DiamondRock Hospitality Co
Form 424B5
January 18, 2007
CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered/ Proposed maximum offering price per unit/ Proposed maximum offering price	Amount of registration fee	
Common Stock, par value $0.01 per share	**$332,916,375**	**$35,625**	**(1)**

(1) This filing fee is calculated in accordance with Rule 457(r) and relates to the Registration Statement on Form S-3 (No. 333-135386) filed by DiamondRock Hospitality Company on June 28, 2006.

PROSPECTUS SUPPLEMENT
(To Prospectus dated June 28, 2006)

Filed Pursuant to Rule 424(b)5
Registration No. 333-135386

15,950,000 Shares

Common Stock

We are selling 15,950,000 shares of our common stock. We have granted the underwriters an option to purchase up to 2,392,500 additional shares of our common stock to cover over-allotments, if any.

We are organized and conduct our operations to qualify as a real estate investment trust, or REIT, for federal income tax purposes. To assist us in complying with certain federal income tax requirements applicable to REITs, our charter contains certain restrictions relating to the ownership and transfer of our stock, including an ownership limit of 9.8% on our common stock.

Our common stock is listed on the New York Stock Exchange, or NYSE, under the symbol DRH . On January 17, 2007, the closing sale price for our common stock, as reported on the NYSE, was $18.27 per share.

Investing in our common stock involves risks. See Risk Factors beginning on page S-3 of this prospectus supplement, page 2 of the accompanying prospectus and page 12 of our Annual Report on Form 10-K for the year ended December 31, 2005, which is incorporated by reference herein.

	Per share	Total
Public offering price	$ 18.15	$ 289,492,500
Underwriting discounts	$ 0.8168	$ 13,027,960
Proceeds, before expenses, to us	$ 17.3332	$ 276,464,540

The underwriters expect to deliver the shares on or about January 23, 2007.

Neither the Securities and Exchange Commission, or SEC, nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement is truthful or complete. Any representation to the contrary is a criminal offense.

Joint Book-Running Managers

Citigroup **Merrill Lynch & Co.**

Friedman Billings Ramsey
Robert W. Baird & Co.

Wachovia Securities
JMP Securities

The date of this prospectus supplement is January 17, 2007.

TABLE OF CONTENTS

PROSPECTUS SUPPLEMENT

	Page
DIAMONDROCK HOSPITALITY COMPANY	S-1
RISK FACTORS	S-3
THE OFFERING	S-4
USE OF PROCEEDS	S-4
SUPPLEMENT TO FEDERAL INCOME TAX CONSIDERATIONS	S-5
UNDERWRITING	S-11
NOTICES TO INVESTORS	S-14
LEGAL MATTERS	S-15
WHERE YOU CAN FIND MORE INFORMATION	S-15
INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE	S-16

PROSPECTUS

	Page
OUR COMPANY	1
RISK FACTORS	2
FORWARD LOOKING INFORMATION	2
USE OF PROCEEDS	4
RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS	4
DESCRIPTION OF CAPITAL STOCK	5
DESCRIPTION OF COMMON STOCK	6
DESCRIPTION OF PREFERRED STOCK	7
DESCRIPTION OF DEPOSITARY SHARES	9
DESCRIPTION OF WARRANTS	13
RESTRICTIONS ON OWNERSHIP AND TRANSFER	13
DESCRIPTION OF CERTAIN MATERIAL PROVISIONS OF MARYLAND LAW, OUR CHARTER AND OUR BYLAWS	18
DESCRIPTION OF THE PARTNERSHIP AGREEMENT OF DIAMONDROCK HOSPITALITY LIMITED PARTNERSHIP	21
FEDERAL INCOME TAX CONSIDERATIONS	25
PLAN OF DISTRIBUTION	36
LEGAL MATTERS	38
EXPERTS	38
WHERE YOU CAN FIND MORE INFORMATION	38
INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE	39

You should rely only on the information provided or incorporated by reference in this prospectus supplement and accompanying prospectus. We have not authorized anyone to provide you with different or additional information. We are not making an offer to sell these securities in any jurisdiction where the offer or sale of these securities is not permitted. You should not assume that the information appearing in this prospectus supplement, the accompanying prospectus or the documents incorporated by reference herein or therein is accurate as of any date other than their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates. To the extent the information contained in this prospectus supplement differs or varies from the information contained in the accompanying prospectus or documents incorporated by reference, the information in this prospectus supplement will supersede such information.

References in this prospectus to we, our, us and our company refer to DiamondRock Hospitality Company, including, as the context requires, DiamondRock Hospitality Limited Partnership, our operating partnership, as well as our other direct and indirect subsidiaries, including our taxable REIT subsidiary, Bloodstone TRS, Inc.

DIAMONDROCK HOSPITALITY COMPANY

We are a self-advised real estate company. We are committed to maximizing shareholder value through investing in premium full-service hotels and, to a lesser extent, premium urban select-service hotels. We believe we have been organized and have operated in a manner that allows us to qualify for taxation as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended, or the Code, commencing with our taxable year ended December 31, 2005.

Recent Developments

Agreement to Purchase the Westin Boston Waterfront Hotel. On January 9, 2007 we entered into a definitive binding agreement to acquire a leasehold interest in the Westin Boston Waterfront Hotel, which we refer to in this prospectus supplement as the Boston Westin Hotel. In addition to the Boston Westin Hotel, the acquisition will include a leasehold interest in 100,000 square feet of retail space and an option to acquire a leasehold interest in a parcel of land with development rights to build a 320 to 350 room hotel. The contractual purchase price for the Boston Westin Hotel, the leasehold interest in the retail space and the option to enter into the ground lease is $330.3 million. Upon entering into the purchase and sale agreement, we made a $15 million deposit, $3 million of which became non-refundable on January 10, 2007. The remaining $12 million of the deposit will become non-refundable on January 18, 2007 if we do not terminate the purchase and sale agreement prior to that date.

The Boston Westin Hotel opened in June 2006 and contains 793 rooms and approximately 32,000 square feet of meeting space. During 2006, in the six months that the hotel was open for business, the Boston Westin Hotel had a RevPAR of $133.06, based on an occupancy of 64.3%, and an average daily rate of $206.80. The Boston Westin Hotel is connected by a sky bridge to the recently built 2.1 million square foot Boston Convention and Exhibition Center, or BCEC, and is located in the Seaport District. The Boston Westin Hotel includes a full service restaurant, a lobby lounge, a Starbucks licensed café, a 400-car underground parking facility, a fitness center, an indoor swimming pool, a business center and a gift shop. The Boston Westin Hotel has the right until 2017 to use, on an as available basis, up to 50,000 square feet of meeting space and up to 40,000 square feet of ballroom space at the BCEC. The manager of the Boston Westin Hotel is currently negotiating a union contract for the hotel.

The retail space is a separate three-floor, 100,000 square foot building attached to the Boston Westin Hotel. When the retail space is leased to one or more third-party tenants, we or the tenants will complete the necessary tenant improvements. There is a significant chance that the acquisition of the retail space may occur, if at all, after the acquisition of the Boston Westin Hotel and the expansion option. We have asked the seller to obtain certain amendments to the retail ground lease, as well as confirmation that such amendments are permitted under the local zoning rules, to permit us to use the entire third floor of the building for additional meeting space and the entire first floor for exhibition space for the hotel. Our right to use the first floor for exhibition space will continue for at least ten years, after which the first floor will be used for retail. We will hold back $20 million of the purchase price until such conditions are satisfied.

The expansion hotel, should we decide to build it, will be located on a 1½ acre parcel of developable land that is immediately adjacent to the Boston Westin Hotel. The expansion hotel is expected to have 320 to 350 rooms as well as 100 underground parking spaces and, upon construction, could also be attached to the BCEC. We are still investigating the cost to construct, and the potential returns associated with, the expansion hotel and have not concluded whether or not to pursue this portion of the project.

Financing the Acquisition. The aggregate purchase price for the acquisition is $330.3 million. The acquisition is expected to be consummated during our first fiscal quarter of 2007, after the completion of this offering. We intend to finance this acquisition through a combination of the proceeds of this offering and an unsecured short-term loan (the Hotel Loan). *See* Use of Proceeds. The Hotel Loan is expected to be a six-month floating rate loan with an interest rate equal to 30-day LIBOR plus 125 basis

points. The amount of the Hotel Loan will be $330.0 million less the net proceeds received by us from this offering. We intend to borrow the Hotel Loan from an affiliate of Citigroup Global Markets Inc., or Citigroup, an underwriter of this offering. We intend to repay in full the Hotel Loan with proceeds from our amended and restated unsecured credit facility.

Amended and Restated Credit Facility

We have agreed with Wachovia Bank, N.A. and Wachovia Capital Markets, LLC to amend and restate our $75 million secured credit facility to expand it into a $200 million unsecured credit facility. The terms of the amended and restated credit facility are subject to finalization of the relevant legal documentation and syndication. As of January 8, 2007, we had drawn, and had outstanding, $5 million under our current secured credit facility. We intend to use this expanded credit facility to refinance the Hotel Loan. Wachovia Capital Markets, LLC is an underwriter of this offering.

Acquisition of Two Renaissance Hotels

On December 8, 2006, we completed the acquisition of the 492-room Renaissance Austin Hotel and the 521-room Renaissance Waverly Atlanta Hotel for a contractual purchase price of $237.5 million. We acquired these hotels from an affiliate of Walton Street Capital, L.L.C.

In order to finance part of the purchase price, we incurred $97 million of debt secured by a mortgage on the Renaissance Waverly Atlanta Hotel from an affiliate of Goldman Sachs Mortgage Company and $83 million of debt secured by a mortgage on the Renaissance Austin Hotel from an affiliate of Merrill Lynch Mortgage Lending, Inc. These loans have a fixed interest rate of approximately 5.5% and are interest only for the full 10-year term.

RISK FACTORS

Investment in any securities offered pursuant to this prospectus supplement involves risks. You should carefully consider the risk factors and other information contained in this prospectus supplement and the accompanying prospectus, as well as the risk factors incorporated by reference from our most recent Annual Report on Form 10-K and the other information contained in this prospectus, as updated by our subsequent filings under the Securities Exchange Act of 1934, as amended, before acquiring any of such securities.

If we do not complete the acquisition of the Boston Westin Hotel, we will have incurred substantial expenses without realizing the expected benefits.

We made a $15 million deposit with an escrow agent for the seller of the Boston Westin Hotel, $3 million of which became non-refundable on January 10, 2007. If we are unable to complete the acquisition of the Boston Westin Hotel, we will lose the $3 million non-refundable portion of the deposit that we have provided to the seller. In addition, we will write off the due diligence, legal and accounting costs incurred in connection with this acquisition. The remaining $12 million of the deposit will become non-refundable on January 18, 2007, if we do not terminate the purchase and sale agreement prior to that date. We cannot assure you that we will acquire the Boston Westin Hotel because the proposed acquisition is subject to a variety of factors, including the satisfaction of closing conditions. If we fail to complete the acquisition of the Boston Westin Hotel, these costs and related write off may adversely impact our results of operations and operating cash flow.

If we are unable to complete the acquisition of the Boston Westin Hotel, we have no designated use for the net proceeds of this offering, which could result in significant dilution to you and our existing stockholders. The net proceeds of this offering alone are insufficient to purchase the Boston Westin Hotel.

We intend to use all of the net proceeds from this offering to acquire the Boston Westin Hotel. We anticipate that the closing of the acquisition of the Boston Westin Hotel will occur during our first fiscal quarter of 2007, but after the date of the expected closing of this offering. However, we cannot assure you that we will acquire this hotel because the proposed acquisition is subject to a variety of factors, including the satisfaction of closing conditions, including the receipt of third-party consents and approvals.

We have a commitment from an affiliate of Citigroup Global Markets Inc., an underwriter of this offering, for the Hotel Loan. However, the obligation to make the Hotel Loan is subject to the negotiation of definitive loan documents. We cannot assure you that we will obtain the Hotel Loan. If we do not obtain the Hotel Loan, we will have insufficient financing to acquire the Boston Westin Hotel.

If we do not complete this acquisition within our anticipated time frame or at all, we may experience delays in locating and securing attractive alternative investments. These delays would result in significant dilution and may cause our future operating results to fall short of expectations. If we are unable to complete the purchase of the Boston Westin Hotel, we will have no specific designated use for the net proceeds from this offering and investors will be unable to evaluate in advance the manner in which we invest the net proceeds or the economic merits of the properties we may ultimately acquire with the net proceeds.

Because the Boston Westin Hotel is a newly-opened hotel with limited operating history in a developing submarket, the hotel may not achieve the returns that we are expecting, and as a result, our overall returns may be negatively impacted.

The Boston Westin Hotel opened in June 2006, and has limited operating history. Our ability to accurately forecast future operations is accordingly limited. In addition, the Boston Westin Hotel is located in a newly-developed submarket of Boston. Should the retail, office and apartment developments of this submarket fail to develop as we currently expect, this submarket may not be an attractive destination to travelers. As a result, there is considerable risk this hotel may not achieve the returns we are expecting and our overall returns may be negatively impacted.

The acquisition of the Boston Westin Hotel adds risk to our portfolio.

The Boston Westin Hotel will be our second largest hotel, representing over 15% of our net assets, and as such, the operations of this hotel will have a significant impact on our overall results of operations. In the event of an economic downturn in Boston, or should we adopt an unsuccessful strategy to manage this hotel, our overall results of operations may be adversely affected.

THE OFFERING

Issuer	DiamondRock Hospitality Company
Common Stock Offered by Us	15,950,000 shares
Common Stock to be Outstanding after this Offering	92,603,159 shares(1)(2)
NYSE Symbol	DRH

(1) Based on 76,653,159 shares outstanding as of January 17, 2007. Excludes 2,392,500 shares issuable upon exercise of the underwriters over-allotment option.

(2) Includes 40,288 unrestricted shares of our common stock issued to our independent directors and 461,527 unvested restricted shares of our common stock issued to our executive officers and other employees pursuant to our equity incentive plan. Excludes 789,151 shares available for future issuance under our equity incentive plan and 413,554 vested deferred common stock units outstanding as of January 17, 2007.

USE OF PROCEEDS

We expect that the net proceeds from this offering will be approximately $276.1 million after deducting underwriting discounts and our estimated expenses of approximately $350,000 (or approximately $317.6 million if the underwriters exercise their option to purchase additional shares in full). We intend to contribute the net proceeds from the sale of the common stock pursuant to this prospectus supplement to our operating partnership. Our operating partnership will subsequently use the net proceeds of this offering to fund a portion of the purchase of the Boston Westin Hotel. The remainder of the purchase price will be funded through the Hotel Loan, for which we have a loan commitment, but which is subject to the finalization of loan documentation.

Pending these uses, we intend to invest the net proceeds in interest-bearing, short-term investment grade securities or money-market accounts that are consistent with our intention to maintain our qualification as a REIT. Such investments may include, for example, government and government agency certificates, interest-bearing bank deposits and mortgage loan participations. In the event that the underwriters exercise any or all of their over-allotment, we expect to use the additional net proceeds towards the purchase price of the Boston Westin Hotel.

SUPPLEMENT TO FEDERAL INCOME TAX CONSIDERATIONS

The following summary outlines certain U.S. federal income tax considerations relating to an investment in our common stock, including the federal income tax consequences under current law that are likely to be material to a purchaser of our common stock in this offering who is a U.S. stockholder (as hereinafter defined) and who will hold its shares as a capital asset. This summary does not contain a complete discussion of the federal tax aspects of the investment that may be important to you. Moreover, it does not address any foreign, state or local tax consequences of an investment in our common stock. The provisions of the Code concerning the federal income tax treatment of a REIT and its stockholders are highly technical and complex; the following discussion sets forth only certain aspects of those provisions. This summary is intended to provide you with general information only and is not intended as a substitute for careful tax planning. The discussion below assumes that you will hold our common stock as a capital asset. We do not address the federal income tax consequences that may be relevant to stockholders subject to special treatment under the Code, including, without limitation, insurance companies, regulated investment companies, financial institutions, broker-dealers, tax-exempt or non-U.S. investors (except as specifically discussed below), foreign governments, stockholders that hold our stock as a hedge, part of a straddle, conversion transaction, or other arrangement involving more than one position, or through a partnership or other entity, or U.S. expatriates.

This summary is based on provisions of the Code, applicable final and temporary Treasury Regulations, judicial decisions and administrative rulings and practice, all in effect as of the date of this prospectus supplement, and should not be construed as legal advice. No assurance can be given that future legislative or administrative changes or judicial decisions will not affect the accuracy of the descriptions or conclusions contained in this summary. In addition, any such changes may be retroactive and apply to transactions entered into prior to the date of their enactment, promulgation or release. We do not expect to seek a ruling from the Internal Revenue Service, or IRS, regarding any of the federal income tax issues discussed in this prospectus supplement, and no assurance can be given that the IRS will not challenge any of the positions we take and that such a challenge will not succeed. ***Prospective purchasers of our stock are urged to consult their own tax advisors prior to any investment in our common stock concerning the potential federal, state, local and foreign tax consequences of the investment with specific reference to their own tax situations.*** This summary supplements and should be read together with the general discussion of the tax considerations relating to our qualification as a REIT described in the accompanying prospectus under the title Federal Income Tax Considerations Related to Our REIT Election.

Taxation of U.S. Stockholders Holding Common Stock

The term U.S. stockholder means an investor that, for U.S. federal income tax purposes, is (i) a citizen or resident of the United States, (ii) a corporation, partnership, or other entity created or organized in or under the laws of the United States, any of its states or the District of Columbia, (iii) an estate, the income of which is subject to United States federal income taxation regardless of its source, or (iv) a trust, if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust. In addition, as used herein, the term U.S. stockholder does not include any entity that is subject to special treatment under the Code.

Distributions by us, other than capital gain dividends, will constitute ordinary dividends to the extent of our current or accumulated earnings and profits as determined for federal income tax purposes. In general, these dividends will be taxable as ordinary income and will not be eligible for the dividends-received deduction for corporate stockholders. Our ordinary dividends generally will not qualify as qualified dividend income taxed as net capital gain for U.S. stockholders that are individuals, trusts, or estates. However, distributions to U.S. stockholders that are individuals, trusts, or estates generally will constitute qualified dividend income taxed as net capital gains to the extent the U.S. stockholder satisfies certain holding period requirements and to the extent the dividends are attributable to (i) qualified dividend income we receive from other corporations, such as Bloodstone TRS, Inc. and other TRSs, and (ii) dividends paid from our undistributed earnings or from built-in gains taxed at the corporate level and provided we properly designate the distributions as such. We do not anticipate distributing a significant amount of qualified dividend income.

To the extent that we make a distribution in excess of our current and accumulated earnings and profits (a return of capital distribution), the distribution will be treated first as a tax-free return of capital, reducing the tax basis in a U.S. stockholder s shares. To the extent a return of capital distribution exceeds a U.S. stockholder s tax basis in its shares, the distribution will be taxable as capital gain realized from the sale of such shares.

Dividends declared by us in October, November or December and payable to a stockholder of record on a specified date in any such month shall be treated both as paid by us and as received by the stockholder on December 31 of the year, provided that the dividend is actually paid by us during January of the following calendar year.

We will be treated as having sufficient earnings and profits to treat as a dividend any distribution up to the amount required to be distributed in order to avoid imposition of the 4% excise tax generally applicable to REITs if certain distribution requirements are not met. Moreover, any deficiency dividend will be treated as an ordinary or a capital gain dividend, as the case may be, regardless of our earnings and profits. As a result, stockholders may be required to treat certain distributions as taxable dividends that would otherwise result in a tax-free return of capital.

Capital Gain Dividends

Distributions that are properly designated as capital gain dividends will be taxed as long-term capital gains (to the extent they do not exceed our actual net capital gain for the taxable year) without regard to the period for which the stockholder has held its shares. However, corporate stockholders may be required to treat up to 20% of certain capital gain dividends as ordinary income. In addition, U.S. stockholders may be required to treat a portion of any capital gain dividend as unrecaptured Section 1250 gain, taxable at a maximum rate of 25%, if we incur such gain. Capital gain dividends are not eligible for the dividends-received deduction for corporations.

The REIT provisions do not require us to distribute our long-term capital gain, and we may elect to retain and pay income tax on our net long-term capital gains received during the taxable year. If we so elect for a taxable year, our stockholders would include in income as long-term capital gains their proportionate share of such portion of our undistributed long-term capital gains for the taxable year as we may designate. A stockholder would be deemed to have paid its share of the tax paid by us on such undistributed capital gains, which would be credited or refunded to the stockholder. The stockholder s basis in its shares would be increased by the amount of undistributed long-term capital gains (less the capital gains tax paid by us) included in the stockholder s long-term capital gains.

Passive Activity Loss and Investment Interest Limitations

Our distributions and gain from the disposition of shares will not be treated as passive activity income and, therefore, U.S. stockholders will not be able to apply any passive losses against such income. With respect to non-corporate U.S. stockholders, our dividends (to the extent they do not constitute a return of capital) that are taxed at ordinary income rates will generally be treated as investment income for purposes of the investment interest limitation; however, net capital gain from the disposition of shares (or distributions treated as such), capital gain dividends, and dividends taxed at net capital gains rates generally will be excluded from investment income except to the extent the U.S. stockholder elects to treat such amounts as ordinary income for federal income tax purposes. U.S. stockholders may not include on their own federal income tax returns any of our tax losses.

Sale or Disposition of Shares

In general, any gain or loss realized upon a taxable disposition of shares of our common stock by a stockholder that is not a dealer in securities will be a long-term capital gain or loss if the shares have been held for more than one year and otherwise as a short-term capital gain or loss. However, any loss upon a sale or exchange of the shares by a stockholder who has held such stock for six months or less (after applying certain holding period rules) will be treated as a long-term capital loss to the extent of our distributions or undistributed capital gains required to be treated by such stockholder as long-term capital gain. All or a portion of any loss realized upon a taxable disposition of shares may be disallowed if other shares are purchased within 30 days before or after the disposition.

Unrelated Business Taxable Income

In General

In general, a tax-exempt organization is exempt from federal income tax on its income, except to the extent of its unrelated business taxable income (UBTI), which is defined by the Code as the gross income derived from any trade or business which is regularly carried on by a tax-exempt entity and unrelated to its exempt purposes, less any directly connected deductions and subject to certain modifications. For this purpose, the Code generally excludes from UBTI any gain or loss from the sale or other disposition of property (other than stock in trade or property held primarily for sale in the ordinary course of a trade or business), dividends, interest, rents from real property, and certain other items. However, a portion of any such gains, dividends, interest, rents, and other items generally are UBTI if derived from debt-financed property, based on the amount of acquisition indebtedness with respect to such debt-financed property. ***Before making an investment in shares of our common stock, a tax-exempt stockholder should consult its own tax advisors with regard to UBTI and the suitability of the investment in our stock.***

Distributions we make to a tax-exempt employee pension trust or other domestic tax-exempt stockholder or gains from our shares held as capital assets generally will not constitute UBTI unless the exempt organization s shares are debt-financed property (e.g., the stockholder has borrowed to acquire or carry its shares). This general rule does not apply, however, to distributions to certain pension trusts that are qualified trusts (as defined below) and that hold more than 10% (by value) of our stock. For these purposes, a qualified trust is defined as any trust described in Section 401(a) of the Code and exempt from tax under Section 501(a) of the Code. If we are treated as a pension-held REIT, such qualified trusts will be required to treat a percentage of their dividends received from us as UBTI if we incur UBTI. We will be treated as a pension-held REIT if (i) we would fail the requirement that, during the last half of each taxable year, no more than 50% in value of our stock may be owned, directly or indirectly, by or for five or fewer individuals (the 5/50 Test) if qualified trusts were treated as individuals for purposes of the 5/50 Test and (ii) we are predominantly held by qualified trusts. Stock ownership for purposes of the 5/50 Test is determined by applying the constructive ownership provisions of Section 544(a) of the Code, subject to certain modifications. The term individual for purposes of the 5/50 Test includes a private foundation, a trust providing for the payment of supplemental unemployment compensation benefits, and a portion of a trust permanently set aside or to be used exclusively for charitable purposes. A qualified trust described in Section 401(a) of the Code and exempt from tax under Section 501(a) of the Code generally is not treated as an individual; rather, shares held by it are treated as owned proportionately by its beneficiaries. We will be predominantly held by qualified trusts if either (i) a single qualified trust holds more than 25% by value of our stock or (ii) one or more qualified trusts, each owning more than 10% by value of our stock, hold in the aggregate more than 50% by value of our stock.

In the event we are a pension-held REIT, a qualified trust owning 10% or more of our shares should expect to recognize UBTI as a result of its investment, and we cannot assure you that we will never be treated as a pension-held REIT. The percentage of any dividend received from us treated as UBTI would be equal to the ratio of (a) the gross UBTI (less certain associated expenses) earned by us (treating us as if we were a qualified trust and, therefore, subject to tax on UBTI) to (b) our total gross income (less certain associated expenses). A *de minimis* exception applies where the ratio set forth in the preceding sentence is less than 5% for any year; in that case, no dividends are treated as UBTI.

Special Issues

Social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts, and qualified group legal services plans that are exempt from taxation under paragraphs (7), (9), (17), and (20),

respectively, of Section 501(c) of the Code are subject to different UBTI rules, which generally will require them to characterize distributions from us as UBTI.

Information Reporting Requirements and Backup Withholding Tax

We will report to our U.S. stockholders and to the IRS the amount of distributions paid during each calendar year, and the amount of tax withheld, if any. Under the backup withholding rules, a U.S. stockholder may be subject to backup withholding at the current rate of 28% with respect to distributions paid, unless such stockholder (i) is a corporation or other exempt entity and, when required, proves its status or (ii) certifies under penalties of perjury that the taxpayer identification number the stockholder has furnished to us is correct and the stockholder is not subject to backup withholding and otherwise complies with the applicable requirements of the backup withholding rules. A U.S. stockholder that does not provide us with its correct taxpayer identification number also may be subject to penalties imposed by the IRS. Any amount paid as backup withholding will be creditable against the stockholder s income tax liability.

Taxation of Non-U.S. Stockholders Holding Common Stock

The rules governing U.S. federal income taxation of our stockholders who are beneficial owners of our common stock and who are not U.S. stockholders, such as nonresident alien individuals, foreign corporations, foreign partnerships, and other foreign stockholders (non-U.S. stockholders), are complex. This section is only a summary of such rules. ***We urge prospective non-U.S. stockholders to consult their own tax advisors to determine the impact of federal, state, local and foreign income tax laws on ownership of our common stock, including any reporting requirements.***

Distributions

A non-U.S. stockholder that receives a distribution that is not attributable to gain from our sale or exchange of United States real property interests (as defined below) and that we do not designate as a capital gain dividend or retained capital gain generally will recognize ordinary income to the extent that we pay the distribution out of our current or accumulated earnings and profits. A withholding tax equal to 30% of the gross amount of the distribution ordinarily will apply unless an applicable tax treaty reduces or eliminates the tax. Under some treaties, lower withholding rates do not apply to dividends from REITs. However, if a distribution is treated as effectively connected with the non-U.S. stockholder s conduct of a U.S. trade or business, the non-U.S. stockholder generally will be subject to federal income tax on the distribution at graduated rates (in the same manner as U.S. stockholders are taxed on distributions) and also may be subject to the 30% branch profits tax in the case of a corporate non-U.S. stockholder. We plan to withhold U.S. income tax at the rate of 30% on the gross amount of any distribution paid to a non-U.S. stockholder that is not a capital gain dividend or distribution that is not attributable to gain from the sale or exchange of United States real property interests unless either (i) a lower treaty rate applies and the non-U.S. stockholder files with us any required IRS Form W-8 (for example, an IRS Form W-8BEN) evidencing eligibility for that reduced rate or (ii) the non-U.S. stockholder files with us an IRS Form W-8ECI claiming that the distribution is effectively connected income.

A non-U.S. stockholder generally will not incur tax on a return of capital distribution in excess of our current and accumulated earnings and profits that is not attributable to the gain from our disposition of a United States real property interest if the excess portion of the distribution does not exceed the adjusted basis of the non-U.S. stockholder s common stock. Instead, the excess portion of the distribution will reduce the adjusted basis of that common stock. However, a non-U.S. stockholder will be subject to tax on such a distribution that exceeds both our current and accumulated earnings and profits and the non-U.S. stockholder s adjusted basis in the common stock, if the non-U.S. stockholder otherwise would be subject to tax on gain from the sale or disposition of its common stock, as described below. Because we generally

cannot determine at the time we make a distribution whether or not the distribution will exceed our current and accumulated earnings and profits, we normally will withhold tax on the entire amount of any distribution at the same rate as we would withhold on a dividend. However, a non-U.S. stockholder may obtain a refund of amounts that we withhold if we later determine that a distribution in fact exceeded our current and accumulated earnings and profits.

We may be required to withhold 10% of any distribution that exceeds our current and accumulated earnings and profits. Consequently, although we intend to withhold at a rate of 30% on the entire amount of any distribution that is neither attributable to the gain from our disposition of a United States real property interest nor designated by us as a capital gain dividend, to the extent that we do not do so, we will withhold at a rate of 10% on any portion of a distribution not subject to withholding at a rate of 30%.

Subject to the exception discussed below for 5% or smaller holders of regularly traded classes of stock, a non-U.S. stockholder will incur tax on distributions that are attributable to gain from our sale or exchange of United States real property interests under special provisions of the Foreign Investment in Real Property Tax Act of 1980, or FIRPTA. The term United States real property interests includes interests in U.S. real property and shares in U.S. corporations at least 50% of whose assets consist of interests in U.S. real property. Under those rules, a non-U.S. stockholder is taxed on distributions attributable to gain from sales of United States real property interests as if the gain were effectively connected with the non-U.S. stockholder s conduct of a U.S. trade or business. A non-U.S. stockholder thus would be taxed on such a distribution at the normal capital gain rates applicable to U.S. stockholders, subject to applicable alternative minimum tax and a special alternative minimum tax in the case of a nonresident alien individual. A corporate non-U.S. stockholder not entitled to treaty relief or exemption also may be subject to the 30% branch profits tax on such a distribution. We generally must withhold 35% of any distribution subject to these rules that we could designate as a capital gain distribution (35% FIRPTA Withholding). A non-U.S. stockholder may receive a credit against its tax liability for the amount we withhold.

A non-U.S. stockholder that owns no more than 5% of our common stock at all times during the one-year period ending on the date of a distribution will not be subject to 35% FIRPTA Withholding with respect to such distribution that is attributable to gain from our sale or exchange of United States real property interests, provided that our common stock continues to be regularly traded on an established securities market in the United States. Instead, any such distributions made to such non-U.S. stockholder will be subject to the general withholding rules discussed above, which generally impose a withholding tax equal to 30% of the gross amount of each distribution (unless reduced by treaty).

Dispositions

If the gain on the sale of the common stock were taxed under FIRPTA, a non-U.S. stockholder would be taxed on that gain in the same manner as U.S. stockholders with respect to that gain, subject to applicable alternative minimum tax, and a special alternative minimum tax in the case of nonresident alien individuals. A non-U.S. stockholder generally will not incur tax under FIRPTA on a sale or other disposition of our stock if we are a domestically controlled qualified investment entity, which means that, during the shorter of the period since our formation and the five-year period ending on the date of the distribution or dispositions, non-U.S. stockholders hold, directly or indirectly, less than 50% in value of our stock. We cannot assure you that we will be a domestically controlled qualified investment entity. However, the gain from a sale of our common stock by a non-U.S. stockholder will not be subject to tax under FIRPTA if (i) our common stock is considered regularly traded under applicable Treasury Regulations on an established securities market in the United States, such as the New York Stock Exchange, and (ii) the non-U.S. stockholder owned, actually or constructively, 5% or less of our common stock at all times during a specified testing period. Since the completion of our initial public offering, our common stock has been regularly traded on an established securities market in the United States. Accordingly, a non-U.S.

stockholder should not incur tax under FIRPTA with respect to gain on a sale of our common stock unless it owns, actually or constructively, more than 5% of our common stock provided that our common stock continues to be regularly traded on an established securities market in the United States.

In addition, even if we are a domestically controlled qualified investment entity, upon a disposition of our common stock, a non-U.S. stockholder may be treated as having gain from the sale or exchange of a United States real property interest if the non-U.S. stockholder (i) disposes of an interest in our common stock during the 30-day period preceding the ex-dividend date of a distribution, any portion of which, but for the disposition, would have been treated as gain from sale or exchange of a United States real property interest and (ii) acquires, enters into a contract or option to acquire, or is deemed to acquire, other shares of our common stock within 30 days after such ex-dividend date. The foregoing rule does not apply if the exception described above for distributions to 5% or smaller holders of regularly traded classes of stock is satisfied.

Furthermore, a non-U.S. stockholder generally will incur tax on gain not subject to FIRPTA if (i) the gain is effectively connected with the non-U.S. stockholder s U.S. trade or business, in which case the non-U.S. stockholder will be subject to the same treatment as U.S. stockholders with respect to such gain, or (ii) the non-U.S. stockholder is a nonresident alien individual who was present in the United States for 183 days or more during the taxable year and has a tax home in the United States, in which case the non-U.S. stockholder will incur a 30% tax on his or her capital gains.

Purchasers of our stock from a non-U.S. stockholder generally will be required to withhold and remit to the IRS 10% of the purchase price unless at the time of purchase (i) any class of our stock is regularly traded on an established securities market in the United States (subject to certain limits if the shares sold are not themselves part of such a regularly traded class) or (ii) we are a domestically-controlled qualified investment entity. The non-U.S. stockholder may receive a credit against its tax liability for the amount withheld.

State, Local, and Foreign Tax

We may be subject to state, local and foreign tax in states, localities and foreign countries in which we do business or own property. The tax treatment applicable to us and our stockholders in such jurisdictions may differ from the federal income tax treatment described above.

Prospective stockholders should consult their own tax advisers for further information about federal, state, local and other tax consequences of investing in our common stock.

UNDERWRITING

Citigroup Global Markets Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated are acting as the joint book-running managers of this offering and as representatives of the underwriters named below. We have entered into an underwriting agreement with the underwriters. Subject to the terms and conditions of the underwriting agreement, the underwriters have agreed to purchase and we have agreed to sell to the underwriters the number of shares listed opposite their names below.

Underwriter	Number of Shares
Citigroup Global Markets Inc.	4,785,000
Merrill Lynch, Pierce Fenner & Smith Incorporated	4,785,000
Friedman, Billings, Ramsey & Co., Inc.	2,392,500
Wachovia Capital Markets, LLC	2,392,500
Robert W. Baird & Co. Incorporated	797,500
JMP Securities LLC	797,500
Total	15,950,000

The underwriting agreement provides that the underwriters must buy all of the shares (other than those shares covered by the over-allotment option described below) if they buy any of them.

Our common stock is offered subject to a number of conditions, including:

- receipt and acceptance of our common stock by the underwriters; and
- the underwriters right to reject orders in whole or in part.

