quarter 2016 results was \$1.6 million, reflected as follows:

(In thousands, except per share amounts)	Three Months Ended	
	March 31, 2016	
	As Reported	As Adjusted
Consolidated Statements of Income:		
Income taxes	\$10,780	\$9,215
Net income	\$19,598	\$21,163
Basis earnings per share	\$0.35	\$0.38
Diluted earnings per share	\$0.35	\$0.37

Consolidated Statements of Cash Flows:

Net cash used by operating activities	\$(22,945)	\$(21,380)
Net cash provided by financing activities	\$64,192	\$62,627

March 31, 2016	
As Reported	As Adjusted

Consolidated Balance Sheets:

Additional paid-in-capital	\$150,127	\$148,562
Retained earnings	\$522,854	\$524,419

Future Adoption of Recently Announced Accounting Guidance

In May 2014, the FASB issued ASU 2014-09, Revenue From Contracts with Customers (Topic 606) ("ASU No. 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, 2017, including interim periods within that reporting

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period. The guidance permits the retrospective or modified retrospective method when adopting ASU No. 2014-09 but early application is not permitted. The Company has not yet selected a transition method and is still assessing the impact that ASU No. 2014-09 will have on its financial statements and disclosures, but believes it could impact the timing of revenue recognition for the Company's initial franchise fees and timing of the recognition for profits from the sales of real estate assets.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing (Topic 606) ("ASU No. 2016-10"). ASU No. 2016-10 does not change the core principles of the standard, ASU 2014-09, Revenue from Contracts with Customers, but clarifies the accounting for licenses of intellectual property, as well as the identification of distinct performance obligations in a contract. The standard should be adopted concurrently with adoption of ASU 2014-09, which is effective for annual and interim periods beginning after December 15, 2017. The Company has not yet selected a transition method and is still assessing the impact that ASU No. 2016-10 will have on its financial statements and disclosures.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU No. 2016-02"). ASU No. 2016-02 requires lessees to recognize most leases on their balance sheet by recording a liability for its lease obligation and an asset for its right to use the underlying asset as of the lease commencement date. The standard requires entities to determine whether an arrangement contains a lease or a service agreement as the accounting treatment is significantly different between the two arrangements. The standard also requires the lessee to evaluate whether a lease is a financing lease or an operating lease as the accounting and presentation guidance between the two are different. ASU No. 2016-02 also modifies the classification criteria and accounting for sales-type and direct financing leases for lessors. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the potential impact that ASU No. 2016-02 will have on the financial statements and disclosures.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326) ("ASU No. 2016-13"), which will require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. The guidance is effective for annual reporting periods beginning after December 15, 2019 and interim periods within those fiscal years. The Company is currently assessing the potential impact that ASU No. 2016-13 will have on its consolidated financial position or results of operations.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments ("ASU No. 2016-15"). ASU No. 2016-15 provides additional guidance on eight specific cash flow issues, such as the classification of debt prepayments or extinguishment costs, contingent consideration payments made after a business combination, and distributions received from equity method investees. The guidance is effective for annual reporting periods beginning after December 15, 2017 and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the potential impact that ASU No. 2016-15 will have on the financial statements and disclosures.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory ("ASU No. 2016-16"). ASU No. 2016-16 provides guidance on recognition of current income tax consequences for intercompany asset transfers (other than inventory) at the time of transfer. This represents a change from current GAAP, where the consolidated tax consequences of intercompany asset transfers are deferred from the time of transfer to a future period. The guidance is effective for annual reporting periods beginning after December 15, 2017 and interim periods within those fiscal years. Early adoption at the beginning of an annual period is permitted. The Company is currently assessing the potential impact that ASU No. 2016-16 will have on the financial statements and disclosures.

In October 2016, the FASB issued ASU 2016-17, Consolidation (Topic 810) - Interests Held through Related Parties That Are under Common Control ("ASU No. 2016-17"). ASU No. 2016-17 alters the primary beneficiary assessment a reporting entity must perform as part of consolidation analysis to determine whether it should consolidate certain types of legal entities. Under current GAAP, indirect interests held through related parties under common control are to be considered in their entirety by the reporting entity in performing the primary beneficiary assessment. ASU No. 2016-17 will revise the guidance such that indirect interests held through related parties under common control will be considered on a proportionate basis in performing the primary beneficiary assessment. The guidance is effective for annual reporting periods beginning after December 15, 2016 and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the potential impact that ASU No. 2016-17 will have on the financial statements and disclosures.