The underwriters have advised us that they intend to make a market in our common stock but that they are not obligated to do so and may discontinue making a market at any time without notice.

In connection with this offering, the underwriters or securities dealers may distribute prospectus supplements and the accompanying prospectuses electronically. The representatives may also agree to allocate a number of shares to underwriters for sale to their online brokerage account holders. The representatives will allocate shares to underwriters that may make internet distributions on the same basis as other allocations. In addition, shares may be sold by the underwriters to securities dealers who resell shares to online brokerage account holders.

Over-Allotment Option

Pursuant to the underwriting agreement, we have granted the underwriters a one-time option to buy up to an aggregate of 2,392,500 additional shares of our common stock. The underwriters may exercise this option solely for the purpose of covering over-allotments, if any, made in connection with this offering. To the extent the option is exercised, each underwriter must purchase a number of additional shares approximately proportionate to that underwriter s initial purchase commitment. The underwriters have 30 days from the date of this prospectus supplement to exercise this option.

Discounts

The underwriters propose to offer some of the shares directly to the public at the public offering price set forth on the cover page of this prospectus supplement and some of the shares to dealers at the public offering price less a concession not to exceed $0.4901 per share. After the initial offering, the public offering price, concession and other selling terms may be changed. Sales of shares made outside the United States may be made by affiliates of the underwriters.

Pursuant to the underwriting agreement, the underwriters are obligated to purchase the shares at the price and upon the terms stated therein and, as a result, thereafter bear any risk associated with changing the offering price to the public or other selling terms.

The following table shows the per share and total underwriting discounts that the underwriters will receive, assuming both no exercise and full exercise of the underwriters option to purchase up to an additional 2,392,500 shares.

	No exercise	Full exercise
Per share	$ 0.8168	$ 0.8168
Total	$ 13,027,960	$ 14,982,154

We estimate that the total expenses of this offering payable by us, not including the underwriting discounts, will be approximately $350,000.

No Sales of Similar Securities

The underwriting agreement provides that we, and our officers and directors, will not, subject to certain exceptions stated in the underwriting agreement (including as set forth below), without the prior consent of the underwriters, offer, pledge, sell, contract to sell or otherwise dispose of, directly or indirectly, any shares of common stock or securities convertible into, or exchangeable or exercisable for, or repayable with our common stock, or file any registration statement with the SEC in respect of such common stock or securities (other than a shelf registration statement under Rule 415); or enter into any swap or other agreement or any transaction that transfers, in whole or in part, directly or indirectly, the economic consequences of ownership of our common stock or any securities convertible into, or exchangeable or exercisable for, or repayable with our common stock, whether any such swap or transaction is to be settled by delivery of our shares of common stock or such other securities, in cash or otherwise. The underwriters have agreed that our officers and directors may sell, pledge or otherwise dispose or transfer up to an aggregate of 125,000 shares of our common stock. These restrictions will be in effect for a period of 60 days from the date of the underwriting agreement. At any time and without public notice, the representatives may, in their sole discretion, release some or all of the securities from these restrictions.

Indemnification

The underwriting agreement provides that we will indemnify the underwriters against certain liabilities, including certain liabilities under the Securities Act of 1933, as amended, or Securities Act. If we are unable to provide this indemnification, the underwriting agreement provides that we will contribute to payments the underwriters may be required to make because of any of those liabilities.

Listing

Our common stock is listed on the NYSE under the trading symbol DRH.

Price Stabilization, Short Positions

In connection with this offering, the underwriters may engage in activities that stabilize, maintain or otherwise affect the price of our common stock, including:

- stabilizing transactions;
- short sales;
- purchases to cover positions created by short sales;

- imposition of penalty bids; and
- syndicate covering transactions.

Stabilizing transactions consist of bids or purchases made for the purpose of preventing or retarding a decline in the market price of our common stock while this offering is in progress. These transactions may also include making short sales of our common stock, which involve the sale by the underwriters of a greater number of shares of common stock than they are required to purchase in this offering. Short sales may be covered short sales, which are short positions in an amount not greater than the underwriters over-allotment option referred to above, or may be naked short sales, which are short positions in excess of that amount. Penalty bids permit the underwriters to reclaim a selling concession from a syndicate member when one of the representatives repurchases shares originally sold by that syndicate member in order to cover syndicate short positions or make stabilizing purchases.

The underwriters may close out any covered short position either by exercising their over-allotment option, in whole or in part, or by purchasing shares in the open market. In making this determination, the underwriters will consider, among other things, the price of shares available for purchase in the open market compared to the price at which they may purchase shares through the over-allotment option. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the common stock in the open market that could adversely affect investors who purchased in this offering.

As a result of these activities, the price of our common stock may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the underwriters at any time. The underwriters may carry out these transactions on the NYSE, in the over-the-counter market or otherwise.

Affiliations

The underwriters and their affiliates may have provided in the past and may provide from time to time in the future certain commercial banking, financial advisory, investment banking and other services for us for which they will be entitled to receive separate fees. On April 7, 2006, we refinanced an existing $220 million floating-rate loan on our Chicago Marriott Downtown Magnificent Mile hotel with a 10-year fixed-rate loan issued by Wachovia Bank, National Association, an affiliate of Wachovia Capital Markets, LLC. In addition, two other hotels owned by us are subject to mortgage debt held by an affiliate of Wachovia Capital Markets, LLC aggregating approximately $140.0 million. On December 8, 2006, in connection with our acquisition of two Renaissance hotels, we incurred approximately $83 million of debt secured by a mortgage on the Renaissance Austin Hotel from an affiliate of Merrill Lynch Mortgage Lending, Inc (an affiliate of Merrill Lynch, Pierce, Fenner & Smith Incorporated). These loans are subject to customary fees and interest rates. In connection with the proposed purchase of the Boston Westin Hotel, we expect to receive the Hotel Loan from an affiliate of Citigroup Global Markets Inc., one of the underwriters of this offering. The size of the Hotel Loan will be reduced by the amount of the proceeds raised by us in this offering. In addition, we have agreed with Wachovia Capital Markets, LLC to amend and restate our secured credit facility. One or more of the underwriters in this offering may agree to become a lender under our amended and restated credit facility. We intend to repay the Hotel Loan with proceeds from the amended and restated credit facility. In connection with the Hotel Loan and the amended and restated credit facility, Citigroup Global Markets Inc. and its affiliates and Wachovia Capital Markets, LLC and its affiliates, respectively and any other banks which participate in our credit facility expect to receive customary fees and interest.

One of our directors, Mr. Daniel J. Altobello, is also a director of Friedman, Billings, Ramsey Group, Inc., the parent company of Friedman, Billings, Ramsey & Co., Inc.

NOTICES TO INVESTORS

No Public Offering Outside the United States

No action has been or will be taken in any jurisdiction (except in the United States) that would permit a public offering of the common stock, or the possession, circulation or distribution of this prospectus supplement, the accompanying prospectus or any other material relating to the company or the common stock in any jurisdiction where action for that purpose is required. Accordingly, the common stock may not be offered or sold, directly or indirectly, and neither this prospectus supplement, the accompanying prospectus nor any other offering material or advertisements in connection with the common stock may be distributed or published, in or from any country or jurisdiction except in compliance with any applicable rules and regulations of any such country or jurisdiction. This prospectus supplement and the accompanying prospectus do not constitute an offer to sell or a solicitation of an offer to buy in any jurisdiction where such offer or solicitation would be unlawful. Persons into whose possession this prospectus supplement and the accompanying prospectus come are advised to inform themselves about and to observe any restrictions relating to this offering, the distribution of this prospectus supplement and the accompanying prospectus and resale of the common stock.

European Economic Area

In relation to each Member State of the European Economic Area (EEA) which has implemented the Prospectus Directive (each, a Relevant Member State), with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the Relevant Implementation Date) our common stock may be offered to the public in that Relevant Member State at any time under the following exemptions under the Prospectus Directive, if they have been implemented in that Relevant Member State:

(a) to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities;

(b) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than 43,000,000 and (3) an annual net turnover of more than 50,000,000, as shown in its last annual or consolidated accounts; or

(c) by the underwriters to fewer than 100 natural or legal persons (other than qualified investors as defined in the Prospectus Directive); or

(d) in any other circumstances falling within Article 3(2) of the Prospectus Directive;

provided that no such offer of common stock shall result in a requirement for the publication by the Company or the underwriters of a prospectus pursuant to Article 3 of the Prospectus Directive.

Each purchaser of securities described in this prospectus supplement and the accompanying prospectus located within a Relevant Member State will be deemed to have represented, acknowledged and agreed that it is a qualified investor within the meaning of Article 2(1)(e) of the Prospectus Directive.

As used above, the expression offered to the public in relation to any of our common stock in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and our common stock to be offered so as to enable an investor to decide to purchase any of our common stock, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State, and the expression Prospectus Directive means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

The EEA selling restriction is in addition to any other selling restrictions set out herein.

United Kingdom

The underwriters have only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the Financial Services and Markets Act 2000 (the FSMA)) received by it in connection with the issue or sale of the common stock in circumstances in which Section 21(1) of the FSMA does not apply to the company. Additionally, the underwriters have complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the common stock in, from or otherwise involving the United Kingdom.

This prospectus supplement is only being distributed to and is directed only at (a) persons outside the United Kingdom or (b) persons in the United Kingdom who (i) have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 as amended (the Order) or (ii) are persons falling within Article 49(2)(a) to (d) of the Order or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA), in connection with the issue or sale of any common stock may otherwise lawfully be communicated or caused to be communicated (all such persons together being referred to as relevant persons). This prospectus supplement is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons.

This prospectus supplement and its contents are confidential and may not be distributed, published or reproduced (in whole or in part) or disclosed by recipients to any other persons in the United Kingdom.

LEGAL MATTERS

Certain legal matters will be passed upon for us by Goodwin Procter LLP and for the underwriters by Hunton & Williams LLP.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the SEC. Our SEC filing number is 001-32514. You may read and copy any document we file with the SEC at the SEC s public reference room at 100 F Street, N.E. Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the public reference room. The SEC also maintains a website that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC at *http://www.sec.gov*. You can inspect reports and other information we file at the offices of the NYSE, 20 Broad Street, New York, New York 10005. In addition, we maintain a website that contains information about us at *www.drhc.com*. The information found on, or otherwise accessible through, our website is not incorporated into, and does not form a part of, this prospectus supplement or any other report or documents we file with or furnish to the SEC.

We have filed with the SEC a registration statement on Form S-3 (File No. 333-135386), of which this prospectus supplement is a part, including exhibits, schedules and amendments filed with, or incorporated by reference in, this registration statement, under the Securities Act, with respect to the shares of our common stock registered hereby. This prospectus supplement does not contain all of the information set forth in the registration statement and exhibits and schedules to the registration statement. For further information with respect to our company and the shares of our common stock registered hereby, reference is made to the registration statement, including the exhibits to the registration statement. Statements contained in this prospectus supplement as to the contents of any contract or other document referred to

in, or incorporated by reference in, this prospectus supplement are not necessarily complete and, where that contract is an exhibit to the registration statement, each statement is qualified in all respects by the exhibit to which the reference relates. Copies of the registration statement, including the exhibits and schedules to the registration statement, may be examined at the SEC s public reference rooms at 100 F Street, N.E. Room 1580, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. Copies of all or a portion of the registration statement can be obtained from the public reference room of the SEC upon payment of prescribed fees. This registration statement is also available to you on the SEC s web site, *http://www.sec.gov*.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The SEC allows us to incorporate by reference in this prospectus supplement certain information we file with the SEC, which means that we may disclose important information in this prospectus supplement by referring you to the document that contains the information. The information incorporated by reference is considered to be a part of this prospectus supplement, and the information we file later with the SEC will automatically update and supersede this information. We incorporate by reference the documents listed below that we filed with the SEC:

- our Annual Report on Form 10-K for the year ended December 31, 2005;
- our Definitive Proxy Statement on Schedule 14A dated March 24, 2006;
- our Quarterly Reports on Form 10-Q for the quarter ended March 24, 2006, filed on June 5, 2006, for the quarter ended June 16, 2006, filed on July 31, 2006, and for the quarter ended September 8, 2006, filed on October 23, 2006;
- our Current Reports on Form 8-K or Form 8-K/A filed on January 30, 2006, February 8, 2006, March 7, 2006, March 30, 2006, April 27, 2006, May 3, 2006 (solely with respect to Item 2.01), June 23, 2006, June 28, 2006, August 14, 2006, September 26, 2006, November 9, 2006, November 21, 2006 (two filed), December 13, 2006, December 21, 2006 and January 10, 2007;
- the description of our common stock, par value $0.01 per share, contained in our Registration Statement on Form 8-A filed on May 25, 2005 (file number 001-32514); and
- all documents filed by us with the SEC pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus and prior to the termination of the offering of the underlying securities.

You may request a copy of these documents, and any exhibits we have specifically incorporated by reference as an exhibit in this prospectus supplement, at no cost by writing us at the following address or calling us at the telephone number listed below:

DiamondRock Hospitality Company
6903 Rockledge Drive, Suite 800
Bethesda, MD 20817
Attention: Investor Relations
(240) 744-1150

Readers should rely on the information provided or incorporated by reference in this prospectus supplement. Readers should not assume that the information in this prospectus supplement is accurate as of any date other than the date on the front cover of the document.

PROSPECTUS

Common Stock, Preferred Stock, Depositary Shares and Warrants

Under this prospectus, we may offer, from time to time, in one or more series or classes, the following securities:

- shares of our common stock;
- shares of our preferred stock;
- depositary shares representing shares of our preferred stock; and
- warrants exercisable for our common stock, preferred stock or depositary shares representing preferred stock.

We refer to our common stock, preferred stock, depositary shares and warrants collectively as the securities.

We may offer the securities separately or together, in separate series or classes and in amounts, at prices and on terms described in one or more supplements to this prospectus. The applicable prospectus supplement also will contain information, where applicable, about U.S. federal income tax considerations relating to, and any listing on a securities exchange of, the securities covered by the prospectus supplement.

We may offer the securities directly to investors, through agents designated from time to time by them or us, or to or through underwriters or dealers. For more detailed information, see Plan of Distribution beginning on page 37. No securities may be sold without delivery of a prospectus supplement describing the method and terms of the offering of those securities.

Our common stock is listed on the New York Stock Exchange, or NYSE, under the symbol DRH.

You should read this entire prospectus, the documents that are incorporated by reference in this prospectus and any prospectus supplement carefully before you invest in any of these securities.

Investing in our securities involves risks. See Risk Factors beginning on page 2 for risks relating to an investment in our securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

This prospectus is dated June 28, 2006

TABLE OF CONTENTS

	Page
OUR COMPANY	1
RISK FACTORS	2
FORWARD LOOKING INFORMATION	2
USE OF PROCEEDS	4
RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS	4
DESCRIPTION OF CAPITAL STOCK	5
DESCRIPTION OF COMMON STOCK	6
DESCRIPTION OF PREFERRED STOCK	7
DESCRIPTION OF DEPOSITARY SHARES	9
DESCRIPTION OF WARRANTS	13
RESTRICTIONS ON OWNERSHIP AND TRANSFER	13
DESCRIPTION OF CERTAIN MATERIAL PROVISIONS OF MARYLAND LAW, OUR CHARTER AND OUR BYLAWS	18
DESCRIPTION OF THE PARTNERSHIP AGREEMENT OF DIAMONDROCK HOSPITALITY LIMITED PARTNERSHIP	21
FEDERAL INCOME TAX CONSIDERATIONS	25
PLAN OF DISTRIBUTION	36
LEGAL MATTERS	38
EXPERTS	38
WHERE YOU CAN FIND MORE INFORMATION	38
INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE	39

You should rely only on the information provided or incorporated by reference in this prospectus or any applicable prospectus supplement. We have not authorized anyone to provide you with different or additional information. We are not making an offer to sell these securities in any jurisdiction where the offer or sale of these securities is not permitted. You should not assume that the information appearing in this prospectus or any applicable prospectus supplement or the documents incorporated by reference herein or therein is accurate as of any date other than their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates.

References in this prospectus to we, our, us and our company refer to DiamondRock Hospitality Company, including, as the context requires, DiamondRock Hospitality Limited Partnership, our operating partnership, as well as our other direct and indirect subsidiaries, including our existing taxable REIT subsidiary, Bloodstone TRS, Inc.

OUR COMPANY

We are a self-advised real estate company. We are committed to maximizing shareholder value through investing in premium full-service hotels and, to a lesser extent, premium urban select-service hotels. We believe we have been organized and have operated in a manner that allows us to qualify for taxation as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended, or the Code, commencing with our taxable year ended December 31, 2005.

Our Structure

We were formed as a Maryland corporation in May 2004. We conduct our business through a traditional umbrella partnership REIT, or UPREIT, in which our hotel properties are owned by DiamondRock Hospitality Limited Partnership, our operating partnership, limited partnerships, limited liability companies or other subsidiaries of our operating partnership. We are the sole general partner of our operating partnership and currently own, either directly or indirectly, all of the limited partnership units of our operating partnership. In the future, we may issue limited partnership units to third parties from time to time in connection with acquisitions of hotel properties. In order for the income from our hotel property investments to constitute rents from real properties for purposes of the gross income tests required for REIT qualification, the income we earn cannot be derived from the operation of any of our hotels. Therefore, we lease each of our hotel properties to a wholly-owned subsidiary of Bloodstone TRS, Inc., our taxable REIT subsidiary, or TRS, except for the Frenchman s Reef & Morning Star Marriott Beach Resort, which is owned by a Virgin Islands corporation, which we have elected to be treated as a TRS. As a result, we do not utilize a lease structure for that hotel. We refer to these subsidiaries of Bloodstone TRS, Inc. as our TRS lessees. We may form additional TRSs and TRS lessees in the future.

Our Principal Office

Our corporate headquarters is located at 6903 Rockledge Drive, Suite 800, Bethesda, MD 20817. Our telephone number is (240) 744-1150. Our Internet address is http://www.drhc.com. The information found on or accessible through our website is not incorporated into and does not constitute a part of this prospectus or any other report or document we file with or furnish to the Securities and Exchange Commission, or SEC.

RISK FACTORS

Investment in any securities offered pursuant to this prospectus involves risks. You should carefully consider the risk factors incorporated by reference to our most recent Annual Report on Form 10-K and the other information contained in this prospectus, as updated by our subsequent filings under the Securities Exchange Act of 1934, as amended, and the risk factors and other information contained in the applicable prospectus supplement before acquiring any of such securities.

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the SEC, utilizing a shelf registration process. This prospectus provides you with a general description of the offered securities. Each time we sell any of the offered securities, we will provide a prospectus supplement and attach it to this prospectus. The prospectus supplement will contain specific information about the method and terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. You should read both this prospectus and the applicable prospectus supplement, together with any additional information described under the heading Where You Can Find More Information.

A WARNING ABOUT FORWARD LOOKING STATEMENTS

We make statements in this prospectus that are forward-looking statements within the meaning of the federal securities laws. In particular, statements pertaining to our capital resources, portfolio performance and results of operations contain forward-looking statements. Likewise, our pro forma financial statements and all of our statements regarding anticipated growth in our funds from operations and anticipated market conditions, demographics and results of operations are forward-looking statements. You can identify forward-looking statements by the use of forward-looking terminology such as believe, expect, may, will, should, seek, approximately, intend, plan, pro forma, estim the negative of these words and phrases or similar words or phrases which are predictions of or indicate future events or trends and which do not relate solely to historical matters. You can also identify forward-looking statements by discussions of strategy, plans, market statistics, or intentions.

Forward-looking statements involve numerous risks and uncertainties and you should not rely on them as predictions of future events. Forward-looking statements depend on assumptions, data or methods which may be incorrect or imprecise and we may not be able to realize them. We do not guarantee that the transactions and events described will happen as described (or that they will happen at all). The following factors, among others, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements:

- difficulties in completing acquisitions;
- our failure to obtain necessary outside financing;
- adverse economic or real estate developments in our markets;
- general economic conditions;
- the degree and nature of our competition;
- increased interest rates and operating costs;
- difficulties in identifying properties to acquire;
- availability of and our ability to retain qualified personnel;
- our failure maintain our status as a REIT;
- changes in our business or investment strategy;

- availability, terms and deployment of capital;
- general volatility of the capital markets and the market price of our common stock;
- environmental uncertainties and risks related to natural disasters;
- changes in real estate and zoning laws and increases in real property tax rates; and
- the other risk factors identified in our Annual Report on Form 10-K, as well as in our other reports filed from time to time with the SEC.

While forward-looking statements reflect our good faith beliefs, they are not guarantees of future performance. You should carefully consider this risk when you make an investment decision concerning our common stock. We disclaim any obligation to publicly update or revise any forward-looking statement to reflect changes in underlying assumptions or factors, of new information, data or methods, future events or other changes. For a further discussion of these and other factors that could impact our future results, performance or transactions, see the section above entitled Risk Factors.

USE OF PROCEEDS

Unless otherwise described in the applicable prospectus supplement to this prospectus used to offer specific securities, we intend to use the net proceeds from the sale of securities under this prospectus for general corporate purposes, which may include acquisitions of additional properties as suitable opportunities arise, the repayment of outstanding indebtedness, capital expenditures, the expansion, redevelopment and/or improvement of properties in our portfolio, working capital and other general purposes. Pending application of cash proceeds, we may use the net proceeds to temporarily reduce borrowings under our revolving credit facility or we will invest the net proceeds in interest-bearing accounts and short-term, interest-bearing securities which are consistent with our intention to qualify as a REIT for federal income tax purposes. Further details regarding the use of the net proceeds of a specific series or class of the securities will be set forth in the applicable prospectus supplement.

RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS

The following table sets forth the ratio of earnings to combined fixed charges and preferred dividends for the periods indicated below.

	Year Ended December 31, 2005	**Period From May 6, 2004 (Inception) to December 31, 2004**	**Period From January 1, 2006 to March 24, 2006**
Income (Loss) Before Income Taxes	$ (8,689,201)	$ (3,699,738)	$ 4,336,100
Fixed Charges	19,883,760	860,215	6,595,442
Amortization of Capitalized Interest	6,591		8,309
Capitalized Interest	(127,652)		(87,902)
Earnings	$ 11,073,498	$ (2,839,523)	$ 10,851,949
Interest Expense	$ 17,367,079	$ 773,101	$ 5,807,705
Portion of Rent Related to Interest	2,389,029	87,114	699,835
Capitalized Interest	127,652	-	87,902
Fixed Charges	19,883,760	860,215	6,595,442
Preferred Stock Dividends			
Combined Fixed Charges and Preferred Stock Dividends	$ 19,883,760	$ 860,215	$ 6,595,442
Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends			**1.6x**
Deficiency	**$ 8,810,262**	**$ 3,699,738**	**$**

The ratio of earnings to combined fixed charges and preferred dividends was computed by dividing earnings by combined fixed charges and preferred dividends. For purposes of computing the ratio of earnings to combined fixed charges and preferred dividends, earnings have been calculated by adding fixed charges to income (loss) before income taxes, plus amortization of capitalized interest, minus interest capitalized. Fixed charges consist of interest costs, whether expensed or capitalized, and amortization of financing costs. Combined fixed charges and preferred dividends consist of fixed charges and preferred dividends paid or accrued for each respective period.

DESCRIPTION OF CAPITAL STOCK

The following summary of the terms of our capital stock does not purport to be complete and is subject to and qualified in its entirety by reference to Maryland law and our charter and bylaws, copies of which have been previously filed with the SEC. See Where You Can Find More Information.

General

Our charter provides that we may issue up to 100,000,000 shares of common stock, $.01 par value per share, and 10,000,000 shares of preferred stock, $.01 par value per share. A majority of our board of directors may, without any action by the stockholders, amend our charter from time to time to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class or series that we have authority to issue. Under Maryland law, stockholders generally are not liable for the corporation s debts or obligations.

Power to Issue Additional Shares of Common Stock and Preferred Stock

We believe that the power of our board of directors to issue additional authorized but unissued shares of common stock or preferred stock and to classify or reclassify unissued shares of common stock or preferred stock and thereafter to cause us to issue such classified or reclassified shares of stock will provide us with increased flexibility in structuring possible future financings and acquisitions and in meeting other needs of our company that might arise. The additional classes or series, as well as the common stock, will be available for issuance without further action by our stockholders, unless such action is required by applicable law or the rules of any stock exchange or automated quotation system on which our securities may be listed or traded. Although our board of directors has no intention at the present time of doing so, it could authorize us to issue a class or series that could have the effect of delaying, deferring or preventing a transaction or a change in control of our company that might involve a premium price for holders of our common stock or otherwise be in their best interests.

Restrictions on Ownership of Our Capital Stock

See Restrictions on Ownership and Transfer.

DESCRIPTION OF COMMON STOCK

The shares of our common stock currently outstanding are listed for trading on the NYSE. We intend to apply to the NYSE to list the additional shares of common stock to be sold pursuant to any prospectus supplement, and we anticipate that such shares will be so listed.

The following description of our common stock sets forth certain general terms and provisions of our common stock to which any prospectus supplement may relate, including a prospectus supplement providing that common stock will be issuable upon conversion or exchange of our preferred stock or upon the exercise of warrants to purchase our common stock. The statements below describing our common stock are in all respects subject to and qualified in their entirety by reference to the applicable provisions of our charter and bylaws and the Maryland General Corporate Law, or MGCL.

Subject to the preferential rights of any other class or series of stock and to the provisions of our charter regarding the restrictions on transfer of stock, holders of shares of our common stock are entitled to receive dividends on such stock if, as and when authorized by our board of directors and declared by us out of assets legally available therefor and to share ratably in the assets of our company legally available for distribution to our stockholders in the event of our liquidation, dissolution or winding up after payment of or adequate provision for all of our known debts and liabilities.

Subject to the provisions of our charter regarding the restrictions on transfer of stock, each outstanding share of our common stock entitles the holder to one vote on all matters submitted to a vote of stockholders, including the election of directors and, except as provided with respect to any other class or series of stock, the holders of such shares will possess the exclusive voting power. There is no cumulative voting in the election of directors, which means that the holders of a majority of the outstanding shares of our common stock can elect all of the directors then standing for election and the holders of the remaining shares will not be able to elect any directors.

Holders of shares of our common stock have no preference, conversion, exchange, sinking fund or redemption rights and have no preemptive rights to subscribe for any of our securities. Subject to the provisions of our charter regarding the restrictions on transfer of stock, shares of our common stock will have equal dividend, liquidation and other rights. Holders of shares of our common stock listed on a national securities exchange or the NASDAQ National Market will not have appraisal rights.

Our charter authorizes our board of directors to reclassify any unissued shares of common stock into other classes or series of classes of stock and to establish the number of shares in each class or series and to set the preferences, conversion and other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications or terms or conditions of redemption for each such class or series.

Transfer Agent and Registrar

The transfer agent and registrar of our common stock is American Stock Transfer & Trust Company.

DESCRIPTION OF PREFERRED STOCK

The following description sets forth certain general terms and provisions of the preferred stock to which any prospectus supplement may relate. This description and the description contained in any prospectus supplement are not complete and are in all respects subject to and qualified in their entirety by reference to our charter, the applicable articles supplementary that describes the terms of the related class or series of preferred stock, and our bylaws, each of which we will make available upon request. See Where You Can Find More Information.

Our charter authorizes our board of directors to classify any unissued shares of preferred stock and to reclassify any previously classified but unissued shares of any series, as authorized by our board of directors. Prior to issuance of shares of each series, our board of directors is required by the MGCL and our charter to set, subject to the provisions of our charter regarding the restrictions on transfer of stock, the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each such series. Thus, our board of directors could authorize the issuance of shares of preferred stock with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control of our company that might involve a premium price for holders of our common stock or otherwise be in their best interests.

The prospectus supplement relating to the class or series of preferred stock being offered thereby will describe the specific terms of such securities, including:

- the title and stated value of such preferred stock;
- the number of shares of such preferred stock offered, the liquidation preference per share and the offering price of such preferred stock;
- the dividend rate(s), period(s) and/or payment date(s) or method(s) of calculation thereof applicable to such preferred stock;
- whether dividends shall be cumulative or non-cumulative and, if cumulative, the date from which dividends on such preferred stock shall accumulate;
- the provisions for a sinking fund, if any, for such preferred stock;
- the provisions for redemption, if applicable, of such preferred stock;
- any listing of such preferred stock on any securities exchange;
- preemptive rights, if any;
- the terms and conditions, if applicable, upon which such preferred stock will be convertible into our common stock, including the conversion price (or manner of calculation thereof) and conversion period;
- any voting rights of such preferred stock;
- a discussion of any material United States federal income tax considerations applicable to such preferred stock;
- the relative ranking and preferences of such preferred stock as to dividend rights and rights upon our liquidation, dissolution or winding up;
- any limitations on issuance of any class or series of preferred stock ranking senior to or on a parity with such class or series of preferred stock as to dividend rights and rights upon our liquidation, dissolution or winding up;

- in addition to those limitations described below, any other limitations on actual and constructive ownership and restrictions on transfer, in each case as may be appropriate to preserve our status as a REIT; and

- any other specific terms, preferences, rights, limitations or restrictions of such preferred stock.

Rank

Unless otherwise specified in the prospectus supplement relating to a particular class or series of preferred stock, the preferred stock will, with respect to dividend rights and rights upon our liquidation, dissolution or winding up, rank:

- senior to all classes or series of our common stock, and to all equity securities ranking junior to such preferred stock;

- on a parity with all equity securities issued by us the terms of which specifically provide that such equity securities rank on a parity with the preferred stock; and

- junior to all equity securities issued by us the terms of which specifically provide that such equity securities rank senior to the preferred stock.

Voting Rights

Holders of our preferred stock generally will not have any voting rights, except as otherwise required by law from time to time or as indicated in the applicable prospectus supplement.

Conversion Rights

The terms and conditions, if any, upon which shares of any class or series of preferred stock are convertible into our common stock will be set forth in the applicable prospectus supplement relating thereto. Such terms will include the number of shares of common stock into which the preferred stock is convertible, the conversion price (or manner of calculation thereof), the conversion period, provisions as to whether conversion will be at the option of the holders of the preferred stock or at our option, the events requiring an adjustment of the conversion price and provisions affecting conversion in the event of the redemption of such preferred stock.

Restrictions on Ownership and Transfer

To assist us in complying with certain federal income tax requirements applicable to REITs, we have adopted certain restrictions relating to the ownership and transfer of our capital stock. We expect to adopt similar restrictions with respect to any class or series offered pursuant to this prospectus under the articles supplementary for each such class or series. The applicable prospectus supplement will specify any additional ownership limitation relating to such class or series. See Restrictions on Ownership and Transfer.

Transfer Agent

The registrar and transfer agent for a particular series of preferred stock will be set forth in the applicable prospectus supplement.

DESCRIPTION OF DEPOSITARY SHARES

General

We may, at our option, elect to offer depositary shares rather than full shares of preferred stock. Each depositary share will represent a fractional interest of a share of a particular series of preferred stock, as specified in the applicable prospectus supplement. Shares of preferred stock of each series represented by depositary shares will be deposited under a separate deposit agreement (each, a deposit agreement) among us, the depositary named therein and the holders from time to time of the depositary receipts. Subject to the terms of the applicable deposit agreement, each owner of a depositary receipt will be entitled, in proportion to the fractional interest of a share of a particular series of preferred stock represented by the depositary shares evidenced by such depositary receipt, to all the rights and preferences of the preferred stock represented by such depositary shares (including dividend, voting, conversion, redemption and liquidation rights).

The depositary shares will be evidenced by depositary receipts issued pursuant to the applicable deposit agreement. Immediately following the issuance and delivery of the preferred stock by us to a preferred stock depositary, we will cause such preferred stock depositary to issue, on our behalf, the depositary receipts. Copies of the applicable form of deposit agreement and depositary receipt may be obtained from us upon request, and the statements made hereunder relating to the deposit agreement and the depositary receipts to be issued thereunder are summaries of certain anticipated provisions thereof and do not purport to be complete and are subject to, and qualified in their entirety by reference to, all of the provisions of the applicable deposit agreement and related depositary receipts.

Unless otherwise indicated in the applicable prospectus supplement, we expect that the following provisions will apply to depositary shares.

Dividends and Other Distributions

The preferred stock depositary will distribute all cash dividends or other cash distributions received in respect of the preferred stock to the record holders of depositary receipts evidencing the related depositary shares in proportion to the number of such depositary receipts owned by such holders, subject to certain obligations of holders to file proofs, certificates and other information and to pay certain charges and expenses to the preferred stock depositary.

In the event of a distribution other than in cash, the preferred stock depositary will distribute property received by it to the record holders of depositary receipts entitled thereto, subject to certain obligations of holders to file proofs, certificates and other information and to pay certain charges and expenses to the preferred stock depositary, unless the preferred stock depositary determines that it is not feasible to make such distribution, in which case the preferred stock depositary may, with our approval, sell such property and distribute the net proceeds from such sale to such holders.

No distribution will be made in respect of any depositary share to the extent that it represents any preferred stock which has been converted into or exchanged for other securities before the record date for such distribution.

Withdrawal of Stock

Upon surrender of the depositary receipts at the corporate trust office of the applicable preferred stock depositary (unless the related depositary shares have previously been called for redemption or converted into other securities), the holders thereof will be entitled to delivery at such office, to or upon such holder s order, of the number of whole or fractional shares of the preferred stock and any money or other property represented by the depositary shares evidenced by such depositary receipts. Holders of

depositary receipts will be entitled to receive whole or fractional shares of the related preferred stock on the basis of the proportion of preferred stock represented by each depositary share as specified in the applicable prospectus supplement, but holders of such shares of preferred stock will not thereafter be entitled to receive depositary shares therefor. If the depositary receipts delivered by the holder evidence a number of depositary shares in excess of the number of depositary shares representing the number of shares of preferred stock to be withdrawn, the preferred stock depositary will deliver to such holder at the same time a new depositary receipt evidencing such excess number of depositary shares.

Redemption

Whenever we redeem shares of preferred stock held by the preferred stock depositary, the preferred stock depositary will redeem as of the same redemption date the number of depositary shares representing shares of the preferred stock so redeemed, provided we shall have paid in full to the preferred stock depositary the redemption price of the preferred stock to be redeemed plus an amount equal to any accrued and unpaid dividends thereon to the date fixed for redemption. The redemption price per depositary share will be equal to the corresponding proportion of the redemption price and any other amounts per share payable with respect to the preferred stock. If fewer than all the depositary shares are to be redeemed, the depositary shares to be redeemed will be selected pro rata (as nearly as may be practicable without creating fractional depositary shares) or by any other equitable method determined by us that will not result in a violation of the ownership restrictions in our charter applicable to owners of our capital stock. See Restrictions on Ownership and Transfer.

From and after the date fixed for redemption, all dividends in respect of the shares of preferred stock so called for redemption will cease to accrue, the depositary shares so called for redemption will no longer be deemed to be outstanding and all rights of the holders of the depositary receipts evidencing the depositary shares so called for redemption will cease, except the right to receive any moneys payable upon such redemption and any money or other property to which the holders of such depositary receipts were entitled upon such redemption and surrender thereof to the preferred stock depositary.

Liquidation Preference

In the event of our liquidation, dissolution or winding up, whether voluntary or involuntary, the holders of each depositary receipt will be entitled to the fraction of the liquidation preference accorded each share of preferred stock represented by the depositary shares evidenced by such depositary receipt, as set forth in the applicable prospectus supplement.

Voting Rights

Upon receipt of notice of any meeting at which the holders of the applicable preferred stock are entitled to vote, the preferred stock depositary will mail the information contained in such notice of meeting to the record holders of the depositary receipts evidencing the depositary shares which represent such preferred stock. Each record holder of depositary receipts evidencing depositary shares on the record date (which will be the same date as the record date for the preferred stock) will be entitled to instruct the preferred stock depositary as to the exercise of the voting rights pertaining to the amount of preferred stock represented by such holder s depositary shares. The preferred stock depositary will vote the amount of preferred stock represented by such depositary shares in accordance with such instructions, and we will agree to take all reasonable action which may be deemed necessary by the preferred stock depositary in order to enable the preferred stock depositary to do so. The preferred stock depositary will abstain from voting the amount of preferred stock represented by such depositary shares to the extent it does not receive specific instructions from the holders of depositary receipts evidencing such depositary shares. The preferred stock depositary will not be responsible for any failure to carry out any instruction to vote, or for

the manner or effect of any such vote made, as long as any such action or non-action is in good faith and does not result from negligence or willful misconduct of the preferred stock depositary.

Conversion Rights

The depositary shares, as such, are not convertible into our common stock or any of our other securities or property. Nevertheless, if so specified in the applicable prospectus supplement relating to an offering of depositary shares, the depositary receipts may be surrendered by holders thereof to the preferred stock depositary with written instructions to the preferred stock depositary to instruct us to cause conversion of the preferred stock represented by the depositary shares evidenced by such depositary receipts into whole shares of common stock, other shares of our preferred stock or other shares of stock, and we have agreed that upon receipt of such instructions and any amounts payable in respect thereof, we will cause the conversion thereof utilizing the same procedures as those provided for delivery of preferred stock to effect such conversion. If the depositary shares evidenced by a depositary receipt are to be converted in part only, a new depositary receipt or receipts will be issued for any depositary shares not to be converted. No fractional shares of common stock will be issued upon conversion, and if such conversion would result in a fractional share being issued, an amount will be paid in cash by us equal to the value of the fractional interest based upon the closing price of the common stock on the last business day prior to the conversion.

Amendment and Termination of Deposit Agreement

The form of depositary receipt evidencing the depositary shares which represent the preferred stock and any provision of the deposit agreement may at any time be amended by agreement between us and the preferred stock depositary. However, any amendment that materially and adversely alters the rights of the holders of depositary receipts or that would be materially and adversely inconsistent with the rights granted to the holders of the related preferred stock will not be effective unless such amendment has been approved by the existing holders of at least two-thirds of the applicable depositary shares evidenced by the applicable depositary receipts then outstanding. No amendment shall impair the right, subject to certain exceptions in the Depositary Agreement, of any holder of depositary receipts to surrender any depositary receipt with instructions to deliver to the holder the related preferred stock and all money and other property, if any, represented thereby, except in order to comply with law. Every holder of an outstanding depositary receipt at the time any such amendment becomes effective shall be deemed, by continuing to hold such depositary receipt, to consent and agree to such amendment and to be bound by the deposit agreement as amended thereby.

The deposit agreement may be terminated by us upon not less than 30 days prior written notice to the preferred stock depositary if (i) such termination is necessary to preserve our status as a REIT or (ii) a majority of each series of preferred stock affected by such termination consents to such termination, whereupon the preferred stock depositary will deliver or make available to each holder of depositary receipts, upon surrender of the depositary receipts held by such holder, such number of whole or fractional shares of preferred stock as are represented by the depositary shares evidenced by such depositary receipts together with any other property held by the preferred stock depositary with respect to such depositary receipts. We have agreed that if the deposit agreement is terminated to preserve our status as a REIT, then we will use our best efforts to list the preferred stock issued upon surrender of the related depositary shares on a national securities exchange. In addition, the deposit agreement will automatically terminate if (i) all outstanding depositary shares thereunder shall have been redeemed, (ii) there shall have been a final distribution in respect of the related preferred stock in connection with our liquidation, dissolution or winding up and such distribution shall have been distributed to the holders of depositary receipts evidencing the depositary shares representing such preferred stock or (iii) each share of the related preferred stock shall have been converted into our securities not so represented by depositary shares.

Charges of Preferred Stock Depositary

We will pay all transfer and other taxes and governmental charges arising solely from the existence of the deposit agreement. In addition, we will pay the fees and expenses of the preferred stock depositary in connection with the performance of its duties under the deposit agreement. However, holders of depositary receipts will pay the fees and expenses of the preferred stock depositary for any duties requested by such holders to be performed which are outside of those expressly provided for in the deposit agreement.

Resignation and Removal of Depositary

The preferred stock depositary may resign at any time by delivering to us notice of its election to do so, and we may at any time remove the preferred stock depositary, any such resignation or removal to take effect upon the appointment of a successor preferred stock depositary. A successor preferred stock depositary must be appointed within 60 days after delivery of the notice of resignation or removal and must be a bank or trust company having its principal office in the United States and having a combined capital and surplus of at least $50,000,000.

Miscellaneous

The preferred stock depositary will forward to holders of depositary receipts any reports and communications that we send to the preferred stock depositary with respect to the related preferred stock.

Neither the preferred stock depositary nor our company will be liable if it is prevented from or delayed in, by law or any circumstances beyond its control, performing its obligations under the deposit agreement. The obligations of our company and the preferred stock depositary under the deposit agreement will be limited to performing their duties thereunder in good faith and without negligence (in the case of any action or inaction in the voting of preferred stock represented by the depositary shares), gross negligence or willful misconduct, and our company and the preferred stock depositary will not be obligated to prosecute or defend any legal proceeding in respect of any depositary receipts, depositary shares or shares of preferred stock represented thereby unless satisfactory indemnity is furnished. We and the preferred stock depositary may rely on written advice of counsel or accountants, or information provided by persons presenting shares of preferred stock represented thereby for deposit, holders of depositary receipts or other persons believed in good faith to be competent to give such information, and on documents believed in good faith to be genuine and signed by a proper party.

In the event the preferred stock depositary shall receive conflicting claims, requests or instructions from any holders of depositary receipts, on the one hand, and us, on the other hand, the preferred stock depositary shall be entitled to act on such claims, requests or instructions received from us.

DESCRIPTION OF WARRANTS

We may issue warrants for the purchase of our common stock, preferred stock or depositary shares representing preferred stock. We may issue warrants separately or together with any other securities offered by means of this prospectus, and the warrants may be attached to or separate from such securities. Each series of warrants will be issued under a separate warrant agreement (each, a warrant agreement) to be entered into between us and a warrant agent specified therein. The warrant agent will act solely as our agent in connection with the warrants of such series and will not assume any obligation or relationship of agency or trust for or with any holders or beneficial owners of warrants.

The applicable prospectus supplement will describe the following terms, where applicable, of the warrants in respect of which this prospectus is being delivered:

- the title and issuer of such warrants;
- the aggregate number of such warrants;
- the price or prices at which such warrants will be issued;
- the currencies in which the price or prices of such warrants may be payable;
- the designation, amount and terms of the securities purchasable upon exercise of such warrants;
- the designation and terms of the other securities with which such warrants are issued and the number of such warrants issued with each such security;
- if applicable, the date on and after which such warrants and the securities purchasable upon exercise of such warrants will be separately transferable;
- the price or prices at which and currency or currencies in which the securities purchasable upon exercise of such warrants may be purchased;
- the date on which the right to exercise such warrants shall commence and the date on which such right shall expire;
- the minimum or maximum amount of such warrants which may be exercised at any one time;
- information with respect to book-entry procedures, if any;
- any anti-dilution protections;
- a discussion of material federal income tax considerations; and
- any other material terms of such warrants, including terms, procedures and limitations relating to the exchange and exercise of such warrants.

RESTRICTIONS ON OWNERSHIP AND TRANSFER

The following summary with respect to restrictions on ownership and transfer of our capital stock sets forth certain general terms and provisions of our charter to which any prospectus supplement may relate. This summary does not purport to be complete and is subject to and qualified in its entirety by reference to our charter, including any articles supplementary relating to any issuance of preferred stock pursuant to this prospectus. A copy of our existing charter is filed with the SEC. Any amendment or supplement to our charter relating to an issuance of securities pursuant to this prospectus shall be filed with the SEC and shall be incorporated by reference as an exhibit to the applicable

prospectus supplement. See Where You Can Find More Information.

In order for us to qualify for and maintain our status as a REIT under the Code, our shares of stock must be beneficially owned by 100 or more persons during at least 335 days of a taxable year of twelve

13

months or during a proportionate part of a shorter taxable year. Also, not more than 50% of the value of the outstanding shares of stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities such as qualified pension plans) during the last half of a taxable year.

In order for us to qualify as a REIT under the Code, our charter, subject to certain exceptions, contains restrictions on the number of shares of our capital stock that a person may beneficially own. Our charter provides that, subject to some exceptions, no person may beneficially own, or be deemed to own by virtue of the attribution provisions of the Code, more than 9.8% of our common stock or of the value of the aggregate outstanding shares of our capital stock (the Ownership Limit), except that certain look through entities, such as mutual funds, may beneficially own up to 15% of our common stock or of the value of the aggregate outstanding shares of our capital stock (the Look-Through Ownership Limit). Our board of directors has waived this ownership limitation for Marriott Hotel Services, Inc. and certain institutional investors in the past. Our bylaws provide that, notwithstanding any other provision of our charter or the bylaws, our board of directors will exempt any person from the Ownership Limit and the Look-Through Ownership Limit, provided that:

- such person shall not beneficially own shares of capital stock that would cause an individual (within the meaning of Section 542(a)(2) of the Internal Revenue Code, but not including a qualified trust (as defined in Code Section 856(h)(3)(E)) subject to the look-through rule of Code Section 856(h)(3)(A)(i)) to beneficially own (i) shares of capital stock in excess of 9.8% in value of the aggregate of the outstanding shares of our capital stock or (ii) in excess of 9.8% (in value or in number of shares, whichever is more restrictive) of the aggregate of the outstanding shares of our common stock;

- the board of directors obtains such representations and undertakings from such person as are reasonably necessary to ascertain that such person s ownership of such shares of capital stock will not now or in the future jeopardize our ability to qualify as a REIT under the Code; and

- such person agrees that any violation or attempted violation of any of the foregoing restrictions or any such other restrictions that may be imposed by our board of directors will result in the automatic transfer of the shares of stock causing such violation to the Trust (as defined below).

Any amendment, alteration or repeal of this provision of our bylaws shall be valid only if approved by the affirmative vote of a majority of votes cast by stockholders entitled to vote generally in the election of directors.

Our charter also prohibits any person from (a) owning shares of our capital stock if such ownership would result in our being closely held within the meaning of Section 856(h) of the Code, (b) transferring shares of our capital stock if such transfer would result in our capital stock being owned by fewer than 100 persons, (c) owning shares of our capital stock if such ownership would cause any of our income that would otherwise qualify as rents from real property to fail to qualify as such, including as a result of any of our hotel management companies failing to qualify as eligible independent contractors under the REIT rules and (d) owning shares of our capital stock if such ownership would result in our failing to qualify as a REIT for federal income tax purposes. Any person who acquires or attempts or intends to acquire beneficial ownership of shares of our capital stock that will or may violate any of these restrictions on transferability and ownership will be required to give notice immediately to us and provide us with such other information as we may request in order to determine the effect of such transfer on our status as a REIT.

The board of directors may require a ruling from the Internal Revenue Service or an opinion of counsel, in either case in form and substance satisfactory to the board of directors in its sole discretion, in order to determine or ensure our status as a REIT. The foregoing restrictions on transferability and

ownership will not apply if our board of directors determines that it is no longer in the best interests of the company to attempt to qualify, or continue to qualify, as a REIT.

If any transfer of shares of our capital stock or other event occurs which, if effective, would result in any person beneficially or constructively owning shares of our capital stock in excess or in violation of the above transfer or ownership limitations (a Prohibited Owner), then that number of shares of our capital stock the beneficial or constructive ownership of which otherwise would cause such person to violate such limitations (rounded to the nearest whole share) shall be automatically transferred to a trust (the Trust) for the exclusive benefit of one or more charitable beneficiaries (the Charitable Beneficiary), and the Prohibited Owner shall not acquire any rights in such shares. Such automatic transfer shall be deemed to be effective as of the close of business on the Business Day (as defined in our charter) prior to the date of such violative transfer. Shares of stock held in the Trust shall be issued and outstanding shares of our capital stock. The Prohibited Owner shall not benefit economically from ownership of any shares of stock held in the Trust, shall have no rights to dividends and shall not possess any rights to vote or other rights attributable to the shares of stock held in the Trust. The trustee of the Trust (the Trustee) shall have all voting rights and rights to dividends or other distributions with respect to shares of stock held in the Trust, which rights shall be exercised for the exclusive benefit of the Charitable Beneficiary. Any dividend or other distribution paid prior to the discovery by us that shares of stock have been transferred to the Trustee shall be paid by the recipient of such dividend or distribution to the Trustee upon demand, and any dividend or other distribution authorized but unpaid shall be paid when due to the Trustee. Any dividend or distribution so paid to the Trustee shall be held in trust for the Charitable Beneficiary. The Prohibited Owner shall have no voting rights with respect to shares of stock held in the Trust and, subject to Maryland law, effective as of the date that such shares of stock have been transferred to the Trust, the Trustee shall have the authority (at the Trustee s sole discretion) (i) to rescind as void any vote cast by a Prohibited Owner prior to the discovery by us that such shares have been transferred to the Trust and (ii) to recast such vote in accordance with the desires of the Trustee acting for the benefit of the Charitable Beneficiary. However, if we have already taken irreversible corporate action, then the Trustee shall not have the authority to rescind and recast such vote.

Within 20 days of receiving notice from us that shares of our capital stock have been transferred to the Trust, the Trustee shall sell the shares of stock held in the Trust to a person, designated by the Trustee, whose ownership of the shares will not violate the ownership limitations set forth in our charter. Upon such sale, the interest of the Charitable Beneficiary in the shares sold shall terminate and the Trustee shall distribute the net proceeds of the sale to the Prohibited Owner and to the Charitable Beneficiary as follows. The Prohibited Owner shall receive the lesser of (i) the price paid by the Prohibited Owner for the shares or, if the Prohibited Owner did not give value for the shares in connection with the event causing the shares to be held in the Trust (e.g., a gift, devise or other such transaction), the Market Price (as defined in the charter) of such shares on the day of the event causing the shares to be held in the Trust and (ii) the price per share received by the Trustee from the sale or other disposition of the shares held in the Trust. Any net sale proceeds in excess of the amount payable to the Prohibited Owner shall be paid immediately to the Charitable Beneficiary. If, prior to the discovery by us that shares of stock have been transferred to the Trust, such shares are sold by a Prohibited Owner, then (i) such shares shall be deemed to have been sold on behalf of the Trust and (ii) to the extent that the Prohibited Owner received an amount for such shares that exceeds the amount that such Prohibited Owner was entitled to receive pursuant to the aforementioned requirement, such excess shall be paid to the Trustee upon demand.

In addition, shares of our capital stock held in the Trust shall be deemed to have been offered for sale to us, or our designee, at a price per share equal to the lesser of (i) the price per share in the transaction that resulted in such transfer to the Trust (or, in the case of a devise or gift, the Market Price at the time of such devise or gift) and (ii) the Market Price on the date we, or our designee, accept such offer. We shall have the right to accept such offer until the Trustee has sold the shares of stock held in the Trust. Upon

such a sale to us, the interest of the Charitable Beneficiary in the shares sold shall terminate and the Trustee shall distribute the net proceeds of the sale to the Prohibited Owner.

In addition, until the completion of our initial public offering, at which time our common stock became publicly-offered securities for purposes of certain regulations promulgated under ERISA by the U.S. Department of Labor, or the Plan Assets Regulation, our charter limited equity participation by benefit plan investors to less than 25% in the aggregate so that such participation in any class of our equity securities by such benefit plan investors would not be deemed significant. For such purposes, the terms benefit plan investors and significant are determined by reference to the Plan Assets Regulation. We believe that, under the Plan Assets Regulation, our common stock should be considered publicly-offered securities after our initial public offering and therefore this 25% limitation is no longer applicable to our common stock. However, benefit plan investors are prohibited from owning any class of our capital stock that does not qualify as publicly-offered securities.

All certificates representing shares of common stock and preferred stock, if any, will bear a legend referring to the restrictions described above.

Each stockholder shall provide to us such information as we may request, in good faith, in order to determine our status as a REIT and to comply with the requirements of any taxing authority or governmental authority or to determine such compliance.

These ownership limits could delay, defer or prevent a transaction or a change in control of our company that might involve a premium price for the common stock or otherwise be in the best interests of our stockholders.

BOOK-ENTRY SECURITIES

We may issue the securities offered by means of this prospectus in whole or in part in book-entry form, meaning that beneficial owners of the securities will not receive certificates representing their ownership interests in the securities, except in the event the book-entry system for the securities is discontinued. If securities are issued in book entry form, they will be evidenced by one or more global securities that will be deposited with, or on behalf of, a depositary identified in the applicable prospectus supplement relating to the securities. The Depository Trust Company is expected to serve as depository. Unless and until it is exchanged in whole or in part for the individual securities represented thereby, a global security may not be transferred except as a whole by the depository for the global security to a nominee of such depository or by a nominee of such depository to such depository or another nominee of such depository or by the depository or any nominee of such depository to a successor depository or a nominee of such successor. Global securities may be issued in either registered or bearer form and in either temporary or permanent form. The specific terms of the depositary arrangement with respect to a class or series of securities that differ from the terms described here will be described in the applicable prospectus supplement.

Unless otherwise indicated in the applicable prospectus supplement, we anticipate that the following provisions will apply to depository arrangements.

Upon the issuance of a global security, the depository for the global security or its nominee will credit on its book-entry registration and transfer system the respective principal amounts of the individual securities represented by such global security to the accounts of persons that have accounts with such depository, who are called participants. Such accounts shall be designated by the underwriters, dealers or agents with respect to the securities or by us if the securities are offered and sold directly by us. Ownership of beneficial interests in a global security will be limited to the depository s participants or persons that may hold interests through such participants. Ownership of beneficial interests in the global security will be shown on, and the transfer of that ownership will be effected only through, records maintained by the

applicable depository or its nominee (with respect to beneficial interests of participants) and records of the participants (with respect to beneficial interests of persons who hold through participants). The laws of some states require that certain purchasers of securities take physical delivery of such securities in definitive form. Such limits and laws may impair the ability to own, pledge or transfer beneficial interest in a global security.

So long as the depository for a global security or its nominee is the registered owner of such global security, such depository or nominee, as the case may be, will be considered the sole owner or holder of the securities represented by such global security for all purposes under the applicable instrument defining the rights of a holder of the securities. Except as provided below or in the applicable prospectus supplement, owners of beneficial interest in a global security will not be entitled to have any of the individual securities of the series represented by such global security registered in their names, will not receive or be entitled to receive physical delivery of any such securities in definitive form and will not be considered the owners or holders thereof under the applicable instrument defining the rights of the holders of the securities.

Payments of amounts payable with respect to individual securities represented by a global security registered in the name of a depository or its nominee will be made to the depository or its nominee, as the case may be, as the registered owner of the global security representing such securities. None of us, our officers and directors or any trustee, paying agent or security registrar for an individual series of securities will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in the global security for such securities or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

We expect that the depository for a series of securities offered by means of this prospectus or its nominee, upon receipt of any payment of principal, premium, interest, dividend or other amount in respect of a permanent global security representing any of such securities, will immediately credit its participants accounts with payments in amounts proportionate to their respective beneficial interests in the principal amount of such global security for such securities as shown on the records of such depository or its nominee. We also expect that payments by participants to owners of beneficial interests in such global security held through such participants will be governed by standing instructions and customary practices, as is the case with securities held for the account of customers in bearer form or registered in street name. Such payments will be the responsibility of such participants.

If a depository for a series of securities is at any time unwilling, unable or ineligible to continue as depository and a successor depository is not appointed by us within 90 days, we will issue individual securities of such series in exchange for the global security representing such series of securities. In addition, we may, at any time and in our sole discretion, subject to any limitations described in the applicable prospectus supplement relating to such securities, determine not to have any securities of such series represented by one or more global securities and, in such event, will issue individual securities of such series in exchange for the global security or securities representing such series of securities.

DESCRIPTION OF CERTAIN MATERIAL PROVISIONS OF MARYLAND LAW, OUR CHARTER AND OUR BYLAWS

The following is a summary of certain provisions of our charter and bylaws and Maryland law, does not purport to be complete and is subject to and qualified in its entirety by reference to Maryland law and our charter and bylaws, copies of which have been previously filed with the SEC. See Where You Can Find More Information.

Number, Election and Removal of Directors

Our charter and bylaws provide that the number of directors may be set only by our board of directors, but may never be less than the minimum number required by the MGCL nor more than 15. Our bylaws provide that a plurality of all the votes cast at a meeting of stockholders duly called and at which a quorum is present shall be sufficient to elect a director.

We have elected to be subject to the provision of Subtitle 8 of Title 3 of the MGCL regarding the filling of vacancies on the board of directors. Accordingly, except as may be provided by the board of directors in setting the terms of any class or series of preferred stock, any and all vacancies on the board of directors may be filled only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum, and any director elected to fill a vacancy shall serve for the remainder of the full term of the directorship in which such vacancy occurred and until a successor is elected and qualified.

The charter provides that a director may be removed with or without cause by the affirmative vote of at least two-thirds of the votes entitled to be cast in the election of directors.

Charter Amendments and Extraordinary Corporate Actions

Under the MGCL, a Maryland corporation generally cannot dissolve, amend its charter, merge, sell all or substantially all of its assets, engage in a share exchange or engage in similar transactions outside the ordinary course of business unless approved by the affirmative vote of stockholders entitled to cast at least two-thirds of the votes entitled to be cast on the matter unless a lesser percentage (but not less than a majority of all of the votes entitled to be cast on the matter) is set forth in the corporation s charter. Our charter generally provides that, if such amendment or action is declared advisable by the board of directors and approved by at least 75% of the continuing directors (as defined in the charter), such amendment or action may be approved by stockholders entitled to cast at least a majority of the votes entitled to be cast on the matter. If such amendment or action is declared advisable by the board of directors, but does not receive the continuing director approval referred to above, such amendment or action must be approved by stockholders entitled to cast at least two-thirds of the votes entitled to be cast on the matter.

Amendment of Bylaws

Our charter and bylaws provide that, with the exception of provisions in our bylaws relating to the business combination and control share provisions of the MGCL and the waiver of the ownership limitations set forth in our charter, which provisions may not be amended without shareholder approval, our board of directors has the exclusive power to adopt, alter or repeal any provision of the bylaws and to make new bylaws.

Business Combinations

Under the MGCL, certain business combinations (including a merger, consolidation, share exchange or, in certain circumstances, an asset transfer or issuance or reclassification of equity securities) between a Maryland corporation and any person who beneficially owns ten percent or more of the voting power of the corporation s shares or an affiliate of the corporation who, at any time within the two-year

period prior to the date in question, was the beneficial owner of ten percent or more of the voting power of the then-outstanding voting stock of the corporation (an Interested Stockholder) or an affiliate of such an Interested Stockholder are prohibited for five years after the most recent date on which the Interested Stockholder becomes an Interested Stockholder. Thereafter, any such business combination must be recommended by the board of directors of such corporation and approved by the affirmative vote of at least (a) 80% of the votes entitled to be cast by holders of outstanding shares of voting stock of the corporation and (b) two-thirds of the votes entitled to be cast by holders of voting stock of the corporation other than shares held by the Interested Stockholder with whom (or with whose affiliate) the business combination is to be effected, unless, among other conditions, the corporation s common stockholders receive a minimum price (as defined in the MGCL) for their shares and the consideration is received in cash or in the same form as previously paid by the Interested Stockholder for its shares. These provisions of the MGCL do not apply, however, to business combinations that are approved or exempted by the board of directors of the corporation prior to the time that the Interested Stockholder becomes an Interested Stockholder. A person is not an Interested Stockholder under the statute if the board of directors approved in advance the transaction by which he otherwise would have become an Interested Stockholder. The board of directors may provide that its approval is subject to compliance with any terms and conditions determined by the board. Our board of directors has adopted a resolution opting out of the business combination provisions of the MGCL. This resolution provides that any alteration or repeal of the resolution by the board of directors shall be valid only if approved, at a meeting duly called, by the affirmative vote of a majority of votes cast by stockholders entitled to vote generally for directors and the affirmative vote of a majority of continuing directors. Our board of directors amended our bylaws to provide that any such alteration or repeal of the resolution, other than pursuant to such resolution, will be valid only if approved, at a meeting duly called, by the affirmative vote of a majority of votes cast by stockholders entitled to vote generally for directors and the affirmative vote of a majority of continuing directors. If this resolution is repealed, the statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

Control Share Acquisitions

The MGCL provides that control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast on the matter, excluding shares of stock owned by the acquiror, by officers or by directors who are employees of the corporation. Control Shares are voting shares of stock which, if aggregated with all other such shares of stock previously acquired by the acquiror or in respect of which the acquiror is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquiror to exercise voting power in electing directors within one of the following ranges of voting power: (i) one-tenth or more but less than one-third, (ii) one-third or more but less than a majority, or (iii) a majority or more of all voting power. Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained stockholder approval. A control share acquisition means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition, upon satisfaction of certain conditions (including an undertaking to pay expenses), may compel the board of directors of the corporation to call a special meeting of stockholders to be held within 50 days of demand to consider the voting rights of the shares. If no request for a meeting is made, the corporation may itself present the question at any stockholders meeting.

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as required by the statute, then, subject to certain conditions and limitations, the corporation may redeem any or all of the control shares (except those for which voting rights have previously been approved) for fair value determined, without regard to the absence of voting rights for the

control shares, as of the date of the last control share acquisition by the acquiror or of any meeting of stockholders at which the voting rights of such shares are considered and not approved. If voting rights for control shares are approved at a stockholders meeting and the acquiror becomes entitled to vote a majority of the shares entitled to vote, all other stockholders may exercise appraisal rights. The fair value of the shares as determined for purposes of such appraisal rights may not be less than the highest price per share paid by the acquiror in the control share acquisition.

The control share acquisition statute does not apply (a) to shares acquired in a merger, consolidation or share exchange if the corporation is a party to the transaction or (b) to acquisitions approved or exempted by the charter or bylaws of the corporation.

Our bylaws contain a provision exempting from the control share acquisition statute any and all acquisitions by any person of shares of our capital stock. Any amendment, alteration or repeal of this provision of our bylaws shall be valid only if approved, at a meeting duly called, by the affirmative vote of a majority of votes cast by stockholders entitled to vote generally for directors and the affirmative vote of a majority of continuing directors. There can be no assurance that such provision will not be amended or eliminated at any time in the future.

Unsolicited Takeovers

The unsolicited takeover provisions of the MGCL permit the board of directors, without stockholder approval and regardless of what is currently provided in the charter or bylaws, to implement takeover defenses, some of which we do not yet have. These provisions may have the effect of inhibiting a third party from making an acquisition proposal for us or of delaying, deferring or preventing a change in control of our company under the circumstances that otherwise could provide the holders of our common stock with the opportunity to realize a premium over the then current market price.

Advance Notice of Director Nominations and New Business

Our bylaws provide that (a) with respect to an annual meeting of stockholders, nominations of persons for election to the board of directors and the proposal of business to be considered by stockholders may be made only (i) pursuant to our notice of the meeting, (ii) by the board of directors or (iii) by a stockholder who is entitled to vote at the meeting and has complied with the advance notice procedures set forth in the bylaws and (b) with respect to special meetings of stockholders, only the business specified in our notice of meeting may be brought before the meeting of stockholders and nominations of persons for election to the board of directors may be made only (i) pursuant to our notice of the meeting, (ii) by the board of directors or (iii) provided that the board of directors has determined that directors shall be elected at such meeting, by a stockholder who is entitled to vote at the meeting and has complied with the advance notice provisions set forth in the bylaws.

Anti-takeover Effect of Certain Provisions of Maryland Law and of the Charter and Bylaws

If the applicable board resolution is repealed, the business combination provisions and, if the applicable provision in the bylaws is rescinded, the control share acquisition provisions of the MGCL, the provisions of the charter relating to removal of directors and the advance notice provisions of the bylaws, among others, could delay, defer or prevent a transaction or a change in control of our company that might involve a premium price for holders of our common stock or otherwise be in their best interests.

DESCRIPTION OF THE PARTNERSHIP AGREEMENT OF DIAMONDROCK HOSPITALITY LIMITED PARTNERSHIP

The following is a summary of the material terms of the agreement of limited partnership of our operating partnership, which we refer to as the Partnership Agreement. This summary does not purport to be complete and is subject to and qualified in its entirety by reference to the Partnership Agreement, a copy of which we have previously filed with the SEC. See Where You Can Find More Information. Because, and so long as, we own all of the partnership interests in our operating partnership, we will be able to amend the Partnership Agreement of our operating partnership and we may, from time to time, modify the agreement so that it varies from the description set forth herein.

Management of the Operating Partnership

DiamondRock Hospitality Limited Partnership is a Delaware limited partnership that was formed on May 26, 2004. As sole general partner of the operating partnership, we exercise exclusive and complete responsibility and discretion in our operating partnership s day-to-day management and control. We can cause our operating partnership to enter into certain major transactions including acquisitions, developments and dispositions of properties and refinancings of existing indebtedness. Currently, our wholly-owned subsidiary, DiamondRock Hospitality, LLC is the only limited partner of our operating partnership. Generally, limited partners may not transact business for, or participate in the management activities or decisions of, our operating partnership, except as provided in the Partnership Agreement and as required by applicable law. Certain restrictions under the Partnership Agreement restrict our ability to engage in a business combination as more fully described in Extraordinary Transactions below.

In the event of any conflict in the fiduciary duties owed by us to our stockholders and by us, as general partner of our operating partnership, to the limited partners, we may act in the best interests of our stockholders without violating our fiduciary duties to the limited partners or being liable for any resulting breach of our duties to the limited partners.

The Partnership Agreement provides that our operating partnership is empowered to do any and all acts and things for the furtherance and accomplishment of our business, including all activities pertaining to the acquisition and operation of our properties, provided that our operating partnership shall not take, and will refrain from taking, any action which, in our judgment could adversely affect our ability to qualify as a REIT.

Removal of the General Partners; Transfer of the General Partner s Interest

The Partnership Agreement provides that the limited partners may not remove us as general partner of the operating partnership. We may not transfer any of our interests as a general or limited partner in the operating partnership except (i) in connection with certain extraordinary transactions as described below; (ii) if the limited partners holding more than 50% of the units held by limited partners (other than limited partnership units held by us) consent to such transfer; or (iii) to certain of our affiliates.

Amendments of the Partnership Agreement

Amendments to the Partnership Agreement may only be proposed by us as general partner. Generally, the Partnership Agreement may be amended with our approval and the approval of the limited partners holding a majority of all outstanding limited partner units (including limited partner units held by us). Certain amendments that would, among other things, convert a limited partner s interest into a general partner s interest, modify the limited liability of a limited partner in a manner adverse to such limited partner, alter the rights of a partner to receive distributions or allocations, alter or modify the redemption right of a partner in a manner adverse to such partner, or cause the termination of the

partnership prior to the time set forth in the Partnership Agreement must be approved by each partner that would be adversely affected by such amendment.

Notwithstanding the foregoing, we will have the power, without the consent of the limited partners, to amend the Partnership Agreement as may be required to:

- add to our obligations or surrender any right or power granted to us or any of our affiliates for the benefit of the limited partners;

- reflect the admission, substitution, termination or withdrawal of partners in accordance with the Partnership Agreement;

- set forth and reflect in the Partnership Agreement the designations, rights, powers, duties and preferences of the holders of any additional partnership units issued pursuant to the Partnership Agreement;

- reflect a change that is of an inconsequential nature and does not adversely affect the limited partners in any material respect, or to cure any ambiguity, correct or supplement any provision in the Partnership Agreement not inconsistent with law or with other provisions, or make other changes with respect to matters arising under the Partnership Agreement that will not be inconsistent with law or with the provisions of the Partnership Agreement; or

- satisfy any requirements, conditions, or guidelines contained in any order, directive, opinion, ruling or regulation of a federal or state agency or contained in federal or state law.

Certain provisions affecting our rights and duties as general partner (e.g., restrictions relating to certain extraordinary transactions involving us or the operating partnership) may not be amended without the approval of a majority of the limited partnership units (excluding limited partnership units held by us).

Redemption Rights

Under the current partnership agreement, limited partners have the right, commencing on or after the first anniversary of the issuance of the units to the limited partners, to require our operating partnership to redeem all or a portion of their units for cash or, at our option, shares of common stock on a one-for-one basis, subject to adjustment in the event of stock splits, stock dividends, issuance of stock rights, specified extraordinary distributions and similar events. The cash redemption amount per unit is based on the market price of our common stock at the time of redemption. We presently anticipate that we would elect to issue shares of our common stock in exchange for units in connection with each redemption request, rather than having our operating partnership redeem the units for cash. With each redemption or exchange, we would increase our percentage ownership interest in our operating partnership. Limited partners who hold units may exercise this redemption right from time to time, in whole or in part, subject to certain limitations, unless delivery of shares of common stock to a limited partner pursuant to the redemption right would be prohibited by our charter or prohibited by federal or state securities laws or regulations. At this time, no limited partnership units have been issued (other than to us), and that we may issue limited partnership units with rights, preferences and privileges different from those described in this paragraph or in this registration statement of which this prospectus is a part.

Issuance of Additional Units, Common Stock or Convertible Securities

As sole general partner, we have the ability to cause our operating partnership to issue additional partnership units to the partners (including to us). These additional units may be issued in one or more classes, or one or more series of any of such classes, with such designations, preferences, rights, powers and duties as we may determine in our sole and absolute discretion. In addition, we may issue additional shares of our common stock or rights, options, warrants or convertible or exchangeable securities, but only if it

causes our operating partnership to issue, to us, partnership units or rights, options, warrants or convertible or exchangeable securities of the operating partnership having designations, preferences and other rights, so that the economic interests of the operating partnership s units issued are substantially similar to the securities that we have issued. Unless expressly granted by the operating partnership, no limited partner will have preemptive, preferential or similar rights with respect to additional capital contributions to the operating partnership or the issuance or sale of any partnership units.

Tax Matters

As the general partner, we are the tax matters partner of our operating partnership and, as such, have authority to make tax elections under the Code on behalf of our operating partnership.