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2. Other Current Assets

Other current assets consist of the following:

	September 30, 2016	December 31, 2015
	(in thousands)	
Prepaid expenses	\$24,336	\$ 14,144
Other current assets	4,232	1,725
Assets held for sale	—	1,698
Total	\$28,568	\$ 17,567

3. Notes Receivable and Allowance for Losses

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

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

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

Credit Quality Indicator	September 30, 2016 (in thousands)			December 31, 2015 (in thousands)		
	Forgivable Notes Receivable	Mezzanine & Other Notes Receivable	Total	Forgivable Notes Receivable	Mezzanine & Other Notes Receivable	Total
Senior	\$—	\$ 52,176	\$52,176	\$—	\$ 40,388	\$40,388
Subordinated	—	6,416	6,416	—	6,197	6,197
Unsecured	51,401	3,915	55,316	44,333	3,526	47,859
Total notes receivable	51,401	62,507	113,908	44,333	50,111	94,444
Allowance for losses on non-impaired loans	5,052	1,050	6,102	4,615	1,364	5,979
Allowance for losses on receivables specifically evaluated for impairment	—	1,647	1,647	—	786	786
Total loan reserves	5,052	2,697	7,749	4,615	2,150	6,765
Net carrying value	\$46,349	\$ 59,810	\$106,159	\$39,718	\$ 47,961	\$87,679
Current portion, net	\$295	\$ 7,414	\$7,709	\$143	\$ 4,964	\$5,107
Long-term portion, net	46,054	52,396	98,450	39,575	42,997	82,572
Total	\$46,349	\$ 59,810	\$106,159	\$39,718	\$ 47,961	\$87,679

The Company classifies notes receivable due within one year as 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, 2016:

Forgivable Notes	Mezzanine
---------------------	-----------

Receivable & Other
Notes
Receivable

(in thousands)

Beginning balance	\$4,615	\$ 2,150
Provisions	1,188	861
Recoveries	(74)	(164)
Write-offs	(301)	(150)
Other ⁽¹⁾	(376)	—
Ending balance	\$5,052	\$ 2,697

(1) Consists of changes in foreign currency exchange rates and default rate assumption changes

Forgivable Notes Receivable

As of September 30, 2016 and December 31, 2015, the unamortized balance of the Company's forgivable notes receivable totaled \$51.4 million and \$44.3 million, respectively. The Company recorded an allowance for credit losses on these forgivable notes receivable of \$5.1 million and \$4.6 million at September 30, 2016 and December 31, 2015, respectively. Amortization expense included in the accompanying consolidated statements of income related to the notes for the three months ended September 30, 2016 and 2015 was \$2.3 million and \$2.1 million, respectively. Amortization expense included in the accompanying consolidated statements of income related to the notes for the nine months ended September 30, 2016 and 2015 was \$6.7 million and \$6.0 million, respectively.

Past due balances of forgivable notes receivable are as follows:

	^{> 90} 30-89 days Past Due	Past Due	Current	Total Notes Receivable
(in thousands)				
As of September 30, 2016				
Forgivable Notes	\$-1,822	\$1,822	\$49,579	\$ 51,401
	\$-1,822	\$1,822	\$49,579	\$ 51,401
As of December 31, 2015				
Forgivable Notes	\$-1,161	\$1,161	\$43,172	\$ 44,333
	\$-1,161	\$1,161	\$43,172	\$ 44,333

Mezzanine and Other Notes Receivable

The Company determined that approximately \$1.9 million and \$0.8 million of its mezzanine and other notes receivable were impaired at September 30, 2016 and December 31, 2015, respectively. The Company recorded allowance for credit losses on these impaired loans totaling \$1.6 million and \$0.8 million at September 30, 2016 and December 31, 2015, respectively. The average mezzanine and other notes receivable on non-accrual status was approximately \$1.4 million and \$0.8 million for the nine months ended September 30, 2016 and 2015, respectively. The Company recognizes interest income for impaired loans on a cash basis. No interest income on impaired loans was recognized during the three months ended September 30, 2016, and 2015. Approximately \$43 thousand and \$33 thousand of interest income on impaired loans was recognized during the nine months ended September 30, 2016, and 2015, respectively. The Company provided loan reserves on non-impaired loans totaling \$1.1 million and \$1.4 million at September 30, 2016 and December 31, 2015, respectively.