Extraordinary Transactions

The Partnership Agreement provides that we may not generally engage in any merger, consolidation, or other combination with any other person or sale of all or substantially all of our assets, or any reclassification, recapitalization or change of outstanding shares of our common stock or adopt a plan of liquidation and dissolution (an extraordinary transaction) unless the holders of units will receive, or have the opportunity to receive, at least the same consideration per unit as holders of our common stock receive per share of common stock in the transaction. If holders of units will not be treated in this manner in connection with a proposed extraordinary transaction, we cannot engage in such a transaction unless limited partners (other than us) holding more than 50% of the units held by limited partners vote to approve the extraordinary transaction.

We may also engage in an extraordinary transaction without the consent or approval of the limited partners if we engage in a merger, or other combination of assets with another entity and:

- substantially all of the assets of the surviving entity are held directly or indirectly by the operating partnership or another limited partnership or limited liability company which is the surviving partnership of a merger, consolidation or combination of assets with the operating partnership;

- the rights, preferences and privileges of such unit holders in the surviving partnership are at least as favorable as those in effect immediately prior to the consummation of the transaction and as those applicable to any other limited partners or non-managing members of the surviving partnership; and

- the limited partners may exchange their units in the surviving partnership for either the same consideration per unit as holders of our common stock receive per share of common stock in the transaction, or if the ultimate controlling person of the surviving partnership has common equity securities, at an exchange ratio based on the relative fair market value of those securities and our common stock.

Term

The operating partnership will continue in full force and effect until 2104, or until sooner dissolved in accordance with the terms of the Partnership Agreement or as otherwise provided by law.

Exculpation and Indemnification of the General Partner

The Partnership Agreement generally provides that we will incur no liability to the operating partnership or any limited partner for losses sustained or liabilities incurred as a result of errors in judgment or mistakes of fact or law or of any act or omission unless we acted in bad faith and the act or omission was material to the matter giving rise to the loss or liability. In addition, we are not responsible for any misconduct or negligence on the part of our agents, provided we appointed our agents in good

faith. We may consult with legal counsel, accountants, appraisers, management consultants, investment bankers and other consultants and advisors, and any action we may take or omit to take in reliance upon the opinion of such persons, as to matters that we reasonably believe to be within such persons professional or expert competence, shall be conclusively presumed to have been done or omitted in good faith and in accordance with such opinion. The Partnership Agreement also provides for indemnification of us, our directors and officers, limited partners and such other persons as we may from time to time designate against any losses, claims, damages, judgments, penalties, fines, settlements and reasonable expenses actually incurred by such person in connection with the preceding unless it is established that:

- the act or omission of the indemnitee was material to the matter giving rise to the proceeding and either was committed in bad faith or was the result of active and deliberate dishonesty;
- the indemnitee actually received an improper personal benefit in money, property or services; or
- in the case of any criminal proceeding, the indemnitee had reasonable cause to believe that the act or omission was unlawful.

FEDERAL INCOME TAX CONSIDERATIONS RELATED TO OUR REIT ELECTION

The following summary outlines certain U.S. federal income tax considerations related to our REIT status which we anticipate to be material to purchasers of our securities. This summary does not attempt to address any aspects of federal income taxation that may be relevant to your ownership of our securities. Instead, the material federal income tax considerations relating to your acquisition, ownership and sale or other disposition of our securities will be provided in the applicable prospectus supplement that relates to those securities. Your tax treatment will vary depending upon the terms of the specific securities that you acquire, as well as your particular situation. Moreover, this summary does not address any foreign, state, or local tax consequences of our election to be taxed as a REIT. The provisions of the Code concerning the federal income tax treatment of a REIT are highly technical and complex; the following discussion sets forth only certain aspects of those provisions. This summary is intended to provide you with general information only and is not intended as a substitute for careful tax planning.

This summary is based on provisions of the Code, applicable final and temporary Treasury Regulations, judicial decisions, and administrative rulings and practice, all in effect as of the date of this prospectus, and should not be construed as legal advice. No assurance can be given that future legislative or administrative changes or judicial decisions will not affect the accuracy of the descriptions or conclusions contained in this summary. In addition, any such changes may be retroactive and apply to transactions entered into prior to the date of their enactment, promulgation or release. We do not expect to seek a ruling from the Internal Revenue Service, or IRS, regarding any of the federal income tax issues discussed in this prospectus, and no assurance can be given that the IRS will not challenge any of the positions we take and that such a challenge will not succeed. ***Prospective purchasers of our securities are urged to consult their own tax advisors prior to any investment in our securities concerning the potential federal, state, local, and foreign tax consequences of the investment with specific reference to their own tax situations. Prospective purchasers also are urged to refer to the applicable prospectus supplement for any amendments or changes to this summary.***

Except as otherwise noted, references in this discussion of Federal Income Tax Considerations to we, our, us and our company refer to DiamondRock Hospitality Company and not our taxable REIT subsidiaries.

Taxation of Our Company

We will elect to be taxed as a REIT starting with the calendar year ended December 31, 2005 and for subsequent taxable years. We decided to be taxed as a C corporation for 2004 and defer the REIT election until 2005 because, during 2004, we received a $2.5 million non-recoverable key money payment from Marriott in connection with our acquisition of the Courtyard Midtown East that, if recognized as income to DiamondRock Hospitality Company for tax purposes, would have prevented us from qualifying as a REIT for 2004. Based on the unique circumstances of that transaction with Marriott, it is not entirely clear whether the receipt of the key money should have been recognized as income to DiamondRock Hospitality Company for tax purposes. We paid approximately $900,000 of taxes as a C corporation in 2004. Assuming that we could have qualified as a REIT for 2004 and that the key money was received by our TRS, and not DiamondRock Hospitality Company, we estimate that our tax liability for 2004 would have been approximately $1 million as a REIT. In 2005, we began structuring our key money transactions to clarify that our TRS, and not DiamondRock Hospitality Company, will receive all future key money payments. Beginning January 1, 2005, we believe we have qualified as a REIT, and except as otherwise noted, the following discussion assumes that we qualify as a REIT effective January 1, 2005.

In connection with this filing, we will receive an opinion of Goodwin Procter LLP that, commencing with our taxable year ended December 31, 2005, we have been organized and operated in conformity with the requirements for qualification and taxation as a REIT under the Code and our current and proposed

ownership and operations will allow us to satisfy the requirements for qualification and taxation as a REIT under the Code for our taxable year ending December 31, 2005 and for subsequent taxable years. The opinion of Goodwin Procter LLP will be based on various assumptions and on our representations to them concerning our current and continuing organization, our prior, current and proposed ownership and operations, and our shareholders current and future relationships with our hotel management companies, and other matters relating to our ability to qualify as a REIT. The opinion will be expressly conditioned upon the accuracy of such assumptions and representations, which Goodwin Procter LLP will not verify. Moreover, our qualification and taxation as a REIT will depend upon our ability to meet, through actual annual operating results, distribution levels, diversity of stock ownership and the absence of prohibited relationships with our hotel management companies, the various and complex REIT qualification tests imposed under the Code, the results of which will not be reviewed or verified by Goodwin Procter LLP. See Qualification as a REIT below. Accordingly, no assurance can be given that we will in fact satisfy such requirements. The opinion of Goodwin Procter LLP will be based upon current law, which is subject to change either prospectively or retroactively. Changes in applicable law could modify the conclusions expressed in the opinion. Moreover, unlike a ruling from the IRS, an opinion of Goodwin Procter LLP is not binding on the IRS, and no assurance can be given that the IRS could not successfully challenge our status as a REIT.

If we qualify as a REIT, we generally will be allowed to deduct dividends paid to our stockholders, and, as a result, we generally will not be subject to federal income tax on that portion of our ordinary income or net capital gain that we currently distribute to our stockholders. We expect to make distributions to our stockholders on a regular basis as necessary to avoid material federal income tax and to comply with the REIT requirements. See Qualification as a REIT Annual Distribution Requirements below.

Notwithstanding the foregoing, even if we qualify for taxation as a REIT, we nonetheless may be subject to federal income tax in certain circumstances, including the following:

- We will be required to pay federal income tax on our undistributed taxable income, including net capital gain;

- We may be subject to the alternative minimum tax;

- We may be subject to tax at the highest corporate rate on certain income from foreclosure property (generally, property acquired by reason of default on a lease or indebtedness held by us);

- We will be subject to a 100% federal income tax on net income from prohibited transactions (generally, certain sales or other dispositions of property, sometimes referred to as dealer property, held primarily for sale to customers in the ordinary course of business);

- If we fail to satisfy the 75% gross income test or the 95% gross income test (discussed below), but nonetheless maintain our qualification as a REIT pursuant to certain relief provisions, we will be subject to a 100% federal income tax on the greater of (i) the amount by which we fail the 75% gross income test or (ii) the amount by which we fail the 95% gross income test, multiplied by a fraction intended to reflect our profitability;

- If we fail to satisfy any of the asset tests, other than the 5% or the 10% asset tests that qualify under the De Minimis Exception, and the failure qualifies under the General Exception, as described below under Qualification as a REIT Asset Tests, then we will have to pay an excise tax equal to the greater of (i) $50,000; and (ii) an amount determined by multiplying the net income generated during a specified period by the assets that caused the failure by the highest federal income tax applicable to corporations.

- If we fail to satisfy any REIT requirements other than the income test or asset test requirements, described below under Qualification as a REIT Income Tests and Qualification as a

26

REIT Asset Tests, respectively, and we qualify for a reasonable cause exception, then we will have to pay a penalty equal to $50,000 for each such failure.

- We will be subject to a 4% excise tax if certain distribution requirements are not satisfied;

- Because we were a C corporation for our taxable year ended December 31, 2004, we generally will be subject to a corporate-level tax on a taxable disposition of any appreciated asset we hold as of the effective date of our REIT election, which was January 1, 2005. Specifically, if we dispose of a built-in-gain asset in a taxable transaction prior to tenth anniversary of the effective date of our REIT election, we would be subject to tax at the highest regular corporate rate (currently 35%) on the lesser of the gain recognized and the asset s built-in-gain.

- If we dispose of an asset acquired by us from a C corporation in a transaction in which we took the C corporation s tax basis in the asset, we may be subject to tax at the highest regular corporate rate on the appreciation inherent in such asset as of the date of acquisition by us;

- We will be required to pay a 100% tax on any redetermined rents, redetermined deductions, and excess interest. In general, redetermined rents are rents from real property that are overstated as a result of services furnished to any of our non-TRS tenants by one of our TRSs. Redetermined deductions and excess interest generally represent amounts that are deducted by a TRS lessee or other TRS for amounts paid to us that are in excess of the amounts that would have been deducted based on arm s-length negotiations; and

- Income earned by our TRS lessees, Bloodstone TRS, Inc. and certain other TRSs will be subject to tax at regular corporate rates.

No assurance can be given that the amount of any such federal income taxes will not be substantial. We note that the assets we acquired during 2004 were acquired on or after October 27, 2004, and we do not believe the built-in gain in such assets as of January 1, 2005 was material. Accordingly, we do not expect to be subject to significant corporate tax liabilities if we decide to sell an asset we acquired in 2004 within the 10-year period following the effective date of our REIT election.

Qualification as a REIT

In General

The REIT provisions of the Code apply to a domestic corporation, trust, or association (i) that is managed by one or more trustees or directors, (ii) the beneficial ownership of which is evidenced by transferable shares or by transferable certificates of beneficial interest, (iii) that properly elects to be taxed as a REIT, (iv) that is neither a financial institution nor an insurance company, (v) that uses a calendar year for federal income tax purposes and complies with applicable recordkeeping requirements, and (vi) that meets the additional requirements discussed below.

Ownership Tests

Commencing with our second REIT taxable year, which is expected to be the calendar year beginning January 1, 2006, (i) the beneficial ownership of our common stock must be held by 100 or more persons during at least 335 days of a 12-month taxable year (or during a proportionate part of the taxable year of less than 12 months) for each of our taxable years and (ii) during the last half of each taxable year, no more than 50% in value of our stock may be owned, directly or indirectly, by or for five or fewer individuals (the 5/50 Test). Stock ownership for purposes for the 5/50 Test is determined by applying the constructive ownership provisions of Section 544(a) of the Code, subject to certain modifications. The term individual for purposes of the 5/50 Test includes a private foundation, a trust providing for the payment of supplemental unemployment compensation benefits, and a portion of a trust permanently set aside or to

be used exclusively for charitable purposes. A qualified trust described in Section 401(a) of the Code and exempt from tax under Section 501(a) of the Code generally is not treated as an individual; rather, shares held by it are treated as owned proportionately by its beneficiaries. However, if (i) treating qualified trusts as individuals would cause us to fail the 5/50 Test and (ii) we are predominantly held by qualified trusts, we will be treated as a pension-held REIT. We will be predominantly held by qualified trusts if either (i) a single qualified trust holds more than 25% by value of our stock or (ii) one or more qualified trusts, each owning more than 10% by value of our stock, hold in the aggregate more than 50% by value of our stock. In the event we are a pension held REIT, a qualified trust owning 10% or more of our shares should expect to recognize UBTI as a result of its investment, and we cannot assure you that we will never be treated as a pension held REIT. Before making an investment in shares of our common stock, a tax-exempt stockholder should consult its own tax advisors with regard to UBTI and the suitability of the investment in our stock.

We believe we have issued sufficient common stock to satisfy the above ownership requirements. In addition, our charter restricts ownership and transfers of our stock that would violate these requirements, although these restrictions may not be effective in all circumstances to prevent a violation. We will be deemed to have satisfied the 5/50 Test for a particular taxable year if we have complied with all the requirements for ascertaining the ownership of our outstanding stock in that taxable year and have no reason to know that we have violated the 5/50 Test.

Income Tests

In order to maintain qualification as a REIT, we must annually satisfy two gross income requirements:

1) First, at least 75% of our gross income (excluding gross income from prohibited transactions) for each taxable year must be derived, directly or indirectly, from investments relating to real property or mortgages on real property or from certain types of temporary investments (or any combination thereof). Qualifying income for the purposes of this 75% gross income test generally includes: (a) rents from real property, (b) interest on debt secured by mortgages on real property or on interests in real property, (c) dividends or other distributions on, and gain from the sale of, shares in other REITs, (d) gain from the sale of real estate assets (other than gain from prohibited transactions), (e) income and gain derived from foreclosure property, and (f) income from certain types of temporary investments; and

2) Second, in general, at least 95% of our gross income (excluding gross income from prohibited transactions) for each taxable year must be derived from the real property investments described above and from other types of dividends and interest, gain from the sale or disposition of stock or securities that are not dealer property, or any combination of the above. Gross income from certain transactions entered into by us to hedge indebtedness we incur to acquire or carry real estate assets is not included in gross income for purposes of the 95% income test.

For purposes of the 75% and the 95% gross income tests, we are treated as receiving our proportionate share of our operating partnership s gross income.

If we fail to satisfy one or both of the 75% or the 95% gross income tests, we may nevertheless qualify as a REIT for such year if we are entitled to relief under certain provisions of the Code. Those relief provisions generally will be available if our failure to meet such tests is due to reasonable cause and not due to willful neglect and we file a schedule describing each item of our gross income for such year(s) in accordance with regulations to be prescribed by the Secretary of the Treasury. It is not possible, however, to state whether in all circumstances we would be entitled to the benefit of these relief provisions. As discussed above in Taxation of Our Company, even if these relief provisions were to apply, we would be subject to federal income tax with respect to our excess net income.

Hotels

Operating revenues from our hotels are not qualifying income for purposes of either the 75% or the 95% gross income test. Accordingly, in order for us to generate qualifying income with respect to our hotel investments under the REIT rules, we must master-lease our hotels. Specifically, our operating partnership has formed a subsidiary, Bloodstone TRS, Inc., that has elected to be treated as our TRS and may, in the future, form other subsidiaries that elect to be treated as our TRSs. Bloodstone TRS, Inc. has formed subsidiaries (each a TRS lessee) that master-lease hotels from the operating partnership (or subsidiaries of the operating partnership). We expect to form additional TRS lessees (under Bloodstone TRS, Inc. or other of our TRSs) as we acquire additional properties. In certain instances we may own a hotel through a TRS. For example, we have elected to treat DiamondRock Frenchman s Owner, Inc., through which we hold the Frenchman s Reef & Morning Star Marriott Beach Resort, as a TRS and we may hold other non-U.S. investments through TRSs. One or more hotel management companies will manage the hotels leased to each TRS lessee or owned by a TRS. We also may lease a hotel to an unrelated lessee.

In general, rent paid by a related party tenant, such as a TRS lessee, is not qualifying rents from real property for purposes of the REIT gross income tests, but rent paid by a TRS lessee to our operating partnership with respect to a lease of a qualified lodging facility from the operating partnership can be qualifying rents from real property under the REIT rules as long as such TRS lessee does not directly or indirectly operate or manage any hotel or provide rights to any brand name under which any hotel is operated. Instead, the hotel must be operated on behalf of the TRS lessee by a person who qualifies as an eligible independent contractor, defined as an independent contractor who is, or is related to a person who is, actively engaged in the trade or business of operating qualified lodging facilities for any person unrelated to us and the TRS lessee. See Investments in Taxable REIT Subsidiaries below for a further discussion of the issue and a discussion of the definition of an independent contractor and the qualification of Marriott (or another hotel management company) as an eligible independent contractor. A qualified lodging facility is a hotel, motel, or other establishment more than one-half of the dwelling units in which are used on a transient basis, provided that wagering activities are not conducted at or in connection with such facility by any person who is engaged in the business of accepting wagers and who is legally authorized to engage in such business at or in connection with such facility. A qualified lodging facility includes customary amenities and facilities operated as part of, or associated with, the lodging facility as long as such amenities and facilities are customary for other properties of a comparable size and class owned by other unrelated owners. We believe that our hotels are qualified lodging facilities. Rent paid by a TRS lessee that failed to qualify as rents from real property under the REIT rules would be non-qualifying income for purposes of the REIT gross income tests.

Two other limitations may affect our ability to treat rent paid by a TRS lessee or other lessee as qualifying rents from real property under the REIT rules. If the rent attributable to personal property leased by the TRS lessee (or other lessee) in connection with a lease of real property is greater than 15% of the total rent under the lease, then the portion of the rent attributable to such personal property will not qualify as rents from real property. Also, an amount received or accrued will not qualify as rents from real property for purposes of either the 75% or the 95% gross income test if it is based in whole or in part on the income or profits derived by any person from such property. However, an amount received or accrued will not be excluded from rents from real property solely by reason of being based on a fixed percentage or percentages of receipts or sales. To comply with the limitation on rents attributable to personal property, a TRS lessee may acquire furnishings, equipment, and/or personal property used in hotel, at least to the extent that they exceed this 15% limit. To comply with the prohibition on rent based on net income, the leases will provide that each TRS lessee is obligated to pay our operating partnership a minimum base rent together with a gross percentage rent, at rates intended to equal market rental rates.

In addition, rent paid by a TRS lessee or other lessee that leases a hotel from our operating partnership will constitute rents from real property for purposes of the REIT gross income tests only if the

lease is respected as a true lease for federal income tax purposes and is not treated as a service contract, joint venture, or some other type of arrangement. The determination of whether a lease is a true lease depends upon an analysis of all the surrounding facts and circumstances. Potential investors in shares of our common stock should be aware, however, that there are no controlling regulations, published administrative rulings, or judicial decisions involving leases with terms substantially similar to the contemplated leases between our operating partnership and the TRS lessees that discuss whether the leases constitute true leases for federal income tax purposes. We believe that the leases with our TRS lessees should be treated as true leases; however, there can be no assurance that the IRS will not assert a contrary position and that a court will not sustain such a challenge. If any leases between our operating partnership and a TRS lessee are re-characterized as service contracts or partnership agreements, rather than as true leases, part or all of the payment that we receive from such TRS lessee would not be considered rent or would otherwise fail the various requirements for qualification as rents from real property.

Finally, for rents received by or attributed to us to qualify as rents from real property, we generally must not furnish or render any services to tenants, other than through a TRS or an independent contractor from whom we derive no income, except that we and our operating partnership may directly provide services that are usually or customarily rendered in connection with the rental of properties for occupancy only, or are not otherwise considered rendered to the occupant for his convenience. Neither we nor our operating partnership provides, or intends to provide, any services to our TRS lessee or any other tenants.

We believe that, for purposes of both the 75% and the 95% gross income tests, our operating partnership s investments in hotels generally give rise to qualifying income in the form of rents from real property, and that gains on the sales of the hotels will also constitute qualifying income. However, no assurance can be given that either the rents or the gains will constitute qualifying income. In that case, we may not be able to satisfy either the 75% or the 95% gross income test and, as a result, could lose our REIT status. In the case of hotels owned, rather than leased, by a TRS, dividends from such TRS of its earnings and gains from such hotels would not be qualifying income for purposes of the 75% gross income test.

We hold the Frenchman s Reef & Morning Star Marriott Beach Resort through a Cayman Islands corporation that holds a U.S. Virgin Islands corporation that we have elected to be treated as our TRS. In the case of hotels owned, rather than leased, by a TRS, dividends paid by such TRS of its earnings and gains from the sale of stock of such a TRS would not be qualifying income for purposes of the 75% gross income test, although such dividends and gains would be qualifying income for purposes of the 95% gross income test.

Asset Tests

At the close of each quarter of our taxable year, we must also satisfy three tests relating to the nature of our assets. First, real estate assets, cash and cash items, and government securities must represent at least 75% of the value of our total assets. Second, of the investments that are not included in the 75% asset class and that are not securities of our TRS lessees or other TRSs, (i) the value of any one issuer s securities owned by us may not exceed 5% of the value of our total assets and (ii) we may not own more than 10% by vote or by value of any one issuer s outstanding securities. For purposes of the 10% value test, debt instruments issued by a partnership are not classified as securities to the extent of our interest as a partner in such partnership (based on our proportionate share of the partnership s equity interests and certain debt securities) or if at least 75% of the partnership s gross income, excluding income from prohibited transactions, is qualifying income for purposes of the 75% gross income test. For purposes of the 10% value test, the term securities also does not include debt securities issued by another REIT, certain straight debt securities (for example, qualifying debt securities of a corporation of which we own

no more than a de minimis amount of equity interest), loans to individuals or estates, and accrued obligations to pay rent. Third, securities of our TRS lessees or other TRSs cannot represent more than 20% of our total assets. Although we believe that we have met and intend to continue to meet these asset tests, no assurance can be given that we will be able to do so. For purposes of these asset tests, we are treated as holding our proportionate share of our operating partnership s assets.

We will monitor the status of our assets for purposes of the various asset tests and will endeavor to manage our portfolio in order to comply at all times with such tests. If we fail to satisfy the asset tests at the end of a calendar quarter, we will not lose our REIT status if one of the following exceptions applies:

- We satisfied the asset tests at the end of the preceding calendar quarter, and the discrepancy between the value of our assets and the asset test requirements arose from changes in the market values of our assets and was not wholly or partly caused by the acquisition of one or more non-qualifying assets; or

- We eliminate any discrepancy within 30 days after the close of the calendar quarter in which it arose.

Moreover, if we fail to satisfy the asset tests at the end of a calendar quarter during a taxable year, we will not lose our REIT status if one of the following additional exceptions applies:

- De Minimis Exception: The failure is due to a violation of the 5% or 10% asset tests referenced above and is de minimis (for this purpose, a de minimis failure is one that arises from our ownership of assets the total value of which does not exceed the lesser of 1% of the total value of our assets at the end of the quarter in which the failure occurred and $10 million), and we either dispose of the assets that caused the failure or otherwise satisfy the asset tests within 6 months after our identification of the failure; or

- General Exception: All of the following requirements are satisfied: (i) the failure is not due to a de minimis (as defined above) violation of the 5% or 10% asset tests (referenced above), (ii) the failure is due to reasonable cause and not willful neglect, (iii) we file a schedule in accordance with Treasury Regulations providing a description of each asset that caused the failure, (iv) we either dispose of the assets that caused the failure or otherwise satisfy the asset tests within 6 months after the last day of the quarter in which our identification of the failure occurred, and (v) we pay an excise tax as described above in Taxation of Our Company.

Annual Distribution Requirements

In order to qualify as a REIT, we must distribute dividends (other than capital gain dividends) to our stockholders in an amount at least equal to (A) the sum of (i) 90% of our REIT taxable income (determined without regard to the dividends paid deduction and by excluding any net capital gain) and (ii) 90% of the net income (after tax), if any, from foreclosure property, minus (B) the sum of certain items of non-cash income. We generally must pay such distributions in the taxable year to which they relate, or in the following taxable year if declared before we timely file our tax return for such year and if paid on or before the first regular dividend payment after such declaration.

To the extent that we do not distribute all of our net capital gain and REIT taxable income, we will be subject to tax on the undistributed amount at corporate capital gains and ordinary tax rates, respectively. Furthermore, if we should fail to distribute during each calendar year at least the sum of (i) 85% of our ordinary income for such year, (ii) 95% of our capital gain net income for such year, and (iii) any undistributed ordinary income and capital gain net income from prior periods, we will be subject to a 4% nondeductible excise tax on the excess of such required distribution over the amounts actually distributed.

Under certain circumstances, we may be able to rectify a failure to meet the distribution requirement for a year by paying deficiency dividends to our stockholders in a later year that may be included in our deduction for dividends paid for the earlier year. Thus, we may be able to avoid being taxed on amounts distributed as deficiency dividends; however, we will be required to pay interest based upon the amount of any deduction taken for deficiency dividends.

In addition, dividends we pay must not be preferential. If a dividend is preferential, it will not qualify for the dividends paid deduction. To avoid paying preferential dividends, we must treat every stockholder of the class of stock with respect to which we make a distribution the same as every other stockholder of that class, and we must not treat any class of stock other than according to its dividend rights as a class.

We may retain and pay income tax on net long-term capital gains we received during the tax year. To the extent we so elect, (i) each stockholder must include in its income (as long-term capital gains) its proportionate share of our undistributed long-term capital gains, (ii) each stockholder s basis in its shares of our stock is increased by the included amount of the undistributed long-term capital gains, and (iii) each stockholder is deemed to have paid, and receives a credit for, its proportionate share of the tax paid by us on the undistributed long-term capital gains.

To qualify as a REIT, we may not have, at the end of any taxable year, any undistributed earnings and profits accumulated in any non-REIT taxable year. Our non-REIT earnings and profits include any earnings and profits we accumulated before the effective date of our REIT election, which is expected to be January 1, 2005. We distributed sufficient earnings and profits before December 31, 2005 to eliminate any non-REIT earnings and profits, which distributions were in addition to distributions we were required to make to satisfy the 90% distribution test (as discussed above) and avoid incurring tax on our undistributed income.

Failure to Qualify

If we fail to qualify as a REIT and such failure is not an asset test or income test failure, we generally will be eligible for a relief provision if the failure is due to reasonable cause and not willful neglect and we pay a penalty of $50,000 with respect to such failure.

If we fail to qualify for taxation as a REIT in any taxable year and no relief provisions apply, we generally will be subject to tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates. Distributions to our stockholders in any year in which we fail to qualify as a REIT will not be deductible by us. In such event, to the extent of current or accumulated earnings and profits, all distributions to our stockholders will be taxable as dividend income. Subject to certain limitations in the Code, corporate stockholders may be eligible for the dividends received deduction, and individual, trust and estate stockholders may be eligible to treat the dividends received from us as qualified dividend income taxable as net capital gains, under the provisions of Section 1(h)(11) of the Code, through the end of 2010. Unless entitled to relief under specific statutory provisions, we also will be ineligible to elect REIT status again prior to the fifth taxable year following the first year in which we failed to qualify as a REIT under the Code.

Our qualification as a REIT for federal income tax purposes will depend on our continuing to meet the various requirements summarized above governing the ownership of our outstanding shares, the nature of our assets, the sources of our income, and the amount of our distributions to our stockholders. Although we intend to operate in a manner that will enable us to comply with such requirements, there can be no certainty that such intention will be realized. In addition, because the relevant laws may change, compliance with one or more of the REIT requirements may become impossible or impracticable for us.

Qualified REIT Subsidiaries and Disregarded Entities

If we own a corporate subsidiary that is a qualified REIT subsidiary (QRS), or if we or our operating partnership own 100% of the membership interests in a limited liability company or other unincorporated entity that does not elect to be treated as a corporation for federal income tax purposes, the separate existence of the QRS, limited liability company or other unincorporated entity generally will be disregarded for federal income tax purposes. Generally, a QRS is a corporation, other than a TRS, all of the stock of which is owned by a REIT. A limited liability company or other unincorporated entity 100% owned by a single member that does not elect to be treated as a corporation for federal income tax purposes generally is disregarded as an entity separate from its owner for federal income tax purposes. All assets, liabilities, and items of income, deduction, and credit of the QRS or disregarded entity will be treated as assets, liabilities, and items of income, deduction, and credit of its owner. If we own a QRS or a disregarded entity, neither will be subject to federal corporate income taxation, although such entities may be subject to state and local taxation in some states.

Taxation of the Operating Partnership

Our operating partnership currently is a disregarded entity because we own 100% of the interests in it, directly or through other disregarded entities. If we admit other limited partners, our operating partnership will be treated as a partnership for tax purposes, as described below.

Under the Code, a partnership is not subject to federal income tax, but is required to file a partnership tax information return each year. In general, the character of each partner s share of each item of income, gain, loss, deduction, credit, and tax preference is determined at the partnership level. Each partner is then allocated a distributive share of such items in accordance with the partnership agreement and is required to take such items into account in determining the partner s income. Each partner includes such amount in income for any taxable year of the partnership ending within or with the taxable year of the partner, without regard to whether the partner has received or will receive any cash distributions from the partnership. Cash distributions, if any, from a partnership to a partner generally are not taxable unless and to the extent they exceed the partner s basis in its partnership interest immediately before the distribution. Any amounts in excess of such tax basis will generally be treated as a sale of such partner s interest in the partnership.

If and when our operating partnership becomes taxable as a partnership, rather than a disregarded entity, we generally will be treated for federal income tax purposes as contributing our properties to the operating partnership at such time. If our properties are appreciated at such time, we could recognize a smaller share of tax depreciation, and a larger share of tax gain on sale, from such properties subsequent to that deemed contribution, as compared to our percentage interest in the operating partnership. This deemed contribution also could trigger tax gain in some circumstances, but we expect to structure the admission of outside partners in a manner that should avoid any such gain.

As noted above, for purposes of the REIT income and asset tests, we are treated as holding or receiving our proportionate share of our operating partnership s assets and income respectively. We control, and intend to continue to control, our operating partnership and intend to operate it consistently with the requirements for our qualification as a REIT.

We may use our operating partnership to acquire hotels in exchange for operating partnership units, in order to permit the sellers of such properties to defer recognition of their tax gain. In such a transaction, our initial tax basis in the hotels acquired generally will be less than the purchase price of the hotels. Consequently, our depreciation deductions for such properties may be less, and our tax gain on a sale of such properties may be more, than the deductions or gain, respectively, that we would have if we acquired these properties in taxable transactions. In addition, we may issue equity compensation to employees in the

form of interests in our operating partnership that provides for capital gain treatment to the employees but does not generate a corresponding deduction for our operating partnership.

The discussion above assumes our operating partnership will be treated as a partnership for federal income tax purposes once it is no longer treated as a disregarded entity. Generally, a domestic unincorporated entity such as our operating partnership with two or more partners is treated as a partnership for federal income tax purposes unless it affirmatively elects to be treated as a corporation. However, certain publicly traded partnerships are treated as corporations for federal income tax purposes. Once our operating partnership is no longer a disregarded entity for federal income tax purposes, we intend to comply with one or more exceptions from treatment as a corporation under the publicly traded partnership rules. Failure to qualify for such an exception would prevent us from qualifying as a REIT.

Investments in Taxable REIT Subsidiaries

We and each subsidiary intended to qualify as a TRS has made (or will make, as applicable) a joint election for such subsidiary to be treated as a taxable REIT subsidiary of our REIT. A domestic TRS (or a foreign TRS with income from a U.S. business) pays federal, state, and local income taxes at the full applicable corporate rates on its taxable income prior to payment of any dividends. Thus, for example, Bloodstone TRS, Inc. generally will pay U.S. corporate tax on key money and yield support when it is paid, notwithstanding the treatment of key money and yield support payments for accounting purposes. A TRS owning or leasing a hotel outside of the U.S., such as DiamondRock Frenchman s Owner, Inc., may pay foreign taxes. The taxes owed by our TRSs could be substantial. To the extent that our TRSs are required to pay federal, state, local, or foreign taxes, the cash available for distribution by us will be reduced accordingly.

A TRS is permitted to engage in certain kinds of activities that cannot be performed directly by us without jeopardizing our REIT status. A TRS is subject to limitations on the deductibility of payments made to us which could materially increase its taxable income and also is subject to prohibited transaction taxes on certain other payments made, directly or indirectly, to us. We will be subject to a 100% tax on the amounts of any rents from real property, deductions, or excess interest received from a TRS that would be reduced through reapportionment under Section 482 of the Code in order to more clearly reflect the income of the TRS. In particular, this 100% tax would apply to our share of any rent paid by a TRS lessee that was determined to be in excess of a market rate rent.

As discussed above in Qualification as a REIT Income Tests, Bloodstone TRS, Inc., through our TRS lessees, leases qualified lodging facilities from our operating partnership (or its affiliates) and a TRS may own hotels (such as DiamondRock Frenchman s Owner, Inc. that owns Frenchman s Reef & Morning Star Marriott Beach Resort). However, a TRS may not directly or indirectly operate or manage any hotel or provide rights to any brand name under which any hotel is operated. Specifically, rents paid by a TRS lessee can qualify as rents from real property only so long as the property is operated and managed on behalf of the TRS lessee by an eligible independent contractor, which is a person (or entity) that satisfies the following requirements: (i) such person is, or is related to a person who is, actively engaged in the trade or business of operating qualified lodging facilities for any person unrelated to us or the TRS lessee; (ii) such person does not own, directly or indirectly, more than 35% of our stock; and (iii) not more than 35% of such person is owned, directly or indirectly, by one or more persons owning 35% or more of our stock. For purposes of determining whether these ownership limits are satisfied, actual ownership as well as constructive ownership under the rules of Section 318 of the Code (with certain modifications) is taken into account. For example, (a) interests owned by a partnership are also treated as owned proportionately by its partners, (b) interests held by a partner with a 25% or greater share of partnership capital interests or profits interests are also treated as owned by the partnership, (c) interests held by a 10% or greater stockholder are also treated as held by the corporation, and (d) interests held by a

corporation are also treated as held by a 10% or greater stockholder (in the proportion that such stockholder s stock bears to all the stock of the corporation). However, if any class of our stock or the stock of a person attempting to qualify as an eligible independent contractor is regularly traded on an established securities market, only persons who own, directly or indirectly, more than 5% of such class of stock shall be taken into account as owning any of the stock of such class for purposes of applying the 35% limitation described in clause (iii) above. In addition, the IRS has ruled to the effect that an advisor or similar fiduciary to a REIT cannot also qualify as an eligible independent contractor with respect to the REIT.