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

	30-89 days Past Due	> 90 days Past Due	Total Past Due	Current	Total Notes Receivable
(in thousands)					
As of September 30, 2016					
Senior	\$6,056	\$—	—\$6,056	\$46,120	\$ 52,176
Subordinated	—	—	—	6,416	6,416
Unsecured	—	—	—	3,915	3,915
	\$6,056	\$—	—\$6,056	\$56,451	\$ 62,507
As of December 31, 2015					
Senior	\$—	\$—	—\$—	\$40,388	\$ 40,388
Subordinated	—	—	—	6,197	6,197
Unsecured	—	—	—	3,526	3,526
	\$—	\$—	—\$—	\$50,111	\$ 50,111

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 fees 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 fees 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 September 30, 2016, cumulative marketing and reservation system costs exceeded cumulative marketing and reservation system revenues earned by \$15.3 million with the excess reflected as a long-term asset in the accompanying consolidated balance sheet. At December 31, 2015 fees collected exceeded expenses by \$30.7 million, with the excess reflected as an other long-term liability in the accompanying consolidated balance sheet. Depreciation and amortization expense attributable to marketing and reservation activities for the three and nine months ended September 30, 2016 were \$6.3 million and \$18.7 million, respectively. Depreciation and amortization expense attributable to marketing and reservation activities for the three and nine months ended September 30, 2015 were \$5.8 million and \$17.0 million, respectively. Interest expense attributable to marketing and reservation activities for the three and nine months ended September 30, 2016 were \$1 thousand and \$6 thousand, respectively. Interest expense attributable to marketing and reservation activities for the three and nine months ended September 30, 2015 were \$6 thousand and \$22 thousand, respectively.

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5. Other Assets

Other assets consist of the following:

	September 30, 2016	December 31, 2015
	(in thousands)	
Land and buildings	\$28,987	\$ 10,206
Advances to marketing and reservation system activities (Note 4)	15,284	—
Other assets	6,392	6,701
Total	\$50,663	\$ 16,907

Land and buildings

Land and buildings 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 develop the properties for the eventual construction of hotels operated under the Company's brands or contribute the land into joint ventures for the same purpose.

6. Investments in Unconsolidated Entities

The Company maintains a portfolio of investments owned through noncontrolling interest in equity method investments with one or more partners. Investments in unconsolidated entities include investments in joint ventures totaling \$81.1 million and \$64.3 million at September 30, 2016 and December 31, 2015, 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 hotel & 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, 2016, the Company recognized loss (income) totaling \$(0.4) million and \$1.6 million, respectively, from these investments. For the three and nine months ended September 30, 2015, the Company recognized losses totaling \$0.2 million and \$2.0 million, respectively, from these investments. The Company's maximum exposure to losses related to its investments in VIEs is limited to its equity investments as well as certain guarantees described in Note 17 "Commitments and Contingencies" of these financial statements.

7. Deferred Revenue

Deferred revenue consists of the following:

	September 30, 2016	December 31, 2015
	(in thousands)	
Loyalty programs	\$107,872	\$ 62,258
Initial, relicensing and franchise fees	7,072	6,530
Procurement service fees	5,887	2,353
Other	761	446
Total	\$121,592	\$ 71,587

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8. Debt

Debt consists of the following at:

	September 30, 2016	December 31, 2015
	(in thousands)	
\$400 million senior unsecured notes with an effective interest rate of 6.0% less deferred issuance costs of \$4.9 million and \$5.4 million at September 30, 2016 and December 31, 2015, respectively	\$395,138	\$ 394,618
\$250 million senior unsecured notes with an effective interest rate of 6.19%, less a discount and deferred issuance costs of \$1.2 million and \$1.4 million at September 30, 2016 and December 31, 2015, respectively	248,799	248,568
\$450 million senior unsecured credit facility with an effective interest rate of 2.03% and 1.87%, less deferred issuance costs of \$2.8 million and \$3.0 million at September 30, 2016 and December 31, 2015, respectively	209,215	156,025
Fixed rate collateralized mortgage with an effective interest rate of 4.57%, plus a fair value adjustment of \$0.8 million and \$0.9 million at September 30, 2016 and December 31, 2015, respectively	9,588	10,048
Economic development loans with an effective rate interest rate of 3.0% at September 30, 2016 and December 31, 2015	3,712	3,712
Capital lease obligations due 2016 with an effective interest rate of 3.18% at September 30, 2016 and December 31, 2015	—	430
Other notes payable	455	735
Total debt	\$866,907	\$ 814,136
Less current portion	660	1,191
Total long-term debt	\$866,247	\$ 812,945

Senior Unsecured 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 6.0%. 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 borrowings under the Company's senior credit facility, to pay a special cash dividend in 2012 totaling approximately \$600.7 million paid to stockholders on August 23, 2012. The Company's 2012 Senior Notes are guaranteed jointly, severally, fully and unconditionally, subject to certain customary limitations by certain of the Company's domestic subsidiaries.

Senior Unsecured 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 5.70% 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 Facilities

On July 21, 2015, the Company entered into a senior unsecured revolving credit agreement ("Credit Agreement"), with Deutsche Bank AG New York Branch, as administrative agent.

The Credit Agreement provides for a \$450 million unsecured revolving credit facility (the "Revolver") with an initial maturity date of July 21, 2020, subject to optional one-year extensions that can be requested by the Company prior to

each of the first, second and third anniversaries of the closing date of the Revolver. The effectiveness of any such extensions is subject to the consent of the lenders under the Credit Agreement and certain customary conditions. On July 5, 2016, the Company exercised its option to extend the maturity date of the Revolver by one year. The new maturity date of the Revolver is July 21, 2021.

Up to \$35 million of borrowings under the Revolver may be used for alternative currency loans and up to \$15 million of borrowings under the Revolver may be used for swing line loans.

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The Revolver is unconditionally guaranteed, jointly and severally, by certain of the Company's domestic subsidiaries, which are considered restricted subsidiaries under the Credit Agreement. The subsidiary guarantors currently include all subsidiaries that guarantee the obligations under the Company's Indenture governing the terms of its 5.75% senior notes due 2022 and its 5.70% senior notes due 2020. If the Company achieves and maintains an Investment Grade Rating, as defined in the Credit Agreement, then the subsidiary guarantees will, at the election of the Company, be released and the Revolver will not be guaranteed.

The Company may at any time prior to the final maturity date increase the amount of the Revolver by up to an additional \$150 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.

The Company currently may elect to have borrowings under the Revolver bear interest at a rate equal to (i) LIBOR plus a margin ranging from 135 to 175 basis points based on the Company's total leverage ratio or (ii) a base rate plus a margin ranging from 35 to 75 basis points based on the Company's total leverage ratio. If the Company achieves an Investment Grade Rating, then the Company may elect to use a different, ratings-based, pricing grid set forth in the Credit Agreement.

The Credit Agreement 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 0.20% per annum. If the Company achieves an Investment Grade Rating and it elects to use the ratings-based pricing grid set forth in the Credit Agreement, then the Company will be required to pay a fee on the total commitments under the Revolver, calculated on the basis of the actual daily amount of the commitments under the Revolver (regardless of usage) times a percentage per annum ranging from 0.10% to 0.25% (depending on the Company's senior unsecured long-term debt rating).

The Credit Agreement requires that the Company and its restricted subsidiaries comply with various covenants, including with respect to restrictions on liens, incurring indebtedness, making investments and affecting mergers and/or asset sales. With respect to dividends, the Company may not declare or make any payment if there is an existing event of default or if the payment would create an event of default. In addition, if the Company's total leverage ratio exceeds 4.0 to 1.0, the Company is generally restricted from paying aggregate dividends in excess of \$50 million in any calendar year.