Each TRS lessee (and any other of our TRSs that owns an interest in our hotels) has hired (or will hire) a hotel management company that we believe qualifies as an eligible independent contractor to manage and operate the hotels leased by (or owned through) the TRS. We believe that Marriott has qualified, and Marriott intends to continue to qualify, as an eligible independent contractor. In that regard, constructive ownership under Section 318 of the Code resulting, for example, from relationships between Marriott and our other shareholders could impact Marriott s ability to satisfy the applicable ownership limit. Because of the broad scope of the attribution rules of Section 318 of the Code, it is possible that not all prohibited relationships will be identified and avoided. The existence of such a relationship would disqualify Marriott (or another hotel management company) as an eligible independent contractor, which would in turn disqualify us as a REIT. Our charter restricts ownership and transfer of our shares in a manner intended to facilitate continuous qualification of Marriott (or another hotel management company) as an eligible independent contractor, but no assurances can be given that such transfer and ownership restrictions will ensure that Marriott (or another hotel management company) will, in fact, be an eligible independent contractor. As noted above, Goodwin Procter LLP s opinion as to REIT qualification will be based upon our representations and covenants as to the absence of such relationships. Marriott s failure to qualify as an eligible independent contractor will not give us the right to terminate the management agreement.

State, Local, and Foreign Tax

We may be subject to state, local and foreign tax in states, localities and foreign countries in which we do business or own property. The tax treatment applicable to us and our stockholders in such jurisdictions may differ from the federal income tax treatment described above.

Prospective stockholders should consult the applicable prospectus supplement, as well as their own tax advisers, for further information about federal, state, local, and other tax consequences of investing in the securities offered by the applicable prospectus supplement.

35

PLAN OF DISTRIBUTION

We may sell the securities offered by means of this prospectus domestically or abroad to one or more underwriters for public offering and sale by them or may sell such securities to investors directly or through dealers or agents. Any such underwriter, dealer or agent involved in the offer and sale of such securities will be named in the prospectus supplement relating to the securities.

Underwriters may offer and sell the securities at: (i) a fixed price or prices, which may be changed, (ii) market prices prevailing at the time of sale, (iii) prices related to the prevailing market prices at the time of sale or (iv) negotiated prices. We may, from time to time, authorize underwriters acting as our agents to offer and sell the securities upon the terms and conditions as are set forth in the applicable prospectus supplement. In connection with a sale of the securities offered by means of this prospectus, underwriters may be deemed to have received compensation from us in the form of underwriting discounts or commissions and may also receive commissions from purchasers of securities for whom they may act as agent. Underwriters may sell the securities to or through dealers, and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions from the purchasers for whom they may act as agent.

Any underwriting compensation paid by us to underwriters or agents in connection with the offering of the securities, and any discounts, concessions or commissions allowed by underwriters to participating dealers, will be set forth in the applicable prospectus supplement. Underwriters, dealers and agents participating in the distribution of the offered securities may be deemed to be underwriters, and any discounts or commissions received by them and any profit realized by them upon the resale of the offered securities may be deemed to be underwriting discounts and commissions, under the Securities Act. Underwriters, dealers and agents may be entitled, under agreements entered into with us, to indemnification against and contribution toward certain civil liabilities, including liabilities under the Securities Act. We will describe any indemnification agreement in the applicable prospectus supplement.

Unless we specify otherwise in the applicable prospectus supplement, any series of securities issued hereunder will be a new issue with no established trading market (other than our common stock, which is listed on the NYSE). If we sell any shares of our common stock pursuant to a prospectus supplement, such shares will be listed on the NYSE, subject to official notice of issuance. We may elect to list any other securities issued hereunder on any exchange, but we are not obligated to do so. Any underwriters or agents to or through whom such securities are sold by us or our operating partnership for public offering and sale may make a market in such securities, but such underwriters or agents will not be obligated to do so and may discontinue any market making at any time without notice. We cannot assure you as to the liquidity of the trading market for any such securities.

If so indicated in a prospectus supplement, we will authorize agents, underwriters or dealers to solicit offers by certain institutional investors to purchase offered securities for payment and delivery on a future date specified in such prospectus supplement. There may be limitations on the minimum amount which may be purchased by any such institutional investor or on the portion of the aggregate principal amount of the particular offered securities which may be sold pursuant to such arrangements. Institutional investors to which such offers may be made, when authorized, include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and such other institutions as may be approved by us. The obligations of any such purchasers pursuant to such delayed delivery and payment arrangements will not be subject to any conditions except that:

- the purchase by an institution of the offered securities shall not at the time of delivery be prohibited under the laws of any jurisdiction in the United States to which such institution is subject; and

- if the offered securities are being sold to underwriters, we shall have sold to such underwriters the total principal amount of such securities or number of warrants less the principal amount or number

thereof, as the case may be, covered by such arrangements. Underwriters will not have any responsibility in respect of the validity of such arrangements or our or such institutional investors performance thereunder.

We may agree to sell the securities to an underwriter for a delayed public offering and may further agree to adjustments before the public offering to the underwriters purchase price for the securities based on changes in the market value of the securities. The prospectus supplement relating to any such public offering will contain information on the number of securities to be sold, the manner of sale or other distribution and other material facts relating to the public offering.

Certain of the underwriters, dealers or agents and their associates may engage in transactions with and perform services for us in the ordinary course of their business for which they receive compensation.

LEGAL MATTERS

The validity of the securities offered hereby will be passed upon for us by Goodwin Procter LLP. Goodwin Procter LLP has also issued an opinion to us regarding certain tax matters described under Federal Income Tax Considerations Related to Our REIT Election.

EXPERTS

The consolidated financial statements and schedule of DiamondRock Hospitality Company as of December 31, 2005 and 2004, and for the year ended December 31, 2005, and the period from May 6, 2004 to December 31, 2004, the financial statements of Chicago 540 Lessee, Inc. as of December 31, 2005 and 2004, and for each of the years in the three-year period ended December 31, 2005, and the financial statements of Chicago 540 Hotel, LLC as of December 31, 2005 and 2004, and for each of the years in the three-year period ended December 31, 2005, have been incorporated by reference herein in reliance upon the reports of KPMG LLP, independent registered public accounting firm, incorporated by reference, and upon the authority of said firm as experts in accounting and auditing.

The financial statements of Orlando Airport Marriott Hotel of the Teachers Retirement System of the State of Illinois for which Stone-Levy, LLC is investment Advisor at June 30, 2005 and 2004 and for each of the two years in the period ended June 30, 2005 and the financial statements of the Westin Atlanta North at Perimeter at December 31, 2005 and 2004 and for each of the two years in the period ended December 31, 2005, incorporated by reference in this prospectus and registration statement, have been audited by Ernst & Young LLP, independent registered public accounting firm, as set forth in their reports thereon incorporated by reference herein and incorporated herein by reference in reliance upon such reports given on the authority of such firm as experts in auditing and accounting.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the SEC. You may read and copy any document we file with the SEC at the SEC s public reference room at 100 F Street, N.E. Room 1580, Washington, D.C. 20549/ Please call the SEC at 1-800-SEC-0330 for further information about the public reference room. The SEC also maintains a website that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC at http://www.sec.gov. You can inspect reports and other information we file at the offices of the NYSE, 20 Broad Street, New York, New York 10005. In addition, we maintain a website that contains information about us at www.drhc.com. The information found on, or otherwise accessible through, our website is not incorporated into, and does not form a part of, this prospectus or any other report or documents we file with or furnish to the SEC.

We have filed with the SEC a shelf registration statement on Form S-3 under the Securities Act of 1933, as amended, or the Securities Act, relating to the securities that may be offered by this prospectus. This prospectus is a part of that registration statement, but does not contain all of the information in the registration statement. We have omitted parts of the registration statement in accordance with the rules and regulations of the SEC. For more detail about us and any securities that may be offered by this prospectus, you may examine the registration statement on Form S-3 and the exhibits filed with it at the locations listed in the previous paragraph.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The SEC allows us to incorporate by reference in this prospectus certain information we file with the SEC, which means that we may disclose important information in this prospectus by referring you to the document that contains the information. The information incorporated by reference is considered to be a part of this prospectus, and the information we file later with the SEC will automatically update and supersede this information. We incorporate by reference the documents listed below that we filed with the SEC:

- our Annual Report on Form 10-K for the year ended December 31, 2005;
- our Definitive Proxy Statement on Schedule 14A filed with the SEC on March 28, 2006;
- our Current Report on Form 8-K/A filed on March 30, 2006;
- our Current Report on Form 8-K filed on April 27, 2006;
- Item 2.01 of our Current Report on Form 8-K filed on May 3, 2006;
- our Quarterly Report on Form 10-Q for the quarter ended March 24, 2006, filed on June 5, 2006;
- our Current Report on Form 8-K/A filed on June 23, 2006;
- our Current Report on Form 8-K/A filed on June 28, 2006;
- The description of our common stock, par value $0.01 per share, contained in our Registration Statement on Form 8-A filed on May 25, 2005 (file number 001-32514); and
- all documents filed by us with the SEC pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act after the date of this prospectus and prior to the termination of the offering of the underlying securities.

You may request a copy of these documents, and any exhibits we have specifically incorporated by reference as an exhibit in this prospectus, at no cost by writing us at the following address or calling us at the telephone number listed below:

DiamondRock Hospitality Company
6903 Rockledge Drive, Suite 800
Bethesda, MD 20817
Attention: Investor Relations
(240) 744-1150

Readers should rely on the information provided or incorporated by reference in this prospectus or in the applicable supplement to this prospectus. Readers should not assume that the information in this prospectus and the applicable supplement is accurate as of any date other than the date on the front cover of the document.

15,950,000 Shares

Common Stock

PROSPECTUS SUPPLEMENT

January 17, 2007

Citigroup

Merrill Lynch & Co.

Friedman Billings Ramsey

Wachovia Securities

Robert W. Baird & Co.

JMP Securities

---

ly:inherit;font-size:10pt;">The Company issues new shares or treasury shares, if available, when restricted stock vests. With respect to shares issued under the Purchase Plan, the Company’s Board of Directors has authorized specific share repurchases to fund the shares issuable under the Purchase Plan.

5. EARNINGS PER SHARE

The two-class method is utilized for the computation of the Company's earnings per share (“EPS”). The two-class method requires a portion of net income to be allocated to participating securities, which are unvested awards of share-based payments with non-forfeitable rights to receive dividends or dividend equivalents, which included the Company’s restricted stock awards. Income allocated to these participating securities is excluded from net earnings available to common shares, as shown in the table below. Basic EPS is computed by dividing net income available to basic common shares by the weighted average number of basic common shares outstanding during the period. Diluted EPS is computed by dividing net income available to diluted common shares by the weighted average number of dilutive common shares outstanding during the period.

The following table sets forth the calculation of EPS for the three and six months ended June 30, 2014 and 2013.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands, except per share amounts)			
Weighted average basic common shares outstanding	23,298	23,315	23,318	22,796
Dilutive effect of contingently convertible notes and warrants	2,937	1,660	2,513	1,743
Dilutive effect of employee stock purchases, net of assumed repurchase of treasury stock	7	5	6	5
Weighted average dilutive common shares outstanding	26,242	24,980	25,837	24,544
Basic:				
Net Income	$16,862	$37,388	$48,165	$59,506
Less: Earnings allocated to participating securities	675	1,689	1,923	2,684
Earnings available to basic common shares	$16,187	$35,699	$46,242	$56,822
Basic earnings per common share	$0.70	$1.53	$1.98	$2.49
Diluted:				
Net Income	$16,862	$37,388	$48,165	$59,506
Less: Earnings allocated to participating securities	619	1,592	1,773	2,522
Earnings available to diluted common shares	$16,243	$35,796	$46,392	$56,984
Diluted earnings per common share	$0.62	$1.43	$1.80	$2.32

As discussed in Note 9, “Long-Term Debt”, the Company is required to include the dilutive effect, if applicable, of the net shares issuable under the 2.25% Notes (as defined in Note 9) and the warrants sold in connection with the 2.25% Notes (“2.25% Warrants”) in its diluted common shares outstanding for the diluted earnings calculation. As a result, the number of shares included in the Company's diluted shares outstanding each period varies based upon the Company's average adjusted closing common stock price during the applicable period. Although the ten-year call options that the Company purchased on its common stock in connection with the issuance of the 2.25% Notes (“2.25% Purchased Options”) have the economic benefit of decreasing the dilutive effect of the 2.25% Notes, the Company cannot factor this benefit into the diluted common shares outstanding for the diluted earnings calculation since the impact would be anti-dilutive. The average adjusted closing price of the Company's common stock for the three months ended June 30, 2014 and 2013 was more than the conversion price then in effect at the end of those periods. Therefore, the respective dilutive effect of the 2.25% Notes was included in the computation of diluted EPS for the three and six months ended June 30, 2014 and 2013. Refer to Note 9, "Long-Term Debt" for a description of the change to the conversion price of the 2.25% Notes, which occurred during the three months ended June 30, 2014 as a result of the Company’s decision to pay a cash dividend in excess of $0.14, as well as the convertibility of the 2.25% Notes as of June 30, 2014 and for further discussion of the Company's notice of redemption issued subsequent to June 30, 2014.

In addition, the Company is required to include the dilutive effect, if applicable, of the net shares issuable under the 3.00% Notes (as defined in Note 9, "Long-Term Debt") and the warrants sold in connection with the 3.00% Notes (“3.00% Warrants”). As a result, the number of shares included in the Company's diluted shares outstanding each period varies based upon the Company's average adjusted closing common stock price during the applicable period. Although the ten-year call options that the Company purchased on its common stock in connection with the issuance of the 3.00% Notes (“3.00% Purchased Options”) have the economic benefit of decreasing the dilutive effect of the 3.00% Notes, the Company cannot factor this benefit into the diluted common shares outstanding for the diluted earnings calculation since the impact would be anti-dilutive. Since the average price of the Company’s common stock for the three months ended June 30, 2014 and 2013, was more than the conversion price then in effect at the end of those periods, the respective dilutive effect of the 3.00% Notes and Warrants was included in the computation of diluted EPS for the three and six months ended June 30, 2014 and 2013. Refer to Note 9, "Long-Term Debt" for a

description of the change to the conversion price of the 3.00% Notes, which occurred during the three months ended June 30, 2014 as a result of the Company’s decision to pay a cash dividend, as well as the convertibility of the 3.00% Notes as of June 30, 2014 and for further discussion of the Company's purchase of $92.5 million of the 3.00% Notes on June 25, 2014.

6. INCOME TAXES

The Company is subject to U.S. federal income taxes and income taxes in numerous U.S. states. In addition, the Company is subject to income tax in the U.K. and Brazil relative to its foreign subsidiaries. The Company's effective income tax rates of 55.9% and 44.9% of pretax income for the three and six months ended June 30, 2014, respectively, differed from the U.S. federal statutory rate of 35.0% due primarily to the tax deductible loss on the purchase of the majority of the 3.00% Notes (as defined in Note 9, "Long-term Debt") that was less than the loss recognized for U.S. GAAP, additional valuation allowances recorded in respect of net operating losses of certain Brazil subsidiaries, as well as the mix of pretax income from taxable state and foreign jurisdictions in which the Company operates.

For the three and six months ended June 30, 2014, the Company's effective tax rate increased to 55.9% and 44.9% from 37.9% and 40.2%, respectively, for the same periods in 2013. These increases were primarily due to the tax deductible loss on the purchase of the majority of the 3.00% Notes that was less than the loss recognized for U.S. GAAP, additional valuation allowances recorded in respect of net operating losses of certain Brazil subsidiaries, as well as the mix of pretax income from taxable state and foreign jurisdictions in which we operate.

As of June 30, 2014 and December 31, 2013, the Company had no unrecognized tax benefits with respect to uncertain tax positions and did not incur any interest and penalties nor did it accrue any interest for the six months ended June 30, 2014. When applicable, consistent with prior practice, the Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

Taxable years 2009 and subsequent remain open for examination by the Company’s major taxing jurisdictions.

7. DETAIL OF CERTAIN BALANCE SHEET ACCOUNTS

Accounts and notes receivable consisted of the following:

	June 30, 2014 (unaudited)	December 31, 2013
	(In thousands)	
Amounts due from manufacturers	$78,839	$78,131
Parts and service receivables	35,180	31,950
Finance and insurance receivables	17,886	19,283
Other	12,631	8,099
Total accounts and notes receivable	144,536	137,463
Less allowance for doubtful accounts	2,421	2,405
Accounts and notes receivable, net	$142,115	$135,058

Inventories consisted of the following:

	June 30, 2014 (unaudited)	December 31, 2013
	(In thousands)	
New vehicles	$1,103,350	$1,165,335
Used vehicles	267,144	231,960
Rental vehicles	85,255	88,523
Parts, accessories and other	65,931	64,156
Total inventories	1,521,680	1,549,974
Less lower of cost or market reserves	7,406	7,656
Inventories, net	$1,514,274	$1,542,318

New and used vehicles are valued at the lower of specific cost or market and are removed from inventory using the specific identification method. Parts and accessories are valued at lower of cost or market determined on either a first-in, first-out basis or on an average cost basis.

Property and equipment consisted of the following:

	Estimated Useful Lives in Years (unaudited)	June 30, 2014	December 31, 2013
		(dollars in thousands)	
Land	—	$290,303	$269,778
Buildings	30 to 40	416,185	405,918
Leasehold improvements	varies	131,199	120,531
Machinery and equipment	7 to 20	83,288	79,209
Furniture and fixtures	3 to 10	75,601	70,918
Company vehicles	3 to 5	8,701	8,508
Construction in progress	—	22,873	19,224
Total		1,028,150	974,086
Less accumulated depreciation		190,329	177,730
Property and equipment, net		$837,821	$796,356

During the six months ended June 30, 2014, the Company incurred $38.9 million of capital expenditures for the construction of new or expanded facilities and the purchase of equipment and other fixed assets in the maintenance of the Company's dealerships and facilities. In addition, the Company purchased real estate (including land and buildings) during the six months ended June 30, 2014 associated with existing dealership operations totaling $21.7 million. And, in conjunction with the acquisition of dealerships and franchises in the six months ended June 30, 2014, the Company acquired $29.8 million of real estate and other property and equipment.

As of June 30, 2014, the Company determined that certain dealerships and the associated real estate qualified as held-for-sale. As a result, the Company classified the carrying value of the asset disposal group real estate totaling $32.7 million in prepaid and other current assets in its Consolidated Balance Sheet.

8. CREDIT FACILITIES

In the U.S., the Company has a $1.7 billion revolving syndicated credit arrangement with 25 financial institutions including six manufacturer-affiliated finance companies ("Revolving Credit Facility"). The Company also has a $300.0 million floorplan financing arrangement ("FMCC Facility") with Ford Motor Credit Company ("FMCC") for financing of new Ford vehicles in the U.S. and other floor plan financing arrangements with several other automobile manufacturers for financing of a portion of its rental vehicle inventory. In the U.K., the Company has financing arrangements with BMW Financial Services, Volkswagen Finance and FMCC for financing of its new and used vehicles. In Brazil, the Company has financing arrangements for new, used, and rental vehicles with several financial institutions, most of which are manufacturer affiliated. Within the Company's Consolidated Balance Sheets, Floorplan notes payable - credit facility and other primarily reflects amounts payable for the purchase of specific new, used and rental vehicle inventory (with the exception of new and rental vehicle purchases financed through lenders affiliated with the respective manufacturer) whereby financing is provided by the Revolving Credit Facility. Floorplan notes payable - manufacturer affiliates reflects amounts related to the purchase of vehicles whereby financing is provided by the FMCC Facility, the financing of rental vehicles in the U.S., as well as the financing of new, used, and rental vehicles in both the U.K. and Brazil. Payments on the floorplan notes payable are generally due as the vehicles are sold. As a result, these obligations are reflected in the accompanying Consolidated Balance Sheets as current liabilities.

Revolving Credit Facility

On June 20, 2013, the Company amended its Revolving Credit Facility principally to increase the total borrowing capacity from $1.35 billion to $1.7 billion and to extend the term from an expiration date of June 1, 2016 to June 20, 2018. The Revolving Credit Facility consists of two tranches, providing a maximum of $1.6 billion for U.S. vehicle inventory floorplan financing ("Floorplan Line"), as well as a maximum of $320.0 million and a minimum of $100.0 million for working capital and general corporate purposes, including acquisitions ("Acquisition Line"). The capacity

under these two tranches can be re-designated within the overall $1.7 billion commitment, subject to the aforementioned limits. Up to $125.0 million of the Acquisition Line can be borrowed in either euros or pound sterling. The Revolving Credit Facility can be expanded to a maximum commitment of $1.95 billion, subject to participating lender approval. The Floorplan Line bears interest at rates equal to the one-month LIBOR plus 125 basis points for new vehicle inventory and the one-month LIBOR plus 150 basis points

16

for used vehicle inventory. The Acquisition Line bears interest at the one-month LIBOR plus 150 basis points plus a margin that ranges from zero to 100 basis points for borrowings in U.S. dollars and 150 to 250 basis points on borrowings in euros or pound sterling, depending on the Company's total adjusted leverage ratio. The Floorplan Line also requires a commitment fee of 0.20% per annum on the unused portion. The Acquisition Line requires a commitment fee ranging from 0.25% to 0.45% per annum, depending on the Company's total adjusted leverage ratio, based on a minimum commitment of $100.0 million less outstanding borrowings. In conjunction with the Revolving Credit Facility, the Company has $6.0 million of related unamortized costs as of June 30, 2014 that are being amortized over the term of the facility.

After considering the outstanding balance of $1,042.3 million at June 30, 2014, the Company had $337.7 million of available floorplan borrowing capacity under the Floorplan Line. Included in the $337.7 million available borrowings under the Floorplan Line was $64.6 million of immediately available funds. The weighted average interest rate on the Floorplan Line was 1.4% as of June 30, 2014 and December 31, 2013, excluding the impact of the Company's interest rate swaps. Amounts borrowed by the Company under the Floorplan Line for specific vehicle inventory are to be repaid upon the sale of the vehicle financed, and in no case is a borrowing for a vehicle to remain outstanding for greater than one year. With regards to the Acquisition Line, borrowings outstanding as of June 30, 2014 and December 31, 2013 were $20.5 million (borrowed as 12.0 million pounds sterling) and $60.0 million, respectively. After considering $43.2 million of outstanding letters of credit and other factors included in the Company's available borrowing base calculation, there was $220.8 million of available borrowing capacity under the Acquisition Line as of June 30, 2014. The amount of available borrowing capacity under the Acquisition Line is limited from time to time based upon certain debt covenants.

All of the U.S. dealership-owning subsidiaries are co-borrowers under the Revolving Credit Facility. The Company's obligations under the Revolving Credit Facility are secured by essentially all of the Company's U.S. personal property (other than equity interests in dealership-owning subsidiaries), including all motor vehicle inventory and proceeds from the disposition of dealership-owning subsidiaries, excluding inventory financed directly with manufacturer-affiliates and other third party financing institutions. The Revolving Credit Facility contains a number of significant covenants that, among other things, restrict the Company's ability to make disbursements outside of the ordinary course of business, dispose of assets, incur additional indebtedness, create liens on assets, make investments and engage in mergers or consolidations. The Company is also required to comply with specified financial tests and ratios defined in the Revolving Credit Facility, such as the fixed charge coverage, total adjusted leverage, and senior secured adjusted leverage ratios. Further, the Revolving Credit Facility restricts the Company's ability to make certain payments, such as dividends or other distributions of assets, properties, cash, rights, obligations or securities ("Restricted Payments"). The Restricted Payments cannot exceed the sum of $125.0 million plus (or minus if negative) (a) one-half of the aggregate consolidated net income for the period beginning on January 1, 2013 and ending on the date of determination and (b) the amount of net cash proceeds received from the sale of capital stock on or after January 1, 2013 and ending on the date of determination less (c) cash dividends and share repurchases ("Restricted Payment Basket"). For purposes of the calculation of the Restricted Payment Basket, net income represents such amounts per the consolidated financial statements adjusted to exclude the Company's foreign operations, non-cash interest expense, non-cash asset impairment charges, and non-cash stock-based compensation. As of June 30, 2014, the Restricted Payment Basket totaled $167.9 million. As of June 30, 2014, the Company was in compliance with all applicable covenants and ratios under the Revolving Credit Facility.

Ford Motor Credit Company Facility

The FMCC Facility provides for the financing of, and is collateralized by, the Company's Ford new vehicle inventory in the U.S., including affiliated brands. This arrangement provides for $300.0 million of floorplan financing, an increase of $100.0 million from March 31, 2014, and is an evergreen arrangement that may be canceled with 30 days notice by either party. As of June 30, 2014, the Company had an outstanding balance of $174.7 million under the FMCC Facility with an available floorplan borrowing capacity of $125.3 million. This facility bears interest at a rate of Prime plus 150 basis points minus certain incentives. As of June 30, 2014, the interest rate on the FMCC Facility was 4.75% before considering the applicable incentives.

Other Credit Facilities

The Company has credit facilities with BMW Financial Services, Volkswagen Finance and FMCC for the financing of new, used and rental vehicle inventories related to its U.K. operations. These facilities are denominated in pound sterling and are evergreen arrangements that may be canceled with notice by either party and bear interest at a base rate, plus a surcharge that varies based upon the type of vehicle being financed. The interest rates charged on borrowings outstanding under these facilities ranged from 1.14% to 3.95% as of June 30, 2014.

The Company has credit facilities with financial institutions in Brazil, most of which are affiliated with the manufacturers, for the financing of new, used and rental vehicle inventories related to its Brazil operations. These facilities are denominated in Brazilian real and have renewal terms ranging from one month to twelve months. They may be canceled with

17

notice by either party and bear interest at a benchmark rate, plus a surcharge that varies based upon the type of vehicle being financed. As of June 30, 2014, the interest rates charged on borrowings outstanding under these facilities ranged from 15.10% to 19.56%.

Excluding rental vehicles financed through the Revolving Credit Facility, financing for U.S. rental vehicles is typically obtained directly from the automobile manufacturers. These financing arrangements generally require small monthly payments and mature in varying amounts over a period of two years. As of June 30, 2014, the interest rate charged on borrowings related to the Company’s rental vehicle fleet varied up to 4.75%. Rental vehicles are typically transferred to used vehicle inventory when they are removed from rental service and repayment of the borrowing is required at that time.

9. LONG-TERM DEBT

The Company carries its long-term debt at face value, net of applicable discounts. Long-term debt consisted of the following:

	June 30, 2014	December 31, 2013
	(dollars in thousands)	
2.25% Convertible Senior Notes	$164,556	$160,334
3.00% Convertible Senior Notes	16,907	84,305
Real Estate Credit Facility	66,316	67,719
5.00% Senior Notes	344,796	—
Acquisition Line	20,457	60,000
Other Real Estate Related and Long-Term Debt	307,738	279,167
Capital lease obligations related to real estate, maturing in varying amounts through June 2034 with a weighted average interest rate of 10.6%	48,321	47,553
	969,091	699,078
Less current maturities of real estate credit facility and other long-term debt	30,516	35,389
	$938,575	$663,689

Purchase of 3.00% Convertible Senior Notes

On June 25, 2014, the Company purchased $92.5 million of the $115.0 million principal outstanding of its 3.00% Convertible Senior Notes due 2020 (“3.00% Notes”) in a tender offer, leaving an outstanding balance of $22.6 million as of June 30, 2014. Consideration paid for the purchase of the 3.00% Notes was $210.4 million. In conjunction with this purchase, the Company recognized a loss of $23.6 million for the three months ended June 30, 2014. Subsequent to June 30, 2014, the Company settled the 3.00% Purchased Options and 3.00% Warrants in the same proportion as the 3.00% Notes purchased. The net cash received as a result was $26.4 million, which will be recognized as an increase to additional paid in capital.

2.25% Convertible Senior Notes

As of June 30, 2014 and December 31, 2013, the carrying value of the Company's 2.25% Convertible Senior Notes due 2036 (“2.25% Notes”), related discount and equity component consisted of the following:

	June 30, 2014	December 31, 2013
	(In thousands)	
Carrying amount of equity component (including temporary equity)	$65,270	$65,270
Allocated underwriter fees, net of taxes	(1,475)	(1,475)
Allocated debt issuance cost, net of taxes	(58)	(58)
Total net equity component	$63,737	$63,737
Deferred income tax component	$6,524	$8,023
Principal amount of 2.25% Notes	$182,753	$182,753
Unamortized discount	(17,511)	(21,574)
Unamortized underwriter fees	(686)	(845)
Net carrying amount of liability component	$164,556	$160,334

Unamortized debt issuance cost	$27	$33

18

For the six months ended June 30, 2014 and 2013, the contractual interest expense and the discount amortization, which is recorded as other interest expense in the accompanying Consolidated Statements of Operations, were as follows:

	Six Months Ended June 30,	
	2014	2013
	(dollars in thousands)	
Year-to-date contractual interest expense	$2,056	$2,056
Year-to-date discount amortization [1]	$3,998	$3,689
Effective interest rate of liability component	7.7 %	7.7 %

[1] Represents the incremental impact of the accounting for convertible debt as primarily codified in ASC 470, Debt. The Company determined the discount using the estimated effective interest rate for similar debt with no convertible features. The original effective interest rate of 7.50% was estimated by comparing debt issuances from companies with similar credit ratings during the same annual period as the Company. The effective interest rate differs from the 7.50% due to the impact of underwriter fees associated with this issuance that were capitalized as an additional discount and are being amortized to interest expense through 2016. The effective interest rate may change in the future as a result of future repurchases of the 2.25% Notes. The Company utilized a ten-year term for the assessment of the fair value of its 2.25% Notes.

The 2.25% Notes are convertible into cash and, if applicable, common stock based on the then-applicable conversion rate under the following circumstances: (a) during any calendar quarter (and only during such calendar quarter), if the closing price of the Company's common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the applicable conversion price per share (or $77.05 as of June 30, 2014)(the "2.25% Stock Price Trigger"); (b) during the five business day period after any ten consecutive trading day period in which the trading price per $1,000 principal amount for each day of the ten day trading period was less than 98% of the product of the last reported sale/bid price of the Company's common stock and the conversion rate on that day; and (c) upon the occurrence of specified corporate transactions set forth in the indenture governing the 2.25% Notes (the "2.25% Notes Indenture"). Upon conversion, a holder will receive an amount in cash and, if applicable, shares of the Company's common stock, determined in the manner set forth in the 2.25% Notes Indenture.

The Company may redeem all or part of the 2.25% Notes if the last reported sale price of the Company's common stock is greater than or equal to 130% of the conversion price then in effect for at least 20 trading days within a period of 30 consecutive trading days ending on the trading day prior to the date on which the Company mails the redemption notice.

As of June 30, 2014, the conversion rate was 16.87 shares of common stock per $1,000 principal amount of 2.25% Notes, with a conversion price of $59.27 per share, which was reduced during the second quarter of 2014 as the result of the Company's decision to pay a cash dividend in excess of $0.14 per share. As of June 30, 2014, the exercise price of the 2.25% Warrants, which are related to the issuance of the 2.25% Notes, was reduced to $80.09 due to the Company's decision to pay a cash dividend in excess of $0.14 per share during the second quarter of 2014. If any cash dividend or distribution is made to all, or substantially all, holders of the Company's common stock in excess of $0.14 per share in the future, the conversion rate will be further adjusted based on the formula defined in the 2.25% Notes Indenture.

Under the terms of the 2.25% Purchased Options, which become exercisable upon conversion of the 2.25% Notes, the Company has the right to receive a total of 3.1 million shares of its common stock at the conversion price then in effect. The exercise price of the 2.25% Purchased Options is subject to certain adjustments that mirror the adjustments to the conversion price of the 2.25% Notes (including payments of cash dividends in excess of $0.14 per share).

As a result of the 2.25% Stock Price Trigger on June 30, 2014, the 2.25% Notes are convertible at the option of the holders during the three months ending September 30, 2014. As such, the Company reclassified the redeemable equity portion of the 2.25% Notes to temporary equity from the additional paid-in capital component of permanent equity on

the Consolidated Balance Sheet as of June 30, 2014. The debt portion of the 2.25% Notes continued to be classified as a long-term liability as of June 30, 2014, since the Company has the intent and ability to refinance any conversion of the 2.25% Notes with another long-term debt instrument. The combination of the debt portion and temporary equity portion represents the aggregate principal obligation of the 2.25% Notes redeemable at the option of the holders as of June 30, 2014. The if-converted value of the 2.25% Notes exceeded the principal amount of the 2.25% Notes by $76.2 million at June 30, 2014.

Subsequent to June 30, 2014, the Company gave notice to holders that the Company will redeem all of the outstanding 2.25% Notes on September 4, 2014.

3.00% Convertible Senior Notes

As of June 30, 2014 and December 31, 2013, the carrying value of the 3.00% Notes, related discount and equity component consisted of the following

	June 30, 2014	December 31, 2013
	(In thousands)	
Carrying amount of equity component (including temporary equity)	$4,973	$25,359
Allocated underwriter fees, net of taxes	(149)	(760)
Allocated debt issuance cost, net of taxes	(22)	(112)
Total net equity component	$4,802	$24,487
Deferred income tax component	$1,936	$10,625
Principal amount of 3.00% Notes	$22,550	$115,000
Unamortized discount	(5,348)	(29,094)
Unamortized underwriter fees	(295)	(1,601)
Net carrying amount of liability component	$16,907	$84,305
Unamortized debt issuance costs	$44	$236

For the six months ended June 30, 2014 and 2013, the contractual interest expense and the discount amortization, which is recorded as interest expense in the accompanying Consolidated Statements of Operations, were as follows:

	Six Months Ended June 30,	
	2014	2013
	(dollars in thousands)	
Year-to-date contractual interest expense	$1,679	$1,725
Year-to-date discount amortization [(1)]	$1,693	$1,588
Effective interest rate of liability component	8.6%	8.6%

[(1)] Represents the incremental impact of the accounting for convertible debt as primarily codified in ASC 470, Debt.

The Company determined the discount using the estimated effective interest rate for similar debt with no convertible features. The original effective interest rate of 8.25% was estimated by receiving a range of quotes from the underwriters for the estimated rate that the Company could reasonably expect to issue non-convertible debt for the same tenure. The effective interest rate differs from the 8.25% due to the impact of underwriter fees associated with this issuance that were capitalized as an additional discount and are being amortized to interest expense through 2020. The effective interest rate may change in the future as a result of future repurchases of the 3.00% Notes. The Company utilized a ten-year term for the assessment of the fair value of its 3.00% Notes.