The Credit Agreement imposes financial maintenance covenants requiring the Company to maintain a total leverage ratio of not more than 4.5 to 1.0 and a consolidated fixed charge coverage ratio of at least 2.5 to 1.0. If the Company achieves and maintains an Investment Grade Rating, then the Company will not need to comply with the consolidated fixed charge coverage ratio covenant.

The Credit Agreement includes customary events of default, the occurrence of which, following any applicable cure period, would permit the lenders to, among other things, declare the principal, accrued interest and other obligations of the Company under the Credit Agreement to be immediately due and payable. At September 30, 2016, the Company was in compliance with all financial covenants under the Credit Agreement.

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

Fixed Rate Collateralized Mortgage

On December 30, 2014, a court awarded the Company title to an office building as settlement for a portion of an outstanding loan receivable for which the building was pledged as collateral. In conjunction with the court award, the Company also assumed the \$9.5 million mortgage on the property with a fixed interest rate of 7.26%. The mortgage, which is collateralized by the office building, requires monthly payments of principal and interest and matures in December 2020 with a balloon payment due of \$6.9 million. At the time of acquisition, the Company determined that

the fixed interest rate of 7.26% exceeded market interest rates and therefore the Company increased the carrying value of the debt by \$1.2 million to record the debt at fair value. The fair value adjustment is being amortized over the remaining term of the mortgage utilizing the effective interest method.

Economic Development Loans

The Company entered into economic development agreements with various governmental entities in conjunction with the relocation of its corporate headquarters in April 2013. In accordance with these agreements, the governmental entities agreed to advance approximately \$4.4 million to the Company to offset a portion of the corporate headquarters relocation and tenant improvement costs in consideration of the employment of permanent, full-time employees within the jurisdictions. At

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September 30, 2016, the Company had been advanced approximately \$3.7 million pursuant to these agreements and expects to receive the remaining \$0.7 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 ten-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, 2016.

9. Accumulated Other Comprehensive Loss

The following represents the changes in accumulated other comprehensive loss, net of tax, by component for the nine months ended September 30, 2016:

	Loss on Cash Flow Hedge	Foreign Currency Items	Total
	(in thousands)		
Beginning balance, December 31, 2015	\$ (4,022)	\$ (4,756)	\$ (8,778)
Other comprehensive income (loss) before reclassification	—	1,036	1,036
Amounts reclassified from accumulated other comprehensive income (loss)	646	—	646
Net current period other comprehensive income (loss)	646	1,036	1,682
Ending balance, September 30, 2016	\$ (3,376)	\$ (3,720)	\$ (7,096)

The amounts reclassified from accumulated other comprehensive loss during the three and nine months ended September 30, 2016 were reclassified to the following line items in the Company's Consolidated Statements of Income.

Component	Amount Reclassified from Accumulated Other Comprehensive Loss Three Months Ended September 30, 2016 (in thousands)	Nine Months Ended September 30, 2016	Affected Line Item in the Consolidated Statement of Net Income
Loss on cash flow hedge			
Interest rate contract	\$ 215	\$ 646	Interest expense

—	—	Tax (expense) benefit
\$ 215	\$ 646	Net of tax

10. 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

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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 and invest these amounts in a selection of available diversified investment options. 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. Under the EDCP and Non-Qualified Plan, (together, the "Deferred Compensation Plan"), the Company recorded current and long-term deferred compensation liabilities of \$24.3 million and \$23.0 million at September 30, 2016 and December 31, 2015, respectively, related to these deferrals and credited investment return under these two deferred compensation plans. 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 for the three months ended September 30, 2016 and 2015 was \$0.9 million and \$(1.0) million, respectively. The net increase (decrease) in compensation expense recorded in SG&A for the nine months ended September 30, 2016 and 2015 was \$1.4 million and \$(0.9) million respectively.

Under the Deferred Compensation Plan, the Company has invested the employee salary deferrals in diversified long-term investments which are intended to provide investment returns that offset the earnings credited to the participants. The diversified investments held in the trusts totaled \$18.9 million and \$17.8 million as of September 30, 2016 and December 31, 2015, respectively, and are recorded at their fair value, based on quoted market prices. At September 30, 2016, the Company expects \$2.5 million of the assets held in the trust to be distributed during the next twelve months to participants. 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) during the three months ended September 30, 2016 and 2015 of approximately \$0.8 million and \$(1.1) million, respectively. The Company recorded investment gains (losses) during the nine months ended September 30, 2016 and 2015 of approximately \$1.0 million and \$(1.0) million, respectively.

11. Fair Value Measurements

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

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

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

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

The Company's policy is to recognize transfers in and transfers out of the three levels of the fair value hierarchy as of the end of each quarterly reporting period. There were no transfers between Level 1, 2 and 3 assets during the three and nine months ended September 30, 2016.

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As of September 30, 2016 and December 31, 2015, the Company had the following assets measured at fair value on a recurring basis:

Assets	Fair Value Measurements at Reporting Date Using			
	Total	Level 1	Level 2	Level 3
(in thousands)				
As of September 30, 2016				
Money market funds, included in cash and cash equivalents	\$50,056	\$—	\$50,056	\$ —
Mutual funds ⁽¹⁾	17,219	17,219	—	—
Money market funds ⁽¹⁾	1,684	—	1,684	—
	\$68,959	\$17,219	\$51,740	\$ —
As of December 31, 2015				
Money market funds, included in cash and cash equivalents	\$50,001	\$—	\$50,001	\$ —
Mutual funds ⁽¹⁾	16,542	16,542	—	—
Money market funds ⁽¹⁾	1,307	—	1,307	—
	\$67,850	\$16,542	\$51,308	\$ —

⁽¹⁾ Included in Investments, employee benefit plans at fair value and other current assets on the consolidated balance sheets.

Other Financial Instruments

The Company believes that the fair value of its current assets and current liabilities approximate their reported carrying amounts due to the short-term nature of these items. In addition, the interest rates of the Company's 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, the notes receivable have been classified as Level 3 inputs. The primary sensitivity in these calculations is based on the selection of appropriate interest and discount rates. For further information on the notes receivables, see Note 3.

The fair values of the Company's \$250 million and \$400 million senior notes are classified as Level 2 as the significant inputs are observable in an active market. At September 30, 2016 and December 31, 2015, the \$250 million senior notes had an approximate fair value of \$272.9 million and \$267.7 million, respectively. At September 30, 2016 and December 31, 2015, the \$400 million senior notes had an approximate fair value of \$439.4 million and \$432.0 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.

12. Income Taxes

The effective income tax rates were 32.2% and 33.5% for the three months ended September 30, 2016 and 2015, respectively. The effective income tax rates were 31.1% and 32.4% for the nine months ended September 30, 2016 and 2015, respectively.

The effective income tax rates for the three and nine months ended September 30, 2016 and 2015 were lower than the U.S. federal income tax rate of 35.0% due to the impact of foreign operations, partially offset by state income taxes. The effective income tax rate for the three and nine months ended September 30, 2016, was also impacted by the adoption of ASU 2016-09, which requires that excess tax benefits and deficiencies be recorded as tax expense or benefit in the income statement. The adoption resulted in a \$0.7 million and \$2.1 million tax benefit for the three and nine months ended September 30, 2016, respectively. The effective income tax rate for the nine months ended September 30, 2015 was further reduced by the settlement of unrecognized tax positions.