The 3.00% Notes are convertible into cash and, if applicable, common stock based on the then-applicable conversion rate under the following circumstances: (a) during any fiscal quarter (and only during such fiscal quarter), if the last reported sale price of the Company’s common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the applicable conversion price per share (or $48.26 as of June 30, 2014) (the “3.00% Stock Price Trigger”); (b) during the five business day period after any ten consecutive trading day period in which the trading price per $1,000 principal amount for each day of the ten day trading period was less than 98% of the product of the last reported sale price of the Company’s common stock and the conversion rate of the 3.00% Notes on that day; and (c) upon the occurrence of specified corporate transactions set forth in the indenture governing the 3.00% Notes (the "3.00% Notes Indenture"). Upon conversion, a holder will receive an amount in cash and, if applicable, shares of the Company’s common stock, determined in the manner set forth in the 3.00% Notes Indenture.

As of June 30, 2014, the conversion rate was 26.94 shares of common stock per $1,000 principal amount of 3.00% Notes, with a conversion price of $37.13 per share, which was reduced during the second quarter of 2014 as the result of the Company’s decision to pay a cash dividend. As of June 30, 2014, the exercise price of the 3.00% Warrants, which are related to the issuance of the 3.00% Notes, was reduced to $54.55 due to the Company’s decision to pay a cash dividend during the second quarter of 2014. If any cash dividend or distribution is made to all, or substantially

all, holders of the Company's common stock in the future, the conversion rate will be further adjusted based on the formula defined in the 3.00% Notes Indenture.

Under the terms of the 3.00% Purchased Options, which become exercisable upon conversion of the 3.00% Notes, the Company has the right to receive a total of 3.1 million shares of its common stock at the conversion price then in effect. Subsequent to June 30, 2014, the Company settled 2.5 million of the 3.00% Purchased Options, congruent with the purchase of

20

the majority of the 3.00% Notes in a tender offer, leaving the Company with the right to receive a total of 0.6 million shares of its common stock at the conversion price then in effect. The exercise price of the 3.00% Purchased Options is subject to certain adjustments that mirror the adjustments to the conversion price of the 3.00% Notes (including payments of cash dividends).

As a result of the 3.00% Stock Price Trigger on June 30, 2014, the 3.00% Notes are convertible at the option of the holders during the three months ending September 30, 2014. As such, the Company reclassified the redeemable equity portion of the 3.00% Notes to temporary equity from the additional paid-in capital component of permanent equity on the Consolidated Balance Sheet as of June 30, 2014. The debt portion of the 3.00% Notes continued to be classified as a long-term liability as of June 30, 2014, since the Company has the intent and ability to refinance any conversion of the 3.00% Notes with another long-term debt instrument. The combination of the debt portion and temporary equity portion represents the aggregate principal obligation of the 3.00% Notes redeemable at the option of the holders as of June 30, 2014. The if-converted value of the 3.00% Notes exceeded the principal amount of the 3.00% Notes by $28.5 million at June 30, 2014.

5.00% Senior Notes

On June 2, 2014, the Company issued 5.00% senior unsecured notes with a face amount of $350.0 million due to mature on June 1, 2022 ("5.00% Notes"). The 5.00% Notes pay interest semiannually, in arrears, in cash on each June 1 and December 1, beginning December 1, 2014. Prior to June 1, 2017, the Company may redeem up to 35.0% of the 5.00% Notes using proceeds of certain equity offerings, subject to certain conditions at a redemption price equal to 105% of principal amount of the 5.00% Notes plus accrued and unpaid interest. In addition, prior to June 1, 2017, the Company may redeem some or all of the 5.00% Notes at a redemption price equal to 100% of the principal amount of the 5.00% Notes redeemed, plus an applicable make-whole premium, and plus accrued and unpaid interest. On or after June 1, 2017, the Company may redeem some or all of the 5.00% Notes at specified prices, plus accrued and unpaid interest. The Company may be required to purchase the 5.00% Notes if it sells certain assets or triggers the change in control provisions defined in the 5.00% Notes indenture. The 5.00% Notes are senior unsecured obligations and rank equal in right of payment to all of our existing and future senior unsecured debt and senior in right of payment to all of our future subordinated debt.

The 5.00% Notes are guaranteed by substantially all of the Company's U.S. subsidiaries. The U.S. subsidiary guarantees rank equally in the right of payment to all of the Company's U.S. subsidiary guarantor’s existing and future subordinated debt. In addition, the 5.00% Notes are structurally subordinated to the liabilities of its non-guarantor subsidiaries.

In connection with the issuance of the 5.00% Notes, the Company entered into a registration rights agreement (the “Registration Rights Agreement”) with the initial purchasers. Pursuant to the Registration Rights Agreement, the Company has agreed to file a registration statement with the Securities and Exchange Commission within 365 days of issuance, so that holders of the 5.00% Notes can exchange the 5.00% Notes for registered 5.00% Notes that have substantially identical terms as the 5.00% Notes. The Company will be required to pay additional interest on the 5.00% Notes if it fails to comply with its obligations to register the 5.00% Notes within the specified time period.

Underwriters' fees totaled $5.3 million, which were recorded as a reduction of the 5.00% Notes principal balance, are being amortized over a period of eight years. The 5.00% Notes are presented net of unamortized underwriter fee of $5.2 million as of June 30, 2014. At the time of issuance of the 5.00% Notes, the Company capitalized $1.5 million of debt issuance costs, which are included in Other Assets on the accompanying Consolidated Balance Sheet and amortized over a period of eight years. Unamortized debt issuance costs as of June 30, 2014 totaled $1.5 million.

Real Estate Credit Facility

Group 1 Realty, Inc., a wholly-owned subsidiary of the Company, is party to a real estate credit facility with Bank of America, N.A. and Comerica Bank (the “Real Estate Credit Facility”) providing the right for up to $99.1 million of term loans, of which $74.1 million had been used as of June 30, 2014. The term loans can be expanded provided that (a) no default or event of default exists under the Real Estate Credit Facility; (b) the Company obtains commitments from the lenders who would qualify as assignees for such increased amounts; and (c) certain other agreed upon terms and conditions have been satisfied. This facility is guaranteed by the Company and substantially all of the existing and

future domestic subsidiaries of the Company and is secured by the real property owned by the Company that is mortgaged under the Real Estate Credit Facility. The Company capitalized $1.1 million debt issuance costs related to the Real Estate Credit Facility that are being amortized over the term of the facility, $0.5 million of which were still unamortized as of June 30, 2014.

The interest rate is equal to (a) the per annum rate equal to one-month LIBOR plus 2.00% per annum, determined on the first day of each month; or (b) 0.95% per annum in excess of the higher of (i) the Bank of America prime rate (adjusted daily on the day specified in the public announcement of such price rate), (ii) the Federal Funds Rate adjusted daily, plus 0.5% or (iii) the per annum rate equal to the one-month LIBOR plus 1.05% per annum. The Federal Funds Rate is the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers on such day, as published by the Federal Reserve Bank of New York on the business day succeeding such day.

The Company is required to make quarterly principal payments equal to 1.25% of the principal amount outstanding and is required to repay the aggregate amount outstanding on the maturity dates of the individual property borrowings, ranging, from December 29, 2015 through February 27, 2017. During the six months ended June 30, 2014, the Company made additional borrowings of $0.2 million and made principal payments of $1.6 million on outstanding borrowings from the Real Estate Credit Facility. As of June 30, 2014, borrowings outstanding under the Real Estate Credit Facility totaled $66.3 million, with $3.5 million recorded as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets.

The Real Estate Credit Facility also contains usual and customary provisions limiting the Company's ability to engage in certain transactions, including limitations on the Company's ability to incur additional debt, additional liens, make investments, and pay distributions to its stockholders. In addition, the Real Estate Credit Facility requires certain financial covenants that are identical to those contained in the Company's Revolving Credit Facility. As of June 30, 2014, the Company was in compliance with all applicable covenants and ratios under the Real Estate Credit Facility.

Acquisition Line

See Note 8, "Credit Facilities," for further discussion on the Company's Revolving Credit Facility and Acquisition Line.

Other Real Estate Related and Long-Term Debt

The Company, as well as certain of its wholly-owned subsidiaries, has entered into separate term mortgage loans in the U.S. with four of its manufacturer-affiliated finance partners, Toyota Motor Credit Corporation ("TMCC"), Mercedes-Benz Financial Services USA, LLC ("MBFS"), BMW Financial Services NA, LLC ("BMWFS") and FMCC as well as several third-party financial institutions (collectively, "Real Estate Notes"). The Real Estate Notes are on specific buildings and/or properties and are guaranteed by the Company. Each loan was made in connection with, and is secured by mortgage liens on, the real property owned by the Company that is mortgaged under the Real Estate Notes. The Real Estate Notes bear interest at fixed rates between 3.67% and 9.00%, and at variable indexed rates plus a spread between 1.90% and 3.35% per annum. The Company capitalized $1.3 million of related debt issuance costs related to the Real Estate Notes that are being amortized over the terms of the notes, $0.6 million of which were still unamortized as of June 30, 2014.

The loan agreements with TMCC consist of eight term loans. As of June 30, 2014, $50.8 million was outstanding under the TMCC term loans, with $7.0 million classified as a current maturity of long-term debt. For the six months ended June 30, 2014, the Company made no additional borrowings and made principal payments of $0.8 million. These loans will mature by September 2020 and provide for monthly payments based on a 20-year amortization schedule. These eight loans are cross-collateralized and cross-defaulted with each other and are cross-defaulted with the Revolving Credit Facility.

The loan agreements with MBFS consist of three term loans. As of June 30, 2014, $44.7 million was outstanding under the MBFS term loans, with $1.7 million classified as a current maturity of long-term debt. For the six months ended June 30, 2014, the Company made no additional borrowings and made principal payments of $0.8 million. The agreements provide for monthly payments based on a 20-year amortization schedule and will mature by December 2030. These three loans are cross-collateralized and cross-defaulted with each other and are also cross-defaulted with the Revolving Credit Facility.

The loan agreements with BMWFS consist of 14 term loans. As of June 30, 2014, $68.1 million was outstanding under the BMWFS term loans, with $4.2 million classified as a current maturity of long-term debt. For the six months ended June 30, 2014, the Company made no additional borrowings and made principal payments of $2.0 million. The agreements provide for monthly payments based on a 15-year amortization schedule and will mature September 2019. In the case of three properties owned by subsidiaries, the applicable loan is also guaranteed by the subsidiary real property owner. These 14 loans are cross-collateralized with each other. In addition, they are cross-defaulted with each other, the Revolving Credit Facility, and certain dealership franchising agreements with BMW of North America, LLC.

The loan agreements with FMCC consist of 2 term loans. As of June 30, 2014, $18.9 million was outstanding under the FMCC term loans, with $0.8 million classified as a current maturity of long-term debt. For the six months ended

June 30, 2014, the Company made additional borrowings and principal payments of $13.8 million and $0.3 million, respectively. The agreements provide for monthly payments based on an 11-year amortization schedule that will mature by January 2024. These 2 loans are cross-defaulted with the Revolving Credit Facility.

In addition, agreements with third-party financial institutions consist of 14 term loans for an aggregate principal amount of $90.6 million, to finance real estate associated with the Company's dealerships. The loans are being repaid in monthly installments that will mature by November 2022. As of June 30, 2014, borrowings under these notes totaled $81.2 million, with $4.6 million classified as a current maturity of long-term debt. For the six months ended June 30, 2014, the Company made additional borrowings and principal payments of $18.7 million and $1.8 million, respectively. These 14 loans are cross-defaulted with the Revolving Credit Facility.

The Company has also entered into separate term mortgage loans in the U.K. with other third-party financial institutions which are secured by the Company's U.K. properties. These mortgage loans (collectively, "Foreign Notes") are being repaid in

monthly installments that mature August 2027. As of June 30, 2014, borrowings under the Foreign Notes totaled $30.2 million, with $4.0 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets. For the six months ended June 30, 2014, the Company made no additional borrowings and made principal payments of $8.5 million.

During the six months ended June 30, 2014, the Company entered into working capital loan agreements with a third-party financial institution in Brazil for R$22.0 million. The proceeds were used to partially pay off manufacturer-affiliated floorplan borrowings. This loan is to be repaid in full by February 2017.

Fair Value of Long-Term Debt

The Company's outstanding 2.25% Notes had a fair value of $261.2 million and $231.6 million as of June 30, 2014 and December 31, 2013, respectively. The Company's outstanding 3.00% Notes had a fair value of $52.9 million and $231.2 million as of June 30, 2014 and December 31, 2013, respectively. The Company's outstanding 5.00% Notes had a fair value of $351.8 million as of June 30, 2014. Of the $307.7 million and $279.2 million other real estate related and long-term debt as of June 30, 2014 and December 31, 2013, respectively, $160.2 million and $164.1 million represented fixed interest rate borrowings. The fair value of such fixed interest rate borrowings was $185.8 million and $190.0 million as of June 30, 2014 and December 31, 2013, respectively. The fair value estimates are based on Level 2 inputs of the fair value hierarchy available as of June 30, 2014 and December 31, 2013. The Company determined the estimated fair value of its long-term debt using available market information and commonly accepted valuation methodologies. Considerable judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, these estimates are not necessarily indicative of the amounts that the Company, or holders of the instruments, could realize in a current market exchange. The use of different assumptions and/or estimation methodologies could have a material effect on estimated fair values. The carrying value of the Company's variable rate debt approximates fair value due to the short-term nature of the interest rates.

10. FAIR VALUE MEASUREMENTS

ASC 820 defines fair value as the price that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date; requires disclosure of the extent to which fair value is used to measure financial and non-financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date; establishes a three-level valuation hierarchy based upon the transparency of inputs utilized in the measurement and valuation of financial assets or liabilities as of the measurement date:

- Level 1 — unadjusted, quoted prices for identical assets or liabilities in active markets;
- Level 2 — quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted market prices that are observable or that can be corroborated by observable market data by correlation; and
- Level 3 — unobservable inputs based upon the reporting entity's internally developed assumptions that market participants would use in pricing the asset or liability.

The Company's financial instruments consist primarily of cash and cash equivalents, contracts-in-transit and vehicle receivables, accounts and notes receivable, investments in debt and equity securities, accounts payable, credit facilities, long-term debt and interest rate swaps. The fair values of cash and cash equivalents, contracts-in-transit and vehicle receivables, accounts and notes receivable, accounts payable, and credit facilities approximate their carrying values due to the short-term nature of these instruments or the existence of variable interest rates.

The Company periodically invests in unsecured, corporate demand obligations with manufacturer-affiliated finance companies, which bear interest at a variable rate and are redeemable on demand by the Company. Therefore, the Company has classified these demand obligations as cash and cash equivalents in the accompanying Consolidated Balance Sheets. The Company determined that the valuation measurement inputs of these instruments include inputs other than quoted market prices, that are observable or that can be corroborated by observable data by correlation. Accordingly, the Company has classified these instruments within level 2 of the hierarchy framework.

The Company's derivative financial instruments are recorded at fair market value. See Note 3, "Derivative Instruments and Risk Management Activities" for further details regarding the Company's derivative financial instruments.

See Note 9, "Long-term Debt" for details regarding the fair value of the Company's long-term debt.
The Company evaluated its assets and liabilities for those that met the criteria of the disclosure requirements and fair value framework of ASC 820 and identified debt instruments and interest rate derivative financial instruments as having met such criteria. The respective fair values measured on a recurring basis as of June 30, 2014 and December 31, 2013, respectively, were as follows:

23

	As of June 30, 2014		
	Level 1	Level 2	Total
	(In thousands)		
Assets:			
Interest rate derivative financial instruments	$—	$536	$536
Debt securities:			
Demand obligations	$—	$74	$74
Total	$—	$610	$610
Liabilities:			
Interest rate derivative financial instruments	$—	$27,271	$27,271
Total	$—	$27,271	$27,271

	As of December 31, 2013		
	Level 1	Level 2	Total
	(In thousands)		
Assets:			
Interest rate derivative financial instruments	$—	$3,919	$3,919
Total	$—	$3,919	$3,919
Liabilities:			
Interest rate derivative financial instruments	$—	$26,078	$26,078
Total	$—	$26,078	$26,078

11. COMMITMENTS AND CONTINGENCIES

From time to time, the Company’s dealerships are named in various types of litigation involving customer claims, employment matters, class action claims, purported class action claims, as well as claims involving the manufacturer of automobiles, contractual disputes and other matters arising in the ordinary course of business. Due to the nature of the automotive retailing business, the Company may be involved in legal proceedings or suffer losses that could have a material adverse effect on the Company’s business. In the normal course of business, the Company is required to respond to customer, employee and other third-party complaints. Amounts that have been accrued or paid related to the settlement of litigation are included in SG&A expenses in the Company’s Consolidated Statements of Operations. In addition, the manufacturers of the vehicles that the Company sells and services have audit rights allowing them to review the validity of amounts claimed for incentive, rebate or warranty-related items and charge the Company back for amounts determined to be invalid payments under the manufacturers’ programs, subject to the Company’s right to appeal any such decision. Amounts that have been accrued or paid related to the settlement of manufacturer chargebacks of recognized incentives and rebates are included in cost of sales in the Company’s Consolidated Statements of Operations, while such amounts for manufacturer chargebacks of recognized warranty-related items are included as a reduction of revenues in the Company’s Consolidated Statements of Operations.

Legal Proceedings

Currently, the Company is not party to any legal proceedings that, individually or in the aggregate, are reasonably expected to have a material adverse effect on the Company's results of operations, financial condition, or cash flows, including class action lawsuits. However, the results of current, or future, matters cannot be predicted with certainty, and an unfavorable resolution of one or more of such matters could have a material adverse effect on the Company's results of operations, financial condition, or cash flows.

Other Matters

The Company, acting through its subsidiaries, is the lessee under many real estate leases that provide for the use by the Company’s subsidiaries of their respective dealership premises. Pursuant to these leases, the Company’s subsidiaries generally agree to indemnify the lessor and other parties from certain liabilities arising as a result of the use of the leased premises, including environmental liabilities, or a breach of the lease by the lessee. Additionally, from time to time, the Company enters into agreements in connection with the sale of assets or businesses in which it agrees to indemnify the purchaser, or other parties, from certain liabilities or costs arising in connection with the

assets or business. Also, in the ordinary course of business in connection with purchases or sales of goods and services, the Company enters into agreements that may contain indemnification provisions. In the event that an indemnification claim is asserted, liability would be limited by the terms of the applicable agreement.

From time to time, primarily in connection with dealership dispositions, the Company's subsidiaries assign or sublet to the dealership purchaser the subsidiaries' interests in any real property leases associated with such dealerships. In general, the Company's subsidiaries retain responsibility for the performance of certain obligations under such leases to the extent that the assignee or sublessee does not perform, whether such performance is required prior to or following the assignment or subletting of the lease. Additionally, the Company and its subsidiaries generally remain subject to the terms of any guarantees made by the Company and its subsidiaries in connection with such leases. Although the Company generally has indemnification rights against the assignee or sublessee in the event of non-performance under these leases, as well as certain defenses, and the Company presently has no reason to believe that it or its subsidiaries will be called on to perform under any such assigned leases or subleases, the Company estimates that lessee rental payment obligations during the remaining terms of these leases were $3.5 million as of June 30, 2014. The Company's exposure under these leases is difficult to estimate and there can be no assurance that any performance of the Company or its subsidiaries required under these leases would not have a material adverse effect on the Company's business, financial condition, or cash flows. The Company and its subsidiaries also may be called on to perform other obligations under these leases, such as environmental remediation of the leased premises or repair of the leased premises upon termination of the lease. However, the Company does not have any known material environmental commitments or contingencies and presently has no reason to believe that it or its subsidiaries will be called on to so perform.

In the ordinary course of business, the Company is subject to numerous laws and regulations, including automotive, environmental, health and safety, and other laws and regulations. The Company does not anticipate that the costs of such compliance will have a material adverse effect on its business, consolidated results of operations, financial condition, or cash flows, although such outcome is possible given the nature of its operations and the extensive legal and regulatory framework applicable to its business. The Dodd-Frank Wall Street Reform and Consumer Protection Act, which was signed into law on July 21, 2010, established a new consumer financial protection agency with broad regulatory powers. Although automotive dealers are generally excluded, the Dodd-Frank Act could lead to additional, indirect regulation of automotive dealers through its regulation of automotive finance companies and other financial institutions. In addition, the Patient Protection and Affordable Care Act, which was signed into law on March 23, 2010, has the potential to increase the Company's future annual employee health care costs. Further, new laws and regulations, particularly at the federal level, may be enacted, which could also have a materially adverse impact on its business.

12. INTANGIBLE FRANCHISE RIGHTS AND GOODWILL

The following is a roll-forward of the Company's intangible franchise rights and goodwill accounts:

	Intangible Franchise Rights			
	U.S.	U.K.	Brazil	Total
	(In thousands)			
BALANCE, December 31, 2013	$216,412	$8,659	$76,434	$301,505
Additions through acquisitions	18,988	—	—	18,988
Purchase price allocation adjustments	(2,114)	—	(9,061)	(11,175)
Currency Translation	—	292	4,803	5,095
BALANCE, June 30, 2014	$233,286	$8,951	$72,176	$314,413

	Goodwill			
	U.S.	U.K.	Brazil	Total
	(In thousands)			
BALANCE, December 31, 2013	$612,468	$19,602	$105,233	$737,303 [1]
Additions through acquisitions	34,588	—	—	34,588
Disposals	(729)	—	—	(729)
Purchase price allocation adjustments	1,446	—	5,975	7,421
Currency Translation	—	662	7,052	7,714
Tax adjustments	(33)	—	—	(33)
BALANCE, June 30, 2014	$647,740	$20,264	$118,260	$786,264 [1]

[1] Net of accumulated impairment of $40.3 million.

13. ACCUMULATED OTHER COMPREHENSIVE LOSS

Changes in the balances of each component of accumulated other comprehensive loss for the six months ended June 30, 2014 and 2013 were as follows:

	Six Months Ended June 30, 2014		
	Accumulated foreign currency translation loss	Accumulated loss on interest rate swaps	Total
	(In thousands)		
Balance, December 31, 2013	$(37,827)	$(13,850)	$(51,677)
Other comprehensive income (loss) before reclassifications:			—
Pre-tax	14,609	(10,182)	4,427
Tax effect	—	3,818	3,818
Amounts reclassified from accumulated other comprehensive income to:			
Floorplan interest expense	—	4,884	4,884
Other interest expense	—	722	722
Tax effect	—	(2,102)	(2,102)
Net current period other comprehensive income	14,609	(2,860)	11,749
Balance, June 30, 2014	$(23,218)	$(16,710)	$(39,928)

	Six Months Ended June 30, 2013		
	Accumulated foreign currency translation loss	Accumulated loss on interest rate swaps	Total
	(In thousands)		
Balance, December 31, 2012	$(6,126)	$(26,931)	$(33,057)
Other comprehensive income (loss) before reclassifications:			
Pre-tax	(26,724)	12,304	(14,420)
Tax effect	—	(4,614)	(4,614)
Amounts reclassified from accumulated other comprehensive income to:			
Floorplan interest expense	—	4,848	4,848
Other interest expense	—	606	606
Tax effect	—	(2,045)	(2,045)
Net current period other comprehensive (loss) income	(26,724)	11,099	(15,625)
Balance, June 30, 2013	$(32,850)	$(15,832)	$(48,682)

14. SEGMENT INFORMATION

As of June 30, 2014, the Company had three reportable segments: (1) the U.S., (2) the U.K., and (3) Brazil. Each of the reportable segments is comprised of retail automotive franchises, which sell new vehicles, used vehicles, parts and automotive services, finance and insurance products, and collision centers. The vast majority of the Company's corporate activities are associated with the operations of the U.S. operating segments and therefore the corporate financial results are included within the U.S. reportable segment.

The reportable segments identified above are the business activities of the Company for which discrete financial information is available and for which operating results are regularly reviewed by our chief operating decision maker to allocate resources and assess performance. Our chief operating decision maker is our Chief Executive Officer.

Reportable segment revenue, income (loss) before income taxes, provision for income taxes and net income (loss) were as follows for the three and six months ended June 30, 2014 and 2013:

	Three Months Ended June 30, 2014				Six Months Ended June 30, 2014			
	U.S.	U.K.	Brazil	Total	U.S.	U.K.	Brazil	Total
	(In thousands)							
Total revenues	$2,060,596	$251,324	$199,718	$2,511,638	$3,895,222	$499,025	$378,254	$4,772,501
Income (loss) before income taxes	34,466 (1)	5,517	(1,789)	38,194	80,328 (1)	10,134	(3,055)	87,407
Provision for income taxes	(20,235)	(691)	(406)	(21,332)	(37,063)	(1,656)	(523)	(39,242)
Net income (loss)	14,231 (1)	4,826	(2,195)	16,862	43,265 (1)	8,478	(3,578)	48,165

	Three Months Ended June 30, 2013				Six Months Ended June 30, 2013			
	U.S.	U.K.	Brazil	Total	U.S.	U.K.	Brazil (2)	Total
	(In thousands)							
Total revenues	$1,881,654	$207,436	$246,020	$2,335,110	$3,603,440	$378,514	$316,988	$4,298,942
Income before income taxes	53,226	3,837	3,116	60,179	91,780	5,841	1,806	99,427
Provision for income taxes	(21,017)	(865)	(909)	(22,791)	(38,106)	(1,353)	(462)	(39,921)
Net income	32,209	2,972	2,207	37,388	53,674	4,488	1,344	59,506

	As of June 30, 2014			
	U.S.	U.K.	Brazil	Total
	(In thousands)			
Total assets	$3,339,609	$276,336	$360,945	$3,976,890
	As of December 31, 2013			
	U.S.	U.K.	Brazil	Total
	(In thousands)			
Total assets	$3,241,192	$237,960	$340,326	$3,819,478

(1) Includes loss on purchase of long-term debt of $23.6 million.

(2) Represents financial data from date of acquisition on February 28, 2013.

28

CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (this “Form 10-Q”) includes certain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 (“Securities Act”), and Section 21E of the Securities Exchange Act of 1934 (“Exchange Act”). This information includes statements regarding our plans, goals or current expectations with respect to, among other things:

•our future operating performance;
•our ability to maintain or improve our margins;
•operating cash flows and availability of capital;
•the completion of future acquisitions;
•the future revenues of acquired dealerships;
•future stock repurchases, refinancing of convertible notes and dividends;
•future capital expenditures;
•changes in sales volumes and availability of credit for customer financing in new and used vehicles and sales volumes in the parts and service markets;
•business trends in the retail automotive industry, including the level of manufacturer incentives, new and used vehicle retail sales volume, customer demand, interest rates and changes in industry-wide inventory levels; and
•the availability of financing for inventory, working capital, real estate and capital expenditures.

Although we believe that the expectations reflected in these forward-looking statements are reasonable when and as made, we cannot assure you that these expectations will prove to be correct. When used in this Form 10-Q, the words “anticipate,” “believe,” “estimate,” “expect,” "intend," “may” and similar expressions, as they relate to our company and management, are intended to identify forward-looking statements. Our forward-looking statements are not assurances of future performance and involve risks and uncertainties (some of which are beyond our control). Actual results may differ materially from anticipated results in the forward-looking statements for a number of reasons, including:

•future deterioration in the economic environment, including consumer confidence, interest rates, the price of gasoline, the level of manufacturer incentives and the availability of consumer credit may affect the demand for new and used vehicles, replacement parts, maintenance and repair services and finance and insurance products;
•adverse domestic and international developments such as war, terrorism, political conflicts or other hostilities may adversely affect the demand for our products and services;
•the existing and future regulatory environment, including legislation related to the Dodd-Frank Wall Street Reform and Consumer Protection Act, climate control changes legislation, and unexpected litigation or adverse legislation, including changes in state franchise laws, may impose additional costs on us or otherwise adversely affect us;
•a concentration of risk associated with our principal automobile manufacturers, especially Toyota, Nissan, Honda, BMW, Ford, Daimler, General Motors, Chrysler, and Volkswagen, because of financial distress, bankruptcy, natural disasters that disrupt production or other reasons, may not continue to produce or make available to us vehicles that are in high demand by our customers or provide financing, insurance, advertising or other assistance to us;
•restructuring by one or more of our principal manufacturers, up to and including bankruptcy may cause us to suffer financial loss in the form of uncollectible receivables, devalued inventory or loss of franchises;
•requirements imposed on us by our manufacturers may require dispositions, limit our acquisitions or increases in the level of capital expenditures related to our dealership facilities;
•our existing and/or new dealership operations may not perform at expected levels or achieve expected improvements;
•our failure to achieve expected future cost savings or future costs may be higher than we expect;
•manufacturer quality issues, including the recall of vehicles, may negatively impact vehicle sales and brand reputation;
•available capital resources, increases in cost of financing (such as higher interest rates) and our various debt agreements may limit our ability to complete acquisitions, complete construction of new or expanded facilities, repurchase shares or pay dividends;
•our ability to refinance or obtain financing in the future may be limited and the cost of financing could increase significantly;

- foreign exchange controls and currency fluctuations;
- new accounting standards could materially impact our reported earnings per share;
- our ability to acquire new dealerships and successfully integrate those dealerships into our business;
- the impairment of our goodwill, our indefinite-lived intangibles and our other long-lived assets;
- natural disasters and adverse weather events;
- our foreign operations and sales in the U.K. and Brazil, which pose additional risks;
- the inability to adjust our cost structure to offset any reduction in the demand for our products and services;
- our loss of key personnel;
- competition in our industry may impact our operations or our ability to complete additional acquisitions;
- the failure to achieve expected sales volumes from our new franchises;
- insurance costs could increase significantly and all of our losses may not be covered by insurance; and
- our inability to obtain inventory of new and used vehicles and parts, including imported inventory, at the cost, or in the volume, we expect.

For additional information regarding known material factors that could cause our actual results to differ from our projected results, please see Part I, "Item 1A. Risk Factors" in our 2013 Form 10-K.

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. We undertake no responsibility to publicly release the result of any revision of our forward-looking statements after the date they are made.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements because of various factors. See "Cautionary Statement about Forward-Looking Statements."

Overview

We are a leading operator in the automotive retail industry. Through our dealerships, we sell new and used cars and light trucks; arrange related vehicle financing; sell service and insurance contracts; provide automotive maintenance and repair services; and sell vehicle parts. We are aligned into four geographic regions: the East and West Regions in the United States ("U.S."), the United Kingdom ("U.K.") Region, and the Brazil Region. Each region represents an operating segment. Each U.S. region is managed by a regional vice president who reports directly to our Chief Executive Officer and is responsible for the overall performance of their regions. The financial matters of each U.S. region are managed by a regional chief financial officer who reports directly to our Chief Financial Officer. Further, the East and West Regions of the U.S. continue to be economically similar in that they deliver the same products and services to a common customer group, their customers are generally individuals, they follow the same procedures and methods in managing their operations, and they operate in similar regulatory environments. As such, the East and West regions of the U.S. are aggregated into one reportable segment, resulting in three reportable segments: the U.S., which includes the activities of our corporate office, the U.K. and Brazil.

As of June 30, 2014, we owned and operated 193 franchises, representing 34 brands of automobiles, at 151 dealership locations and 37 collision centers worldwide. We own 151 franchises at 118 dealerships and 28 collision centers in the U.S., 19 franchises at 14 dealerships and four collision centers in the U.K., as well as 23 franchises at 19 dealerships and five collision centers in Brazil. Our operations are primarily located in major metropolitan areas in Alabama, California, Florida, Georgia, Kansas, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York, Oklahoma, South Carolina and Texas in the U.S., in 13 towns of the U.K. and in key metropolitan markets in the states of Sao Paulo and Parana in Brazil.

Outlook

During the six months ended June 30, 2014, consumer demand for new and used vehicles in the U.S. improved over the same period in 2013. According to industry experts, the average seasonally adjusted annual rate of sales ("SAAR") in the U.S. for the six months ended June 30, 2014 was 16.1 million units, compared to 15.4 million units for the six months ended June 30, 2013. We believe that the improving economic trends provide opportunities for us to improve our operating results as we: (a) expand our new and used vehicle unit sales and improve our sales efficiency; (b) continue to focus on our higher margin parts and service business, implementing strategic selling methods, and improving operational efficiencies; (c) invest capital where necessary to support our anticipated growth, particularly in our parts and service business; and (d) further leverage our revenue and gross profit growth through continued cost controls.

The U.K. economy represents the sixth largest economy in the world. The U.K. automotive sales market continues to outperform the rest of Europe. Vehicle registrations in the U.K. increased 10.6% in the six months ended June 30, 2014, as compared to the same period a year ago. Sustainable growth is expected for the remainder of 2014 with new vehicle sales continuing to improve.

The Brazilian economy represents the seventh largest in the world and recently has been one of the fastest growing economies in the world. However, the Brazilian economy is facing many challenges and is currently not demonstrating significant growth. New vehicle registrations in Brazil declined 7.3% during the six months ended June 30, 2014 as compared to the same period a year ago. With government elections pending, we expect economic conditions in Brazil to remain challenged in the near term and automobile industry sales to be flat to down for the remainder of 2014. But, we remain optimistic for the growth in the longer term.

During the first six months of 2014, several manufacturers recalled vehicles in the U.S. and worldwide, mostly during the second quarter. General Motors, Honda, Mazda, Nissan, BMW, Ford, Toyota, and Chrysler recalled millions of vehicles for varying issues including air bags, power steering and ignition switches. Some of these recalls included the stop-sale orders for certain models, impacting our vehicle sales performance and increasing our inventory carrying

costs. The manufacturers' recalls are anticipated to have a positive effect on our warranty parts and service business through at least the fourth quarter of 2014. However, the impact of these product quality issues to the aforementioned manufacturer's brand reputation, as well as the resulting impact to our new and used vehicle businesses, cannot be accurately predicted at this time.

Our operations have generated, and we believe that our operations will continue to generate, positive cash flow. As such, we are focused on maximizing the return that we generate from our invested capital and positioning our balance sheet to take advantage of investment opportunities as they arise. We remain committed to our growth-by-acquisition strategy. We believe that significant opportunities exist to enhance our portfolio with dealerships that meet our stringent investment criteria in the U.S., U.K. and Brazil. During the first six months of 2014, we completed the acquisition of four dealerships, were granted one

franchise in the U.S. and opened a dealership for an awarded franchise in Brazil. We will continue to pursue dealership investment opportunities that we believe will add value for our stockholders.

We continue to closely scrutinize all planned future capital spending and work closely with our original equipment manufacturer ("OEM") partners in this area to make prudent investment decisions that are expected to generate an adequate return and/or improve the customer experience. We anticipate that our capital spending for the year of 2014 will be less than $95.0 million.

Financial and Operational Highlights

Our operating results reflect the combined performance of each of our interrelated business activities, which include the sale of new vehicles, used vehicles, finance and insurance products, and parts, as well as maintenance and collision repair services. Historically, each of these activities has been directly or indirectly impacted by a variety of supply/demand factors, including vehicle inventories, consumer confidence, discretionary spending, availability and affordability of consumer credit, manufacturer incentives, weather patterns, fuel prices and interest rates. For example, during periods of sustained economic downturn or significant supply/demand imbalances, new vehicle sales may be negatively impacted as consumers tend to shift their purchases to used vehicles. Some consumers may even delay their purchasing decisions altogether, electing instead to repair their existing vehicles. In such cases, however, we believe the new vehicle sales impact on our overall business is mitigated by our ability to offer other products and services, such as used vehicles and parts, as well as maintenance and collision repair services. In addition, our ability to reduce our costs in response to lower sales also tempers the impact of lower new vehicle sales volume.

In the U.S., we generally experience higher volumes of vehicle sales and service in the second and third calendar quarters of each year. This seasonality is generally attributable to consumer buying trends and the timing of manufacturer new vehicle model introductions. In addition, in some regions of the U.S., vehicle purchases decline during the winter months due to inclement weather. As a result, our U.S. revenues and operating income are typically lower in the first and fourth quarters and higher in the second and third quarters. For the U.K., the first and third calendar quarters tend to be stronger, driven by plate change months of March and September. For Brazil, we expect higher volumes in the third and fourth calendar quarters. The first quarter is generally the weakest, driven by heavy consumer vacations and activities associated with Carnival. Other factors unrelated to seasonality, such as changes in economic condition and manufacturer incentive programs, may exaggerate seasonal or cause counter-seasonal fluctuations in our revenues and operating income.

For the three months ended June 30, 2014, total revenues increased 7.6% from 2013 levels to $2.5 billion and gross profit improved 8.2% to $369.1 million over the prior year period. For the six months ended June 30, 2014, total revenues increased 11.0% from 2013 levels to $4.8 billion and gross profit improved 10.2% to $707.3 million over the prior year period. Operating income increased from 2013 levels by 5.1% to $84.7 million for the three months ended June 30, 2014 and by 11.5% to $155.3 million for the six months ended June 30, 2014. Income before income taxes decreased to $38.2 million for the second quarter of 2014, which was a 36.5% decline over the comparable prior year period, and decreased to $87.4 million for six months ended June 30, 2014, which was a 12.1% decline from 2013. For the three months ended June 30, 2014, we experienced a 54.9% decline in net income to $16.9 million and a 56.6% decrease in diluted income per share to $0.62 each as compared to the three months ended June 30, 2013. For the six months ended June 30, 2014, we experienced a 19.1% decrease in net income to $48.2 million and a 22.4% decrease in diluted income per share to $1.80 as compared to the six months ended June 30, 2013. The decreases in income before income taxes and net income for the three and six months ended June 30, 2014 compared to 2013 primarily reflect the $23.6 million loss recognized on the purchase of the majority of our 3.00% Convertible Senior Notes due 2020 ("3.00% Notes") in a tender offer in June 2014. For the three and six months ended June 30, 2014, our weighted average dilutive common shares outstanding increased 5.1% and 5.3% over the prior year periods to 26.2 million and 25.8 million, respectively. This increase was primarily the result of the increase in dilution from the potential conversion of our 3.00% Notes and 2.25% Convertible Senior Notes due 2036 ("2.25% Notes"), which mirrors the rise in our average stock price during the second quarter and first half of 2014 as compared with the same periods in 2013. The share dilution calculation does not include the beneficial impact of the call spreads that we have in place. A complete presentation of the dilutive effect of the 3.00% Notes and 2.25% Notes can be found in the Liquidity and Capital Resources section of this Item 2. For the six months ended June 30, 2014 and 2013, our net cash

provided by operations was $130.9 million and $87.3 million, respectively, and our adjusted net cash provided by operations was $87.2 million and $154.6 million, respectively. See further explanation of the adjusted cash flow metrics in the Non-GAAP Financial Measures section of this Item 2.

Table of Contents

Key Performance Indicators

Consolidated Statistical Data

The following table highlights certain of the key performance indicators we use to manage our business.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Unit Sales				
Retail Sales				
New Vehicle	42,456	41,531	80,205	74,627
Used Vehicle	26,721	25,634	53,598	48,872
Total Retail Sales	69,177	67,165	133,803	123,499
Wholesale Sales	13,230	13,072	26,014	24,407
Total Vehicle Sales	82,407	80,237	159,817	147,906
Gross Margin				
New Vehicle Retail Sales	5.5 %	5.8 %	5.4 %	5.8 %
Total Used Vehicle Sales	7.0 %	7.1 %	7.1 %	7.4 %
Parts and Service Sales	53.4 %	52.5 %	53.0 %	52.6 %
Total Gross Margin	14.7 %	14.6 %	14.8 %	14.9 %
SG&A[1] as a % of Gross Profit	73.7 %	73.6 %	74.9 %	75.5 %
Operating Margin	3.4 %	3.5 %	3.3 %	3.2 %
Pretax Margin	1.5 %	2.6 %	1.8 %	2.3 %
Finance and Insurance Revenues per Retail Unit Sold	$1,303	$1,188	$1,299	$1,214

(1) Selling, general and administrative expenses.

The following discussion briefly highlights certain of the results and trends occurring within our business. Throughout the following discussion, references are made to Same Store results and variances which are discussed in more detail in the "Results of Operations" section that follows.

Our consolidated new vehicle retail sales revenues increased 6.5% and 10.0% for the three and six months ended June 30, 2014, respectively, as compared to the same periods in 2013. This growth is primarily a result of stronger consumer confidence in the U.S., better industry conditions in the U.K., dealership acquisition activity, improved inventory levels and the execution of initiatives made by our operating team, partially offset by weakening economic conditions in Brazil which were magnified in the second quarter by disruptions from the 2014 FIFA World Cup activities. New vehicle retail gross margin declined 30 basis points to 5.5% and 40 basis points to 5.4% for the three and six months ended June 30, 2014, respectively, as compared to the same periods in 2013, as gross profit per retail unit sold decreased in most of our brands, primarily reflecting the increasingly competitive nature of the U.S. industry.

Our used vehicle results are directly affected by economic conditions, the level of manufacturer incentives on new vehicles and new vehicle financing, the number and quality of trade-ins and lease turn-ins, the availability of consumer credit, and our ability to effectively manage the level and quality of our overall used vehicle inventory. Our used vehicle retail sales revenues increased 7.9% and 12.0% for the three and six months ended June 30, 2014, respectively, as compared to the same periods in 2013. This growth primarily reflects increases in the used vehicle retail unit sales of 4.2% and 9.7%, as compared to the respective periods in 2013, including the impact of our dealership acquisitions in the U.K. and Brazil in the first quarter of 2013, as well as our other 2013 and 2014 acquisitions. The improving economic environment in the U.S. and the U.K. that has benefited new vehicle sales also supported improved used vehicle demand. Used vehicle retail gross margin declined 20 and 50 basis points, respectively, for the three and six months ended June 30, 2014, as compared to the same periods in 2013. Used vehicle margins are generally lower in our U.K. and Brazil segments, therefore, the decline in consolidated used vehicle gross margin partially relates to the mix shift effect, as a result of a larger contribution from our foreign segments.

Our parts and service sales increased 8.5% and 10.8% for the three and six months ended June 30, 2014, respectively, as compared to the same periods in 2013. This growth was driven by increases in all aspects of our business: customer-pay, wholesale parts, warranty and collision. Our parts and service gross margin increased 90 and 40 basis

points for the three and six months ended June 30, 2014, respectively, as compared to the same periods in 2013.
Our consolidated finance and insurance revenues per retail unit ("PRU") sold increased $115 and $85 for the three and six months ended June 30, 2014, as compared to the same periods in 2013, primarily as a result of higher income per contract and

33

Table of Contents

penetration rates from most of our major U.S. product offerings. This improvement was partially offset by the mix effect of increased business in the U.K. and Brazil where income per retail unit sold tends to be lower.

Our total gross margin increased 10 basis points for the three months ended June 30, 2014 and decreased 10 basis points for the first half of 2014, as compared to the same periods in 2013.

Our consolidated SG&A expenses increased as a percentage of gross profit by 10 basis points to 73.7% for the second quarter of 2014, as compared to the same period in 2013. Declines of 80 basis points and 260 basis points in the U.S. and U.K. were more than offset by an increase in Brazil, driven largely by a 15.6% decline in gross profit. For the six months ended June 30, 2014, SG&A expenses as a percentage of gross profit declined by 60 basis points to 74.9%, as compared to the same period in 2013, partially reflecting the impact of charges for catastrophic event and business acquisition costs incurred in 2013, offset by gains on real estate and dealership transactions in 2013, unfavorable country mix and the impact of severe winter weather in the U.S. which drove higher costs for snow removal and wages paid during store closures in the first quarter of 2014.

For the three months ended June 30, 2014, floorplan interest expense decreased 5.0%, as compared to the same period in 2013, primarily reflecting a 25 basis point decline in the floorplan line interest rate of our U.S. Revolving Credit Facility, which was effective with the June 20, 2013 amendment. For the first half of 2014, floorplan interest expense increased 5.0% as compared to the same period in 2013, primarily as a result of an increase in our floorplan borrowings associated with dealership acquisitions, particularly the 2013 acquisition of UAB Motors Particpações S.A. (“UAB Motors”), and expanded inventory levels necessary to support higher sales rates. Other interest expense, net increased 31.3% and 22.7%, respectively, for the three and six months ended June 30, 2014, as compared to the same periods in 2013, primarily reflecting the impact of the 5.00% Notes offering executed in June 2014, as well as higher average borrowing to support additional dealership acquisitions and the associated real estate. A portion of the proceeds from the 5.00% Notes offering was subsequently used to purchase our 3.00% Notes.

We address these items further, and other variances between the periods presented, in the “Results of Operations” section below.

Critical Accounting Policies and Accounting Estimates

The preparation of our Consolidated Financial Statements in conformity with U.S. generally accepted accounting principles requires management to make certain estimates and assumptions.

We disclosed certain critical accounting policies and estimates in our Form 10-K for the year ended December 31, 2013 (the "2013 Form 10-K"), and no significant changes have occurred since that time.

Table of Contents

Results of Operations

The following tables present comparative financial and non-financial data for the three and six months ended June 30, 2014 and 2013 of (a) our "Same Store" locations, (b) those locations acquired or disposed of during the periods ("Transactions"), and (c) the consolidated company. Same Store amounts include the results of dealerships for the identical months in each period presented in the comparison, commencing with the first full month in which the dealership was owned by us and, in the case of dispositions, ending with the last full month it was owned by us. Same Store results also include the activities of our corporate headquarters.

Total Same Store Data

(dollars in thousands, except per unit amounts)

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	% Change	2013	2014	% Change	2013
Revenues						
New vehicle retail	$1,379,746	3.0%	$1,339,116	$2,493,991	3.6%	$2,408,273
Used vehicle retail	543,487	4.2%	521,342	1,034,349	5.7%	978,208
Used vehicle wholesale	90,347	12.4%	80,354	170,257	11.8%	152,355
Parts and service	266,405	5.6%	252,332	507,677	5.9%	479,270
Finance, insurance and other	85,573	9.9%	77,893	163,838	12.4%	145,742
Total revenues	$2,365,558	4.2%	$2,271,037	$4,370,112	5.0%	$4,163,848
Cost of Sales						
New vehicle retail	$1,303,775	3.5%	$1,259,998	$2,359,656	4.0%	$2,268,036
Used vehicle retail	500,990	4.6%	478,882	953,853	6.4%	896,743
Used vehicle wholesale	89,053	11.8%	79,628	166,127	11.3%	149,220
Parts and service	124,501	4.0%	119,754	238,387	4.9%	227,355
Total cost of sales	$2,018,319	4.1%	$1,938,262	$3,718,023	5.0%	$3,541,354
Gross profit	$347,239	4.3%	$332,775	$652,089	4.8%	$622,494
SG&A	$255,146	1.9%	$250,355	$483,483	1.9%	$474,481
Depreciation and amortization expenses	$10,073	16.5%	$8,648	$19,003	12.5%	$16,885
Floorplan interest expense	$9,802	(8.0)%	$10,650	$18,938	(4.4)%	$19,809
Gross Margin						
New vehicle retail	5.5%		5.9%	5.4%		5.8%
Total used vehicle	6.9%		7.2%	7.0%		7.5%
Parts and service	53.3%		52.5%	53.0%		52.6%
Total gross margin	14.7%		14.7%	14.9%		14.9%
SG&A as a % of gross profit	73.5%		75.2%	74.1%		76.2%
Operating margin	3.4%		3.2%	3.4%		3.1%
Finance and insurance revenues per retail unit sold	$1,319	10.4%	$1,195	$1,352	10.5%	$1,223

The discussion that follows provides explanation for the variances noted above. In addition, each table presents by primary income statement line item comparative financial and non-financial data of our Same Store locations, those locations acquired or disposed of ("Transactions") during the periods and the consolidated company for the three and six months ended June 30, 2014 and 2013.

Table of Contents

New Vehicle Retail Data
(dollars in thousands, except per unit amounts)

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	% Change	2013	2014	% Change	2013
Retail Unit Sales						
Same Stores						
U.S.	32,231	3.0%	31,297	60,347	3.0%	58,566
U.K.	3,626	0.6%	3,605	6,955	8.1%	6,432
Brazil	4,087	(23.4)%	5,337	5,330	(21.9)%	6,828
Total Same Stores	39,944	(0.7)%	40,239	72,632	1.1%	71,826
Transactions	2,512		1,292	7,573		2,801
Total	42,456	2.2%	41,531	80,205	7.5%	74,627
Retail Sales Revenues						
Same Stores						
U.S.	$1,106,285	6.2%	$1,041,504	$2,058,721	4.9%	$1,963,058
U.K.	131,803	19.3%	110,473	254,063	23.8%	205,298
Brazil	141,658	(24.3)%	187,139	181,207	(24.5)%	239,917
Total Same Stores	1,379,746	3.0%	1,339,116	2,493,991	3.6%	2,408,273
Transactions	86,318		37,103	240,909		78,181
Total	$1,466,064	6.5%	$1,376,219	$2,734,900	10.0%	$2,486,454
Gross Profit						
Same Stores						
U.S.	$57,615	0.9%	$57,091	$105,410	(1.6)%	$107,155
U.K.	9,040	26.5%	7,148	17,210	24.9%	13,781
Brazil	9,316	(37.4)%	14,879	11,715	(39.3)%	19,301
Total Same Stores	75,971	(4.0)%	79,118	134,335	(4.2)%	140,237
Transactions	4,875		1,247	13,417		2,763
Total	$80,846	0.6%	$80,365	$147,752	3.3%	$143,000
Gross Profit per Retail Unit Sold						
Same Stores						
U.S.	$1,788	(2.0)%	$1,824	$1,747	(4.5)%	$1,830
U.K.	$2,493	25.7%	$1,983	$2,474	15.4%	$2,143
Brazil	$2,279	(18.3)%	$2,788	$2,198	(22.2)%	$2,827
Total Same Stores	$1,902	(3.3)%	$1,966	$1,850	(5.2)%	$1,952
Transactions	$1,941		$965	$1,772		$986
Total	$1,904	(1.6)%	$1,935	$1,842	(3.9)%	$1,916
Gross Margin						
Same Stores						
U.S.	5.2 %		5.5 %	5.1 %		5.5 %
U.K.	6.9 %		6.5 %	6.8 %		6.7 %
Brazil	6.6 %		8.0 %	6.5 %		8.0 %
Total Same Stores	5.5 %		5.9 %	5.4 %		5.8 %
Transactions	5.6 %		3.4 %	5.6 %		3.5 %
Total	5.5 %		5.8 %	5.4 %		5.8 %

Table of Contents

Same Store New Vehicle Unit Sales

The following table sets forth our Same Store new vehicle retail unit sales volume by manufacturer.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	% Change	2013	2014	% Change	2013
Toyota	11,109	4.2%	10,660	20,077	3.9%	19,317
BMW	4,617	3.2%	4,474	8,214	4.3%	7,872
Honda	4,586	(8.0)%	4,985	8,004	(7.3)%	8,637
Ford	4,014	(14.4)%	4,687	7,754	(7.5)%	8,382
Nissan	3,943	1.9%	3,868	7,152	3.5%	6,909
Volkswagen	2,662	2.3%	2,602	5,151	5.8%	4,870
General Motors	2,061	11.7%	1,845	3,912	8.3%	3,612
Hyundai	1,996	11.1%	1,797	3,844	17.3%	3,276
Chrysler	1,857	14.4%	1,623	3,583	17.9%	3,038
Mercedes-Benz	1,775	0.7%	1,763	3,278	0.6%	3,259
Other	1,324	(31.6)%	1,935	1,663	(37.3)%	2,654
Total	39,944	(0.7)%	40,239	72,632	1.1%	71,826

We believe the focus that we have placed on improving our dealership sales processes, as well as the increase in overall U.S. and U.K. industry sales, have contributed to increased Same Store new vehicle retail sales in those segments. In Brazil, however, our new vehicle sales experienced pressure as the economy slowed and sales efforts were disrupted with the events of the 2014 FIFA World Cup. Our total Same Store new vehicle retail sales revenues increased 3.0% for the three months ended June 30, 2014, as compared to the same period in 2013, as a result of the 3.0% increase in new vehicle retail unit sales in the U.S., as well as a 3.1% increase in the U.S. Same Store average retail sales price to $34,324. In total, our new vehicle retail unit sales improved in most of our major brand offerings, highlighted by a 4.2% improvement in Toyota, 14.4% growth in Chrysler, an 11.7% increase in General Motors, and an 11.1% improvement in Hyundai unit sales. Our U.S. Same Store new vehicle retail unit sales experienced similar brand trends. The growth in our U.S. Same Store average retail sales price was highlighted by increases in our BMW, Mercedes-Benz, Chrysler and General Motors brands. The level of retail sales, as well as our own ability to retain or grow market share during any future period, is difficult to predict.

Our total Same Store new vehicle gross profit decreased 4.0% for the three months ended June 30, 2014, as compared to the same period in 2013. Within the total decrease, U.S. Same Store new vehicle gross profit rose 0.9%, on the growth in new retail unit sales, partially offset by a 2.0% decline in gross profit PRU. Same Store gross profit in the U.K. grew 26.5%, primarily as a result of a 25.7% improvement in gross profit PRU. More than offsetting these increases, Brazil's Same Store new vehicle gross profit declined 37.4%, driven by an 18.3% decline in Brazil Same Store gross profit PRU to $2,279 coupled with a 23.4% decrease in unit sales. As a result, our total Same Store new vehicle gross margin for the three months ended June 30, 2014 declined 40 basis points to 5.5% as compared to the same period in 2013.

For the six months ended June 30, 2014, total Same Store new vehicle retail sales revenues increased 3.6% and unit sales increased 1.1%, as compared to the same period in 2013. Our U.S. Same Store average retail sales price increased 1.8% to $34,115, compared to the same period in 2013. Total Same Store gross profit PRU decreased 5.2% to $1,850 in the first six months of 2014 from $1,952 during the same period in 2013, and, as a result, our gross margin decreased 40 basis points from 5.8% to 5.4%.

Most manufacturers offer interest assistance to offset floorplan interest charges incurred in connection with inventory purchases. This assistance varies by manufacturer, but generally provides for a defined amount, adjusted periodically for changes in market interest rates, regardless of our actual floorplan interest rate or the length of time for which the inventory is financed. We record these incentives as a reduction of new vehicle cost of sales as the vehicles are sold, impacting the gross profit and gross margin detailed above. The total assistance recognized in cost of sales during the three months ended June 30, 2014 and 2013 was $11.5 million and $10.0 million, respectively. The amount of interest assistance we recognize in a given period is primarily a function of: (a) the mix of units being sold, as U.S. domestic brands tend to provide more assistance, (b) the specific terms of the respective manufacturers' interest assistance

programs and market interest rates, (c) the average wholesale price of inventory sold, and (d) our rate of inventory turnover. Over the past three years, manufacturers' interest assistance as a percentage of our total consolidated floorplan interest expense has ranged from 87.3% in the first quarter of 2013 to 115.9% in the third quarter of 2012. For the second quarter of 2014, consolidated manufacturer's assistance was 111.7% of consolidated floorplan interest expense, and U.S. manufacturer's interest assistance was 136.1% of U.S. floorplan interest expense.

37

Table of Contents

We decreased our new vehicle inventory levels by $62.0 million, or 5.3%, from $1,165.3 million as of December 31, 2013 to $1,103.4 million as of June 30, 2014, partially reflecting the continued improvement in the U.S. and U.K. selling environments. We increased our new vehicle inventory levels by $102.0 million, or 10.2%, from $1,001.4 million as of June 30, 2013. Our consolidated days' supply of new vehicle inventory remained flat at 72 days as of June 30, 2014 compared to December 31, 2013 and increased compared to 67 days as of June 30, 2013.

Used Vehicle Retail Data
(dollars in thousands, except per unit amounts)

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	% Change	2013	2014	% Change	2013
Retail Unit Sales						
Same Stores						
U.S.	20,955	(1.2)%	21,215	42,156	1.5%	41,549
U.K.	2,720	7.8%	2,524	4,773	12.3%	4,252
Brazil	1,271	7.5%	1,182	1,605	1.8%	1,576
Total Same Stores	24,946	0.1%	24,921	48,534	2.4%	47,377
Transactions	1,775		713	5,064		1,495
Total	26,721	4.2%	25,634	53,598	9.7%	48,872
Retail Sales Revenues						
Same Stores						
U.S.	$440,854	1.3%	$435,111	$865,179	3.1%	$838,917
U.K.	73,260	25.4%	58,429	132,804	28.4%	103,394
Brazil	29,373	5.7%	27,802	36,366	1.3%	35,897
Total Same Stores	543,487	4.2%	521,342	1,034,349	5.7%	978,208
Transactions	33,763		13,462	92,798		27,995
Total	$577,250	7.9%	$534,804	$1,127,147	12.0%	$1,006,203
Gross Profit						
Same Stores						
U.S.	$35,809	(4.0)%	$37,299	$70,471	(4.3)%	$73,648
U.K.	4,930	21.8%	4,048	7,830	25.0%	6,265
Brazil	1,758	58.0%	1,113	2,195	41.4%	1,552
Total Same Stores	42,497	0.1%	42,460	80,496	(1.2)%	81,465
Transactions	3,169		1,045	7,971		2,316
Total	$45,666	5.0%	$43,505	$88,467	5.6%	$83,781
Gross Profit per Unit Sold						
Same Stores						
U.S.	$1,709	(2.8)%	$1,758	$1,672	(5.7)%	$1,773
U.K.	$1,813	13.0%	$1,604	$1,640	11.3%	$1,473
Brazil	$1,383	46.8%	$942	$1,368	38.9%	$985
Total Same Stores	$1,704	—%	$1,704	$1,659	(3.5)%	$1,720
Transactions	$1,785		$1,466	$1,574		$1,549
Total	$1,709	0.7%	$1,697	$1,651	(3.7)%	$1,714
Gross Margin						
Same Stores						
U.S.	8.1%		8.6%	8.1%		8.8%
U.K.	6.7%		6.9%	5.9%		6.1%
Brazil	6.0%		4.0%	6.0%		4.3%
Total Same Stores	7.8%		8.1%	7.8%		8.3%
Transactions	9.4%		7.8%	8.6%		8.3%

Total	7.9	%	8.1	%	7.8	%	8.3	%

Table of Contents

Used Vehicle Wholesale Data
(dollars in thousands, except per unit amounts)

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	% Change	2013	2014	% Change	2013
Wholesale Unit Sales						
Same Stores						
U.S.	9,883	4.5%	9,453	19,403	4.1%	18,638
U.K.	2,195	(2.5)%	2,251	3,919	6.1%	3,694
Brazil	561	(36.3)%	881	721	(35.4)%	1,116
Total Same Stores	12,639	0.4%	12,585	24,043	2.5%	23,448
Transactions	591		487	1,971		959
Total	13,230	1.2%	13,072	26,014	6.6%	24,407
Wholesale Sales Revenues						
Same Stores						
U.S.	$64,025	19.1%	$53,763	$124,920	14.7%	$108,883
U.K.	21,549	20.0%	17,958	39,297	23.9%	31,722
Brazil	4,773	(44.7)%	8,633	6,040	(48.6)%	11,750
Total Same Stores	90,347	12.4%	80,354	170,257	11.8%	152,355
Transactions	4,624		2,962	13,887		5,512
Total	$94,971	14.0%	$83,316	$184,144	16.6%	$157,867
Gross Profit						
Same Stores						
U.S.	$1,192	158.0%	$462	$3,507	36.1%	$2,576
U.K.	(281)	(54.2)%	(614)	131	124.7%	(531)
Brazil	383	(56.4)%	878	492	(54.9)%	1,090
Total Same Stores	1,294	78.2%	726	4,130	31.7%	3,135
Transactions	(53)		(214)	223		(201)
Total	$1,241	142.4%	$512	$4,353	48.4%	$2,934
Gross Profit per Wholesale Unit Sold						
Same Stores						
U.S.	$121	146.9%	$49	$181	31.2%	$138
U.K.	$(128)	(53.1)%	$(273)	$33	122.9%	$(144)
Brazil	$683	(31.5)%	$997	$682	(30.2)%	$977
Total Same Stores	$102	75.9%	$58	$172	28.4%	$134
Transactions	$(90)		$(439)	$113		$(210)
Total	$94	141.0%	$39	$167	39.2%	$120
Gross Margin						
Same Stores						
U.S.	1.9%		0.9%	2.8%		2.4%
U.K.	(1.3)%		(3.4)%	0.3%		(1.7)%
Brazil	8.0%		10.2%	8.1%		9.3%
Total Same Stores	1.4%		0.9%	2.4%		2.1%
Transactions	(1.1)%		(7.2)%	1.6%		(3.6)%
Total	1.3%		0.6%	2.4%		1.9%

Table of Contents

Total Used Vehicle Data
(dollars in thousands, except per unit amounts)

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	% Change	2013	2014	% Change	2013
Used Vehicle Unit Sales						
Same Stores						
U.S.	30,838	0.6%	30,668	61,559	2.3%	60,187
U.K.	4,915	2.9%	4,775	8,692	9.4%	7,946
Brazil	1,832	(11.2)%	2,063	2,326	(13.6)%	2,692
Total Same Stores	37,585	0.2%	37,506	72,577	2.5%	70,825
Transactions	2,366		1,200	7,035		2,454
Total	39,951	3.2%	38,706	79,612	8.6%	73,279
Sales Revenues						
Same Stores						
U.S.	$504,879	3.3%	$488,874	$990,099	4.5%	$947,800
U.K.	94,809	24.1%	76,387	172,101	27.4%	135,116
Brazil	34,146	(6.3)%	36,435	42,406	(11.0)%	47,647
Total Same Stores	633,834	5.3%	601,696	1,204,606	6.5%	1,130,563
Transactions	38,387		16,424	106,685		33,507
Total	$672,221	8.8%	$618,120	$1,311,291	12.6%	$1,164,070
Gross Profit						
Same Stores						
U.S.	$37,001	(2.0)%	$37,761	$73,978	(2.9)%	$76,224
U.K.	4,649	35.4%	3,434	7,961	38.8%	5,734
Brazil	2,141	7.5%	1,991	2,687	1.7%	2,642
Total Same Stores	43,791	1.4%	43,186	84,626	—%	84,600
Transactions	3,116		831	8,194		2,115
Total	$46,907	6.6%	$44,017	$92,820	7.0%	$86,715
Gross Profit per Unit Sold						
Same Stores						
U.S.	$1,200	(2.5)%	$1,231	$1,202	(5.1)%	$1,266
U.K.	$946	31.6%	$719	$916	26.9%	$722
Brazil	$1,169	21.1%	$965	$1,155	17.7%	$981
Total Same Stores	$1,165	1.2%	$1,151	$1,166	(2.3)%	$1,194
Transactions	$1,317		$693	$1,165		$862
Total	$1,174	3.3%	$1,137	$1,166	(1.4)%	$1,183
Gross Margin						
Same Stores						
U.S.	7.3 %		7.7 %	7.5 %		8.0 %
U.K.	4.9 %		4.5 %	4.6 %		4.2 %
Brazil	6.3 %		5.5 %	6.3 %		5.5 %
Total Same Stores	6.9 %		7.2 %	7.0 %		7.5 %
Transactions	8.1 %		5.1 %	7.7 %		6.3 %
Total	7.0 %		7.1 %	7.1 %		7.4 %

In addition to factors such as general economic conditions and consumer confidence, our used vehicle business is affected by the level of manufacturer incentives on new vehicles and new vehicle financing, the number and quality of trade-ins and lease turn-ins, the availability of consumer credit, and our ability to effectively manage the level and

quality of our overall used vehicle inventory.

Our total Same Store used vehicle retail revenues increased 4.2% for the three months ended June 30, 2014, as compared to the same period in 2013, reflecting a 4.1% increase in average used vehicle retail selling price to $21,787 on relatively flat total Same Store used vehicle retail unit sales. Each of our segments generated growth in Same Store used vehicle retail revenues, led by our U.K. Same Store used vehicle retail revenues that increased 25.4% for the three months ended June 30,

Table of Contents

2014, as compared to the same period in 2013, reflecting a 16.3% increase in average used vehicle retail sales price and an increase in used retail vehicle unit sales of 7.8%. Same Store average used vehicle retail sales price also grew in the U.S., from $20,510 in 2013 to $21,038. In Brazil, a 7.5% improvement in Same Store used retail unit sales was partially offset by a 1.7% decline in Same Store used vehicle average retail sales price from $23,521 in 2013 to $23,110.

For the six months ended June 30, 2014, our total Same Store used vehicle retail revenue improved by 5.7% primarily as a result of an increase in total Same Store used vehicle average retail sales price of 3.2% to $21,312, coupled with a 2.4% increase in total Same Store used vehicle retail unit sales, as compared to the same period in 2013.

Our total Same Store used vehicle retail gross profit grew 0.1% for the three months ended June 30, 2014, as compared to prior year, reflecting improvements in both our U.K. and Brazil segments, which were substantially offset by a decline in our U.S. segment. Same Store used vehicle retail gross profit PRU increased 13.0% in the U.K. and 46.8% in Brazil, offset by a decrease in the U.S. of 2.8%. For the six months ended June 30, 2014, we realized similar trends.

Our U.S. Same Store Certified Pre-Owned ("CPO") volume increased 6.6% to 6,050 units sold for the three months ended June 30, 2014, as compared to the same period of 2013. As a percentage of the U.S. Same Store used vehicle retail unit sales, CPO units increased 210 basis points to 28.9% for the second quarter of 2014, as compared to the same period in 2013. CPO units sold represented 28.5% of U.S. Same Store used retail units sold for the six months ended June 30, 2014, as compared to 26.9% for the same period in 2013.

During the second quarter of 2014, total Same Store wholesale used vehicle revenue increased by 12.4%, driven by a 4.5% increase in our U.S. Same Store wholesale used vehicle unit sales, along with an increase in U.S. Same Store used vehicle wholesale average sales price of 13.9%, as compared to the same period in 2013. Total Same Store wholesale used vehicle gross profit per unit increased $44 to $102 for the three months ended June 30, 2014 and $38 to $172 for the six months ended June 30, 2014, as compared to the same periods in 2013.

We increased our used vehicle inventory levels by $35.2 million, or 15.2%, from $232.0 million as of December 31, 2013 and by $41.2 million, or 18.3%, from $225.9 million as of June 30, 2013 to $267.1 million as of June 30, 2014, primarily in response to an improved selling environment and our dealership acquisitions. Our consolidated days' supply of used vehicle inventory was 35 days at June 30, 2014, which was flat from December 31, 2013 levels and up from 33 days at June 30, 2013.

Table of Contents

Parts and Service Data
(dollars in thousands)

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	% Change	2013	2014	% Change	2013
Parts and Services Revenue						
Same Stores						
U.S.	$227,172	5.4%	$215,467	$444,027	5.4%	$421,248
U.K.	20,206	18.7%	17,024	38,588	21.4%	31,795
Brazil	19,027	(4.1)%	19,841	25,062	(4.4)%	26,227
Total Same Stores	266,405	5.6%	252,332	507,677	5.9%	479,270
Transactions	16,802		8,618	44,847		19,190
Total	$283,207	8.5%	$260,950	$552,524	10.8%	$498,460
Gross Profit						
Same Stores						
U.S.	$122,599	6.2%	$115,414	$237,416	5.7%	$224,556
U.K.	11,331	18.2%	9,585	21,351	25.1%	17,069
Brazil	7,974	5.2%	7,579	10,523	2.3%	10,290
Total Same Stores	141,904	7.0%	132,578	269,290	6.9%	251,915
Transactions	9,345		4,493	23,622		10,174
Total	$151,249	10.3%	$137,071	$292,912	11.8%	$262,089
Gross Margin						
Same Stores						
U.S.	54.0%		53.6%	53.5%		53.3%
U.K.	56.1%		56.3%	55.3%		53.7%
Brazil	41.9%		38.2%	42.0%		39.2%
Total Same Stores	53.3%		52.5%	53.0%		52.6%
Transactions	55.6%		52.1%	52.7%		53.0%
Total	53.4%		52.5%	53.0%		52.6%

Our total Same Store parts and service revenues increased 5.6% to $266.4 million for the three months ended June 30, 2014 and 5.9% to $507.7 million for the six months ended June 30, 2014, as compared to the same periods in 2013, reflecting growth in both our U.S. and U.K. segments. For the three months ended June 30, 2014, our U.S. Same Store parts and service revenue increased 5.4%, or $11.7 million, driven primarily by an 11.3% increase in wholesale parts revenues, a 7.8% increase in warranty revenues, a 2.1% increase in customer-pay parts and service revenue, and a 3.8% increase in collision revenue, when compared to the same period in 2013. For the six months ended June 30, 2014, our U.S. Same Store parts and service revenues increased 5.4%, as compared to the same period in 2013. The overall increase in our U.S. Same Store parts and service revenue consisted of improvements in our wholesale parts business of 11.6%, our warranty parts and service revenues of 6.0%, our collision revenues of 7.0% and our customer pay parts and service revenues of 1.8%. These results were tempered by the negative impact of severe winter weather in the U.S. during the first quarter 2014. Our U.K. Same Store parts and service revenues grew 18.7%, or $3.2 million, for the three months ended June 30, 2014 and 21.4%, or $6.8 million, for the six months ended June 30, 2014, as compared to the same periods in 2013, driven primarily by an increase in customer-pay parts and service revenues of 13.7% for the three months ended June 30, 2014 and 17.6% for the six months ended June 30, 2014, as well as increases in our other U.K. parts and service revenues. Our Same Store parts and service revenues in Brazil declined 4.1%, or $0.8 million, and 4.4%, or $1.2 million, for the three and six months ended June 30, 2014, respectively, largely due to a decline in our Same Store customer-pay parts and service business.

Our total Same Store gross profit for the three and six months ended June 30, 2014 increased 7.0% and 6.9%, respectively, as compared to the same periods in 2013. For the three months ended June 30, 2014, our total Same Store parts and service gross margins improved 80 basis points, as compared to the same period in 2013. Similarly, for the six months ended June 30, 2014, our total Same Store parts and service gross margins increased 40 basis points, as

compared to the same period in 2013.