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13. Share-Based Compensation and Capital Stock

Stock Options

No stock options were granted during the three months ended September 30, 2016 and 2015. The Company granted 0.7 million and 0.5 million options to certain employees of the Company at a fair value of \$6.9 million and \$6.2 million for the nine months ended September 30, 2016 and 2015, 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:

	2016	2015		
	Grants	Grants		
Risk-free interest rate	1.22 %	1.45 %		
Expected volatility	23.76 %	23.94 %		
Expected life of stock option	4.6	4.6		
	years	years		
Dividend yield	1.59 %	1.23 %		
Requisite service period	4	4 years		
	years			
Contractual life	7	7 years		
	years			
Weighted average fair value of options granted (per option)	\$9.30	\$12.39		

The expected life of the options and volatility are based on historical data, which is believed to be indicative of future exercise patterns or actual volatility. Historical volatility is calculated based on a period that corresponds to the expected term 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, 2016 was \$10.4 million and \$10.1 million, respectively. The total intrinsic value of options exercised during the three months ended September 30, 2016 and 2015 was approximately \$2.4 million and \$0.9 million, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2016 and 2015 was approximately \$6.8 million and \$9.5 million, respectively.

The Company received approximately \$2.6 million and \$0.7 million in proceeds from the exercise of 104,442 and 30,808 employee stock options during the three months ended September 30, 2016 and 2015, respectively. The Company received approximately \$6.8 million and \$6.4 million in proceeds from the exercise of 297,398 and 263,600 employee stock options during the nine months ended September 30, 2016 and 2015, respectively.

Restricted Stock

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

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Restricted share grants	21,357	7,836	188,509	114,281
Weighted average grant date fair value per share	\$48.03	\$51.07	\$51.21	\$62.45
Aggregate grant date fair value (\$000)	\$1,026	\$400	\$9,654	\$7,137
Restricted shares forfeited	14,072	9,522	23,686	17,964
Vesting service period of shares granted	36 - 48	24 - 48	12 - 48	12 - 48
	months	months	months	months
Fair value of shares vested (\$000)	\$180	\$553	\$7,363	\$12,292

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.

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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 175% 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, 2016		Nine Months Ended September 30, 2015	
Performance vested restricted stock units granted at target	10,387	—	89,944	51,309
Weighted average grant date fair value per share	\$48.14	\$	—\$47.85	\$60.94
Aggregate grant date fair value (\$000)	\$500	\$	—\$4,304	\$3,126
Stock units forfeited	26,363	6,079	54,556	6,079
Requisite service period	9 - 24 months	—	9 - 43 months	36 - 43 months

No PVRSU grants vested during the three months ended September 30, 2016. During the nine months ended September 30, 2016, PVRSU grants totaling 22,062 vested at a grant date fair value of \$0.8 million. These PVRSU grants were initially granted at a target of 44,118 units. However, since the Company achieved only 50% of the targeted performance conditions contained in the stock awards granted in prior periods, 22,056 shares were forfeited. In addition, during the nine months ended September 30, 2016, PVRSU grants totaling 6,126 vested at a grant date fair value of \$0.2 million. These PVRSU grants were initially granted at a target of 4,083 units. However, since the Company achieved 150% of the targeted performance conditions contained in the stock awards granted in prior periods, an additional 2,043 shares were earned and issued.

No PVRSU grants vested during the three months ended September 30, 2015. During the nine months ended September 30, 2015, a total of 42,326 PVRSU grants vested at a grant date fair value of \$1.5 million. These PVRSU grants were initially granted at a target of 38,476 units. However, since the Company achieved 110% of the targeted performance conditions contained in the stock awards granted in prior periods, an additional 3,850 shares were earned and issued.

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A summary of stock-based award activity as of September 30, 2016 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, 2016	2,084,201	\$ 41.36		384,490	\$ 47.40	226,737	\$ 45.09
Granted	745,769	51.49		188,509	51.21	89,944	47.85
Performance based leveraging ⁽¹⁾	—	—		—	—	2,043	36.76
Exercised/Vested	(297,398)	22.87		(149,318)	43.48	(28,188)	36.76
Expired	—	—		—	—	—	—
Forfeited	(80,869)	53.86		(23,686)	51.06	(54,556)	42.82
Outstanding at September 30, 2016	2,451,703	\$ 46.27	4.5 years	399,995	\$ 50.44	235,980	\$ 47.59
Options exercisable at September 30, 2016	1,059,365	\$ 37.79	2.9 years				

⁽¹⁾PVRSU units outstanding have been increased by 2,043 units due to the Company exceeding the targeted performance conditions contained in PVRSUs granted in prior periods during the nine months ended September 30, 2016.

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, 2016 and 2015:

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
(in millions)				
Stock options	\$1.0	\$0.8	\$ 3.6	\$ 2.4
Restricted stock	1.7	1.6	5.7	5.1
Performance vested restricted stock units	0.4	1.0	1.7	1.6
Total	\$3.1	\$3.4	\$ 11.0	\$ 9.1
Income tax benefits	\$1.1	\$1.3	\$ 4.1	\$ 3.4

In conjunction with the termination of a Company officer, stock option, restricted stock and performance vested restricted stock compensation expense for the nine months ended September 30, 2016, included an additional \$0.4 million, \$0.4 million and \$0.1 million, respectively, of accelerated recognition of share based payment awards. During the three and nine months ended September 30, 2015, 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 increased by \$0.4 million and \$0.2 million for the three and nine months ended September 30, 2015.

Dividends

The Company currently pays a quarterly dividend on its common stock of \$0.205 per share, however the declaration of future dividends is subject to the discretion of the board of directors. During the three and nine months ended September 30, 2016, the Company's board of directors declared dividends totaling \$0.205 and \$0.615 per share or approximately \$11.5 million and \$34.6 million, respectively, in the aggregate.

In addition, during the nine months ended September 30, 2016, the Company recorded dividends totaling \$0.1 million related to previously declared dividends that were contingent upon the vesting of performance vested restricted stock

units.

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Share Repurchases and Redemptions

The Company purchased 0.1 million and 0.6 million shares of common stock under the share repurchase program at a total cost of \$5.6 million and \$28.6 million during the three and nine months ended September 30, 2016, respectively. During the three and nine months ended September 30, 2016, the Company redeemed 1,284 and 118,063 shares of common stock at a total cost of approximately \$61 thousand and \$5.4 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.

14. Earnings Per Share

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

(In thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Computation of Basic Earnings Per Share:				
Numerator:				
Net income	\$47,565	\$41,419	\$107,550	\$98,826
Income allocated to participating securities	(342)	(278)	(749)	(695)
Net income available to common shareholders	\$47,223	\$41,141	\$106,801	\$98,131
Denominator:				
Weighted average common shares outstanding – basic	55,630	56,843	55,904	57,019
Basic earnings per share	\$0.85	\$0.72	\$1.91	\$1.72
Computation of Diluted Earnings Per Share:				
Numerator:				
Net income	\$47,565	\$41,419	\$107,550	\$98,826
Income allocated to participating securities	(341)	(277)	(746)	(691)
Net income available to common shareholders	\$47,224	\$41,142	\$106,804	\$98,135
Denominator:				
Weighted average common shares outstanding – basic	55,630	56,843	55,904	57,019
Diluted effect of stock options and PVRsUs	281	378	296	479
Weighted average common shares outstanding – diluted	55,911	57,221	56,200	57,498
Diluted earnings per share	\$0.84	\$0.72	\$1.90	\$1.71

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, 2016 and 2015, the Company had 2.5 million and 2.1 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, 2016, the Company excluded 1.2 million of anti-dilutive stock options from the diluted earnings per share calculation. For the three and nine months ended September 30, 2015, the Company excluded 0.5 million of anti-dilutive stock options from the diluted earnings per share calculation.

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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, 2016 and 2015, PVRSUs totaling 235,980 and 207,040, respectively, were excluded from the computation since the performance conditions had not been met.

15. 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, 2016

(Unaudited, in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
REVENUES:					
Royalty fees	\$90,462	\$ 32,059	\$ 12,090	\$ (38,497)	\$ 96,114
Initial franchise and relicensing fees	6,187	—	97	—	6,284
Procurement services	7,344	—	271	—	7,615
Marketing and reservation system	140,792	99,595	4,771	(93,140)	152,018
Other	3,443	75	2,305	(277)	5,546
Total revenues	248,228	131,729	19,534	(131,914)	267,577
OPERATING EXPENSES:					
Selling, general and administrative	38,876	28,591	5,664	(38,774)	34,357
Depreciation and amortization	467	1,910	609	—	2,986
Marketing and reservation system	143,920	97,018	4,220	(93,140)	152,018
Total operating expenses					