Table of Contents

Finance and Insurance Data
(dollars in thousands, except per unit amounts)

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	% Change	2013	2014	% Change	2013
Retail New and Used Unit Sales						
Same Stores						
U.S.	53,186	1.3%	52,512	102,503	2.4%	100,115
U.K.	6,346	3.5%	6,129	11,728	9.8%	10,684
Brazil	5,358	(17.8)%	6,519	6,935	(17.5)%	8,404
Total Same Stores	64,890	(0.4)%	65,160	121,166	1.6%	119,203
Transactions	4,287		2,005	12,637		4,296
Total	69,177	3.0%	67,165	133,803	8.3%	123,499
Retail Finance Fees						
Same Stores						
U.S.	$25,287	4.2%	$24,265	$49,158	5.6%	$46,565
U.K.	2,713	33.6%	2,030	5,111	38.5%	3,689
Brazil	731	(0.1)%	732	766	(19.3)%	949
Total Same Stores	28,731	6.3%	27,027	55,035	7.5%	51,203
Transactions	1,876		795	4,000		1,706
Total	$30,607	10.0%	$27,822	$59,035	11.6%	$52,909
Vehicle Service Contract Fees						
Same Stores						
U.S.	$30,549	6.2%	$28,757	$60,638	10.4%	$54,905
U.K.	53	—%	53	94	67.9%	56
Brazil	—	—%	—	—	—%	—
Total Same Stores	30,602	6.2%	28,810	60,732	10.5%	54,961
Transactions	1,463		732	2,569		1,634
Total	$32,065	8.5%	$29,542	$63,301	11.8%	$56,595
Insurance and Other						
Same Stores						
U.S.	$22,345	19.4%	$18,722	$42,077	21.0%	$34,778
U.K.	1,735	18.8%	1,461	3,279	28.5%	2,552
Brazil	2,160	15.3%	1,873	2,715	20.8%	2,248
Total Same Stores	26,240	19.0%	22,056	48,071	21.5%	39,578
Transactions	1,234		401	3,379		876
Total	$27,474	22.3%	$22,457	$51,450	27.2%	$40,454
Total Finance and Insurance Revenues						
Same Stores						
U.S.	$78,181	9.0%	$71,744	$151,873	11.5%	$136,248
U.K.	4,501	27.0%	3,544	8,484	34.7%	6,297
Brazil	2,891	11.0%	2,605	3,481	8.9%	3,197
Total Same Stores	85,573	9.9%	77,893	163,838	12.4%	145,742
Transactions	4,573		1,928	9,948		4,216
Total	$90,146	12.9%	$79,821	$173,786	15.9%	$149,958
Finance and Insurance Revenues per Retail Unit Sold						
Same Stores						
U.S.	$1,470	7.6%	$1,366	$1,482	8.9%	$1,361

U.K.	$709	22.7%	$578	$723	22.8%	$589
Brazil	$540	35.0%	$400	$502	32.1%	$380
Total Same Stores	$1,319	10.4%	$1,195	$1,352	10.5%	$1,223
Transactions	$1,067	10.9%	$962	$787	(19.8)%	$981
Total	$1,303	9.7%	$1,188	$1,299	7.0%	$1,214

Table of Contents

Our efforts to improve our finance and insurance business processes, coupled with improved retail vehicle sales volumes, continued to generate growth in our finance and insurance revenues. Our total Same Store finance and insurance revenues increased 9.9%, to $85.6 million, for the three months ended June 30, 2014, as compared to the same period in 2013, driven by our U.S. Same Store revenues growing $6.4 million, or 9.0%. The improvement in the U.S. was primarily the result of an increase in income per contract and penetration rates from most of our major product offerings, as well as a 1.3% increase in new and used retail unit sales. These increases more than offset an increase in our chargeback expense. We generated a 27.0% increase in our U.K. Same Store finance and insurance revenues, reflecting improved finance penetration rates and finance income per contract. As a result of the improvements in both income per contract and penetration rates, our total Same Store finance and insurance revenues PRU improved 10.4% to $1,319, as compared to the same period in 2013.

Our total Same Store finance and insurance revenues improved 12.4% for the six months ended June 30, 2014, as compared to the same period in 2013, primarily reflecting a 2.4% increase in our U.S. new and used retail sales volumes, coupled with an increase in our U.S. income per contract and improvements in penetration rates of most of our major U.S. product offerings. Our Same Store finance and insurance revenues in the U.K. grew as a result of the 9.8% increase in retail unit sales, as well as improved finance penetration rates and finance income per contract. For the six months ended June 30, 2014, our total Same Store revenues PRU increased 10.5% to $1,352, as compared to the same period in 2013.

Selling, General and Administrative Data
(dollars in thousands)

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	% Change	2013	2014	% Change	2013
Personnel						
Same Stores						
U.S.	$128,890	2.5%	$125,796	$254,720	2.3%	$248,987
U.K.	13,298	25.0%	10,640	25,043	24.6%	20,104
Brazil	11,241	(9.2)%	12,377	14,286	(11.6)%	16,159
Total Same Stores	153,429	3.1%	148,813	294,049	3.1%	285,250
Transactions	10,048		4,789	26,513		10,050
Total	$163,477	6.4%	$153,602	$320,562	8.6%	$295,300
Advertising						
Same Stores						
U.S.	$16,983	28.0%	$13,265	$30,808	22.7%	$25,102
U.K.	910	19.9%	759	1,881	58.5%	1,187
Brazil	642	(7.8)%	696	812	(4.4)%	849
Total Same Stores	18,535	25.9%	14,720	33,501	23.4%	27,138
Transactions	1,349		751	2,802		1,416
Total	$19,884	28.5%	$15,471	$36,303	27.1%	$28,554
Rent and Facility Costs						
Same Stores						
U.S.	$21,139	1.1%	$20,906	$42,722	2.2%	$41,798
U.K.	2,107	0.2%	2,102	3,975	(3.1)%	4,101
Brazil	4,083	(5.0)%	4,299	5,436	(6.2)%	5,793
Total Same Stores	27,329	0.1%	27,307	52,133	0.9%	51,692
Transactions	1,742		1,945	5,965		3,905
Total	$29,071	(0.6)%	$29,252	$58,098	4.5%	$55,597
Other SG&A						
Same Stores						

U.S.	$43,911	(12.3)%	$50,056	$85,634	(9.2)%	$94,313
U.K.	6,001	18.5%	5,062	11,078	20.3%	9,207
Brazil	5,941	35.1%	4,397	7,088	3.0%	6,881
Total Same Stores	55,853	(6.2)%	59,515	103,800	(6.0)%	110,401
Transactions	3,685		(6,681)	10,765		(5,260)
Total	$59,538	12.7%	$52,834	$114,565	9.0%	$105,141
Total SG&A						
Same Stores						
U.S.	$210,923	0.4%	$210,023	$413,884	0.9%	$410,200
U.K.	22,316	20.2%	18,563	41,977	21.3%	34,599
Brazil	21,907	0.6%	21,769	27,622	(6.9)%	29,682
Total Same Stores	255,146	1.9%	250,355	483,483	1.9%	474,481
Transactions	16,824		804	46,045		10,111
Total	$271,970	8.3%	$251,159	$529,528	9.3%	$484,592
Total Gross Profit						
Same Stores						
U.S.	$295,396	4.7%	$282,010	$568,677	4.5%	$544,183
U.K.	29,521	24.5%	23,711	55,006	28.3%	42,881
Brazil	22,322	(17.5)%	27,054	28,406	(19.8)%	35,430
Total Same Stores	347,239	4.3%	332,775	652,089	4.8%	622,494
Transactions	21,909		8,499	55,181		19,269
Total	$369,148	8.2%	$341,274	$707,270	10.2%	$641,763
SG&A as a % of Gross Profit						
Same Stores						
U.S.	71.4%		74.5%	72.8%		75.4%
U.K.	75.6%		78.3%	76.3%		80.7%
Brazil	98.1%		80.5%	97.2%		83.8%
Total Same Stores	73.5%		75.2%	74.1%		76.2%
Transactions	76.8%		9.5%	83.4%		52.5%
Total	73.7%		73.6%	74.9%		75.5%
Employees	12,000		11,000	12,000		11,000

44

Table of Contents

Our SG&A consists primarily of salaries, commissions and incentive-based compensation, as well as rent and facility costs, advertising, insurance, benefits, utilities and other fixed expenses. We believe that the majority of our personnel and all of our advertising expenses are variable and can be adjusted in response to changing business conditions. We continue to aggressively pursue opportunities that take advantage of our size and negotiating leverage with our vendors and service providers in order to rationalize our cost structure. Our business was hampered by severe weather in the U.S. during the first quarter 2014, causing store closures, reduced store traffic and incremental costs. For the three and six months ended June 30, 2014, our total Same Store SG&A included $1.7 million of charges relative to catastrophic events. For the comparable periods of 2013, our total Same Store SG&A included $11.1 million and $11.9 million of catastrophic events charges and zero and $6.5 million of acquisition costs, respectively.

Our total Same Store SG&A increased 1.9%, or $4.8 million, for the three months ended June 30, 2014, as compared to the same period in 2013. For the six months ended on June, 30 2014, total Same Store SG&A increased 1.9%, or $9.0 million as compared to the same period in 2013. Our total Same Store personnel costs also increased for the three and six months ended June 30, 2014, generally correlating with increased commission payments as a result of increased vehicle sales. For the three months ended June 30, 2014, our total Same Store rent and facility costs increased 0.1%, to $27.3 million, reflecting an increase in our U.S. Same Store rent and facility costs of 1.1%, as compared with the same period in 2013. For the six months ended June 30, 2014, our total Same Store rent and facility costs increased 0.9% to $52.1 million, driven by an increase in our U.S. Same Store rent and facility expense of 2.2%. Our total Same Store other SG&A decreased 6.2% and 6.0%, respectively, for the three and six months ended June 30, 2014, as compared to the same periods in 2013, partially as a result of the impact of business acquisition costs incurred in 2013 that did not repeat in 2014, as well as the catastrophic events charges mentioned above.

Table of Contents

Depreciation and Amortization Data
(dollars in thousands)

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	% Change	2013	2014	% Change	2013
Same Stores						
U.S.	$8,707	14.0%	$7,639	$16,867	12.2%	$15,032
U.K.	849	36.3%	623	1,452	17.7%	1,234
Brazil	517	33.9%	386	684	10.5%	619
Total Same Stores	10,073	16.5%	8,648	19,003	12.5%	16,885
Transactions	680		236	1,675		412
Total	$10,753	21.0%	$8,884	$20,678	19.5%	$17,297

Our total Same Store depreciation and amortization expense increased 16.5% and 12.5%, respectively, for the three and six months ended June 30, 2014, as compared to the same periods in 2013, as we continue to strategically add dealership-related real estate to our portfolio and make improvements to our existing facilities that are designed to enhance the profitability of our dealerships and the overall customer experience. We critically evaluate all planned future capital spending, working closely with our OEM partners to maximize the return on our investments.

Floorplan Interest Expense
(dollars in thousands)

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	% Change	2013	2014	% Change	2013
Same Stores						
U.S.	$7,842	(6.9)%	$8,422	$15,883	(3.8)%	$16,513
U.K.	336	(20.2)%	421	747	2.8%	727
Brazil	1,624	(10.1)%	1,807	2,308	(10.2)%	2,569
Total Same Stores	9,802	(8.0)%	10,650	18,938	(4.4)%	19,809
Transactions	527		223	2,304		428
Total	$10,329	(5.0)%	$10,873	$21,242	5.0%	$20,237
Memo:						
Total manufacturer’s assistance	$11,534	15.2%	$10,010	$21,351	17.4%	$18,183

Our floorplan interest expense fluctuates with changes in our borrowings outstanding and interest rates, which are based on the one-month London Inter Bank Offered Rate (“LIBOR”) (or Prime rate in some cases) in the U.S. and U.K. and a benchmark rate plus a spread in Brazil. To mitigate the impact of interest rate fluctuations, we employ an interest rate hedging strategy, whereby we swap variable interest rate exposure for a fixed interest rate over the term of the variable interest rate debt.

As of June 30, 2014, we had effective interest rate swaps with an aggregate notional amount of $450.0 million that fixed our underlying one-month LIBOR at a weighted average interest rate of 2.6%. The majority of the monthly settlements of these interest rate swap liabilities are recognized as floorplan interest expense. From time to time, we utilize excess cash on hand to pay down our floorplan borrowings, and the resulting interest earned is recognized as an offset to our gross floorplan interest expense.

Our total Same Store floorplan interest expense decreased 8.0% to $9.8 million for the three months ended June 30, 2014, and 4.4 % to $18.9 million, during the six months ended June 30, 2014, as compared to the same periods in 2013. The decreases represent a decline in our floorplan borrowing rate in the U.S. of 25 basis points that was effective on June 20, 2013 with the amendment to our Revolving Credit Facility. This decline was partially offset by an increase in Same Store weighted average floorplan borrowings outstanding in the U.S. of $62.1 million and $94.8 million for the three and six months ended June 30, 2014, respectively.

Other Interest Expense, net

Table of Contents

Other interest expense, net consists of interest charges primarily on our real estate related debt and our other long-term debt, partially offset by interest income. For the three months ended June 30, 2014, other interest expense increased $3.0 million, or 31.3%, to $12.6 million, as compared to the same period in 2013. For the six months ended June 30, 2014, other net interest expense increased $4.3 million, or 22.7%, to $23.1 million, as compared to the same period in 2013. These increases were primarily attributable to interest incurred on our 5.00% Notes offering that was executed in June 2014 in part to purchase the majority of our 3.00% Notes, as well as additional mortgage borrowings associated with recent dealership acquisitions and an increase in weighted average borrowings on our Acquisition Line (as defined below) to support dealership acquisitions.

Included in other interest expense, net for the three months ended June 30, 2014 and 2013 was a non-cash, discount amortization expense of $2.9 million and $2.7 million, respectively. For the six months ended June 30, 2014 and 2013, the discount amortization expense was $5.7 million and $5.3 million, respectively, representing the impact of the accounting for convertible debt as required by Accounting Standards Codifications Topic ("ASC") 470. The Company used a portion of the proceeds from the 5.00% Notes offering to purchase $92.5 million of the $115.0 million outstanding principal of the 3.00% Notes during the three months ended June 30, 2014 and notified holders of the 2.25% Notes on July 7, 2014 that it will redeem all of the outstanding 2.25% Notes on September 4, 2014.

Provision for Income Taxes

Our provision for income taxes decreased $1.5 million to $21.3 million for the three months ended June 30, 2014, as compared to the same period in 2013, primarily due to the decrease of pretax book income. For the three months ended June 30, 2014, our effective tax rate increased to 55.9% from 37.9% from the same period in 2013. This increase was primarily due to the tax deductible loss on the purchase of the majority of the 3.00% Notes that was less than the loss recognized for U.S. GAAP, additional valuation allowances recorded in respect of net operating losses of certain Brazil subsidiaries, as well as the mix of our pretax income from taxable state and foreign jurisdictions in which we operate. We expect our effective tax rate for the remainder of 2014 will be approximately 38.0%. We believe that it is more likely than not that our deferred tax assets, net of valuation allowances provided, will be realized, based primarily on the assumption of future taxable income and taxes available in carry back periods.

Our provision for income taxes decreased $0.7 million to $39.2 million for the six months ended June 30, 2014, as compared to the same period in 2013, primarily due to the decrease of pretax book income. For the six months ended June 30, 2014, our effective tax rate increased to 44.9% from 40.2% from the same period in 2013. This increase was also primarily due to the tax deductible loss on the purchase of the majority of the 3.00% Notes that was less than the loss recognized for U.S. GAAP, additional valuation allowances recorded in respect of net operating losses of certain Brazil subsidiaries,, as well as the mix of our pretax income from the taxable states and foreign jurisdictions in which we operate.

Liquidity and Capital Resources

Our liquidity and capital resources are primarily derived from cash on hand, cash temporarily invested as a pay down of Floorplan Line (defined below) levels, cash from operations, borrowings under our credit facilities, which provide vehicle floorplan financing, working capital and dealership and real estate acquisition financing, and proceeds from debt and equity offerings. Based on current facts and circumstances, we believe we will have adequate cash flow, coupled with available borrowing capacity, to fund our current operations, capital expenditures and acquisitions for the remainder of 2014. If economic and business conditions deteriorate or if our capital expenditures or acquisition plans for 2014 change, we may need to access the private or public capital markets to obtain additional funding.

Cash on Hand. As of June 30, 2014, our total cash on hand was $21.3 million. The balance of cash on hand excludes $64.6 million of immediately available funds used to pay down our Floorplan Line as of June 30, 2014. We use the pay down of our Floorplan Line as a channel for the short-term investment of excess cash.

Table of Contents

Cash Flows. With respect to all new vehicle floorplan borrowings in the normal course of business, the manufacturers of the vehicles draft our credit facilities directly with no cash flow to or from us. With respect to borrowings for used vehicle financing, we finance up to 80% of the value of our used vehicle inventory in the U.S., and the funds flow directly to us from the lender. All borrowings from, and repayments to, lenders affiliated with our vehicle manufacturers (excluding the cash flows from or to manufacturer-affiliated lenders participating in our syndicated lending group) are presented within Cash Flows from Operating Activities on the Consolidated Statements of Cash Flows in conformity with accounting principles generally accepted in the United States ("U.S. GAAP"). All borrowings from, and repayments to, the Revolving Credit Facility (defined below) (including the cash flows from or to manufacturer-affiliated lenders participating in the facility) and other credit facilities in Brazil unaffiliated with our manufacturer partners, are presented within Cash Flows from Financing Activities in conformity with U.S. GAAP. However, the incurrence of all floorplan notes payable represents an activity necessary to acquire inventory for resale, resulting in a trade payable. Our decision to utilize our Revolving Credit Facility does not substantially alter the process by which our vehicle inventory is financed, nor does it significantly impact the economics of our vehicle procurement activities. Therefore, we believe that all floorplan financing of inventory purchases in the normal course of business should correspond with the related inventory activity and be classified as an operating activity. As a result, we use the non-GAAP measure "Adjusted net cash provided by operating activities" to evaluate our cash flows. We believe that this classification eliminates excess volatility in our operating cash flows prepared in accordance with U.S. GAAP and avoids the potential to mislead the users of our financial statements.

Because the majority of our dealership acquisitions and dispositions are negotiated as asset purchases, we do not assume transfer of liabilities for floorplan financing in the execution of the transactions. Therefore, borrowings and repayments of all floorplan financing associated with dealership acquisition and disposition are characterized as either operating or financing activities in our statement of cash flows presented in conformity with U.S. GAAP, depending on the relationship described above. However, the floorplan financing activity is so closely related to the inventory acquisition process that we believe the presentation of all acquisition and disposition related floorplan financing activities should be classified as investing activity to correspond with the associated inventory activity, and we have made such adjustments in our adjusted operating cash flow presentations.

The following table sets forth selected historical information regarding cash flows from our Consolidated Statements of Cash Flows on an adjusted, non-GAAP basis. For further explanation and reconciliation to the most directly comparable measures see "Non-GAAP Financial Measures" below.

	Six Months Ended June 30,	
	2014	2013
	(In thousands)	
Adjusted net cash provided by operating activities	$87,181	$154,583
Adjusted net cash used in investing activities	(162,484)	(73,204)
Adjusted net cash provided by (used in) financing activities	75,296	(74,548)
Effect of exchange rate changes on cash	1,087	(629)
Net increase in cash and cash equivalents	$1,080	$6,202

Sources and Uses of Liquidity from Operating Activities

For the six months ended June 30, 2014, we generated $130.9 million of net cash flow from operating activities. On an adjusted basis, we generated $87.2 million in net cash flow from operating activities, primarily consisting of $48.2 million in net income, as well as non-cash adjustments related to depreciation and amortization of $20.7 million, a loss on the purchase of a majority of our 3.00% Notes in a tender offer of $23.6 million, deferred income taxes of $8.9 million, amortization of debt discounts and debt issue costs of $7.2 million, and stock-based compensation of $7.9 million. The cash inflows were partially offset by a $30.4 million net change in operating assets and liabilities. Included in the adjusted net changes of operating assets and liabilities were cash inflows of $24.4 million from decreases of inventory levels, $30.4 million from increases in accounts payable and accrued expenses, $15.0 million from decreases of vehicle receivables and contracts-in-transit, $0.2 million from increases in deferred revenues, and $0.7 million from the net decrease in prepaid expenses and other assets. These cash inflows were more than offset by adjusted cash outflows of $96.2 million from the net decrease in floorplan borrowings from manufacturer-affiliates

and other credit facilities and $4.8 million from the net increase in accounts and notes receivable.

For the six months ended June 30, 2013, we generated $87.3 million of net cash flow from operating activities. On an adjusted basis, we generated $154.6 million in net cash flow from operating activities, primarily driven by $59.5 million in net income and $63.9 million in adjusted net increase in operating assets and liabilities, as well as significant non-cash adjustments related to depreciation and amortization of $17.3 million, deferred income taxes of $9.3 million, amortization of debt discounts and debt issue costs of $6.8 million and stock-based compensation of $7.0 million. These cash inflows were partially offset by a $9.7 million gain on the disposition of assets. Included in the adjusted net changes of operating assets and liabilities are

adjusted cash inflows of $111.1 million from an increase in floorplan borrowings from manufacturer-affiliates and other credit facilities, $19.2 million from decreases of vehicle receivables and contracts-in-transit, $46.3 million from increases in accounts payable and accrued expenses, and $2.1 million from decreases in prepaid expenses and other assets. These cash inflows were partially offset by cash outflows of $111.9 million from increases in inventory levels and $3.1 million from increases in accounts and notes receivable.

Working Capital. At June 30, 2014, we had $211.2 million of working capital. Changes in our working capital are explained primarily by changes in floorplan notes payable outstanding. Borrowings on our new vehicle floorplan notes payable, subject to agreed upon pay-off terms, are equal to 100% of the factory invoice of the vehicles. Borrowings on our used vehicle floorplan notes payable, subject to agreed upon pay-off terms, are limited to 80% of the aggregate book value of our used vehicle inventory, except in the U.K. and Brazil. At times, we have made payments on our floorplan notes payable using excess cash flow from operations and the proceeds of debt and equity offerings. As needed, we re-borrow the amounts later, up to the limits on the floorplan notes payable discussed above, for working capital, acquisitions, capital expenditures or general corporate purposes.

Sources and Uses of Liquidity from Investing Activities

During the six months ended June 30, 2014, we used $194.4 million in net cash flow for investing activities. On an adjusted basis, we used $162.5 million in net cash flow for investing activities. We used $89.1 million of adjusted cash flows for the acquisition of four dealerships, including the associated real estate, in California and Texas. We also used $68.7 million during the first six months of 2014 for purchases of property and equipment and to construct new and improve existing facilities, consisting of $38.9 million for capital expenditures, $21.6 million for the purchase of real estate associated with existing dealership operations and an $8.2 million net decrease in the accrual for capital expenditures from year-end. We also used $6.1 million for escrow deposits on pending dealership and real estate acquisitions. These cash outflows were partially offset by cash inflows of $1.5 million related to dispositions of franchises and fixed assets.

During the six months ended June 30, 2013, we used $58.6 million for investing activities. On an adjusted basis, we used $73.2 million in net cash flow for investing activities, primarily related to the acquisition of 23 dealerships located in Brazil, the U.K. and the U.S. for $77.0 million in cash and 1.45 million shares of the Company's common stock. We also used $47.3 million during the first six months of 2013 for purchases of property and equipment and to construct new and improve existing facilities, consisting of $32.4 million for capital expenditures and $10.7 million for the purchase of real estate associated with existing dealership operations as well as a $4.2 million net change in the accrual for capital expenditures. These cash outflows were partially offset by cash proceeds of $50.5 million from dispositions of assets, which was primarily related to the disposition of dealerships as well as the related real estate.

Capital Expenditures. Our capital expenditures include costs to extend the useful lives of current facilities, as well as to start or expand operations. In general, expenditures relating to the construction or expansion of dealership facilities are driven by dealership acquisition activity, new franchises being granted to us by a manufacturer, significant growth in sales at an existing facility, relocation opportunities, or manufacturer imaging programs. We critically evaluate all planned future capital spending, working closely with our manufacturer partners to maximize the return on our investments. We forecast our capital expenditures for the full year of 2014 to be less than $95.0 million, which could generally be funded from excess cash.

Acquisitions. We generally purchase businesses based on expected return on investment. In general, the purchase price, excluding real estate and floorplan liabilities, is approximately 15% to 20% of the annual revenue. Cash needed to complete our acquisitions generally comes from excess working capital, operating cash flows of our dealerships, and borrowings under our floorplan facilities, Real Estate Credit Facility, term loans and our Acquisition Line.

Sources and Uses of Liquidity from Financing Activities

For the six months ended June 30, 2014, we generated $63.4 million in net cash flow from financing activities. On an adjusted basis, we generated $75.3 million in net cash flow from financing activities, primarily related to the issuance of $350.0 million of 5.00% Notes, $32.6 million from borrowings of long-term debt related to real estate loans, and $5.9 million of net borrowings of other debt mainly consisting of working capital loans in Brazil. These cash inflows were partially offset by $210.4 million used for the purchase of a majority of our 3.00% Notes in a tender offer, $40.0 million of net principal payments on our Acquisition Line, $17.8 million for principal payments of long-term debt

related to real estate loans, $8.2 million for dividend payments, $16.9 million to repurchase our Company's common stock, $6.5 million of debt issue costs related to our 5.00% Notes, and $14.6 million in adjusted net payments on our Floorplan Line.

Table of Contents

For the six months ended June 30, 2013, we used $21.9 million in net cash outflows from financing activities. On an adjusted basis, we used $74.5 million in net cash flow from financing activities, primarily related to $80.8 million of principal payments on debt, including $65.1 million for the extinguishment of debt assumed in the acquisition of 18 dealerships in Brazil, as well as $20.2 million for principal payments of long-term debt related to real estate loans. We used an additional $7.5 million for dividend payments during the first half of 2013. These cash outflows were partially offset by inflows of $25.6 million in net borrowings under the Floorplan Line, which included a net cash inflow of $30.3 million due to a decrease in our floorplan offset account, and $6.0 million from borrowings of long-term debt related to real estate loans.

Credit Facilities. Our various credit facilities are used to finance the purchase of inventory and real estate, provide acquisition funding and provide working capital for general corporate purposes.

Revolving Credit Facility. On June 20, 2013, we amended our Revolving Credit Facility principally to increase the total borrowing capacity from $1.35 billion to $1.7 billion and to extend the term from an expiration date of June 1, 2016 to June 20, 2018. The Revolving Credit Facility, which is comprised of 25 financial institutions, including six manufacturer-affiliated finance companies, consists of two tranches, providing a maximum of $1.6 billion for U.S. vehicle inventory floorplan financing (“Floorplan Line”), as well as a maximum of $320.0 million and a minimum of $100.0 million for working capital and general corporate purposes, including acquisitions (“Acquisition Line”). The capacity under these two tranches can be re-designated within the overall $1.7 billion commitment, subject to the aforementioned limits. Up to $125.0 million of the Acquisition Line can be borrowed in either euros or pound sterling. The Revolving Credit Facility can be expanded to a maximum commitment of $1.95 billion, subject to participating lender approval. The Floorplan Line bears interest at rates equal to the one-month LIBOR plus 125 basis points for new vehicle inventory and the one-month LIBOR plus 150 basis points for used vehicle inventory. The Acquisition Line bears interest at the one-month LIBOR plus 150 basis points plus a margin that ranges from zero to 100 basis points for borrowings in U.S. dollars and 150 to 250 basis points on borrowings in euros or pound sterling, depending on our total adjusted leverage ratio. The Floorplan Line requires a commitment fee of 0.20% per annum on the unused portion. The Acquisition Line also requires a commitment fee ranging from 0.25% to 0.45% per annum, depending on our total adjusted leverage ratio, based on a minimum commitment of $100.0 million less outstanding borrowings.

As of June 30, 2014, after considering outstanding balances, we had $337.7 million of available floorplan borrowing capacity under the Floorplan Line. Included in the $337.7 million available borrowings under the Floorplan Line was $64.6 million of immediately available funds. The weighted average interest rate on the Floorplan Line was 1.4% as of June 30, 2014, excluding the impact of our interest rate swaps. After considering $20.5 million in borrowings outstanding as of June 30, 2014, $43.2 million of outstanding letters of credit at June 30, 2014, and other factors included in our available borrowing base calculation, there was $220.8 million of available borrowing capacity under the Acquisition Line as of June 30, 2014. The amount of available borrowing capacity under the Acquisition Line may be limited from time to time based upon certain debt covenants.

All of our U.S. dealership-owning subsidiaries are co-borrowers under the Revolving Credit Facility. Our obligations under the Revolving Credit Facility are secured by essentially all of our U.S. personal property (other than equity interests in dealership-owning subsidiaries), including all motor vehicle inventory and proceeds from the disposition of dealership-owning subsidiaries, excluding inventory financed directly with manufacturer-affiliates and other third party financing institutions. The Revolving Credit Facility contains a number of significant covenants that, among other things, restrict our ability to make disbursements outside of the ordinary course of business, dispose of assets, incur additional indebtedness, create liens on assets, make investments and engage in mergers or consolidations. We are also required to comply with specified financial tests and ratios defined in the Revolving Credit Facility, such as the fixed charge coverage, total adjusted leverage, and senior secured adjusted leverage ratios. Further, the Revolving Credit Facility restricts our ability to make certain payments, such as dividends or other distributions of assets, properties, cash, rights, obligations or securities (“Restricted Payments”). The Restricted Payments are limited to the sum of $125.0 million plus (or minus if negative) (a) one-half of the aggregate consolidated net income for the period beginning on January 1, 2013 and ending on the date of determination and (b) the amount of net cash proceeds received from the sale of capital stock on or after January 1, 2013 and ending on the date of determination less (c) cash dividends and share repurchases (“Restricted Payment Basket”). For purposes of the calculation of the Restricted

Payment Basket calculation, net income represents such amounts per our consolidated financial statements, adjusted to exclude our foreign operations, non-cash interest expense, non-cash asset impairment charges, and non-cash stock-based compensation. As of June 30, 2014, the Restricted Payment Basket totaled $167.9 million.

Table of Contents

As of June 30, 2014, we were in compliance with all our financial covenants, including:

	As of June 30, 2014	
	Required	Actual
Senior Secured Adjusted Leverage Ratio	< 3.75	2.12
Total Adjusted Leverage Ratio	< 5.50	3.71
Fixed Charge Coverage Ratio	> 1.35	2.13

Based upon our current five-year operating and financial projections, we believe that we will remain compliant with such covenants in the future.

Ford Motor Credit Company Facility. Our floorplan financing arrangement ("FMCC Facility") with Ford Motor Credit Company ("FMCC") provides for the financing of, and is collateralized by, our U.S. Ford new vehicle inventory, including affiliated brands. This arrangement provides for $300.0 million of floorplan financing, an increase of $100.0 million from March 31, 2014, and is an evergreen arrangement that may be canceled with 30 days notice by either party. As of June 30, 2014, we had an outstanding balance of $174.7 million under the FMCC Facility with an available floorplan borrowing capacity of $125.3 million. This facility bears interest at a rate of Prime plus 150 basis points minus certain incentives. As of June 30, 2014, the interest rate on the FMCC Facility was 4.75% before considering the applicable incentives.

Other Credit Facilities. We have credit facilities with BMW Financial Services, Volkswagen Finance and FMCC for the financing of new, used and rental vehicle inventories related to our U.K. operations. These facilities are denominated in pound sterling and are evergreen arrangements that may be canceled with notice by either party and bears interest of a base rate, plus a surcharge that varies based upon the type of vehicle being financed. Dependent upon the type of inventory financed, the interest rates charged on borrowings outstanding under these facilities ranged from 1.14% to 3.95% as of June 30, 2014.

We have credit facilities with financial institutions in Brazil, most of which are affiliated with the manufacturers, for the financing of new, used and rental vehicle inventories related to our operations in Brazil. These facilities are denominated in Brazilian real and have renewal terms ranging from one month to twelve months. They may be canceled with notice by either party and bear interest at a benchmark rate, plus a surcharge that varies based upon the type of vehicle being financed. Dependent upon the type of inventory financed, the interest rates charged on borrowings outstanding under these facilities ranged from 15.10% to 19.56% as of June 30, 2014.

Excluding rental vehicles financed through the Revolving Credit Facility, financing for U.S. rental vehicles is typically obtained directly from the automobile manufacturers. These financing arrangements generally require small monthly payments and mature in varying amounts over the next two years. As of June 30, 2014, the interest rate charged on borrowings related to our rental vehicle fleet varied up to 4.75%. Rental vehicles are typically transferred to used vehicle inventory when they are removed from rental service and repayment of the borrowing is required at that time.

The following table summarizes the position of our U.S. credit facilities as of June 30, 2014.

	As of June 30, 2014		
U.S. Credit Facility	Total Commitment	Outstanding	Available
		(In thousands)	
Floorplan Line [1]	$1,380,000	$1,042,348	$337,652
Acquisition Line [2]	320,000	63,611	220,782
Total Revolving Credit Facility	1,700,000	1,105,959	558,434
FMCC Facility	300,000	174,721	125,279
Total U.S. Credit Facilities [3]	$2,000,000	$1,280,680	$683,713

(1) The available balance at June 30, 2014 includes $64.6 million of immediately available funds.

(2) The outstanding balance of $63.6 million is related to outstanding letters of credit of $43.2 million and $20.5 million in borrowings as of June 30, 2014. The available borrowings may be limited from time-to-time, based upon certain debt covenants.

(3) The outstanding balance excludes $139.3 million of borrowings with manufacturer-affiliates and third-party financial institutions for foreign and rental vehicle financing not associated with any of our U.S. credit facilities.

Real Estate Credit Facility. Our wholly-owned subsidiary, Group 1 Realty, Inc., is party to a real estate credit facility with Bank of America, N.A. and Comerica Bank (the "Real Estate Credit Facility"). The Real Estate Credit Facility provides the right for up to $99.1 million of term loans, of which $74.1 million has been used as of June 30, 2014. The term loans can be expanded provided that (a) no default or event of default exists under the Real Estate Credit Facility, (b) we obtain commitments from the lenders who would qualify as assignees for such increased amounts, and (c) certain other agreed upon

51

terms and conditions have been satisfied. The Real Estate Credit Facility is guaranteed by us and substantially all of our existing and future domestic subsidiaries. Each loan is secured by the relevant real property (and improvements related thereto) that is mortgaged under the Real Estate Credit Facility.

The interest rate is equal to (a) the per annum rate equal to one-month LIBOR plus 2.00% per annum, determined on the first day of each month, or (b) 0.95% per annum in excess of the higher of (i) the Bank of America prime rate (adjusted daily on the day specified in the public announcement of such price rate), (ii) the Federal Funds Rate adjusted daily, plus 0.50%, or (iii) the per annum rate equal to one-month LIBOR plus 1.05% per annum. The Federal Funds Rate is the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers on such day, as published by the Federal Reserve Bank of New York on the business day succeeding such day.

We are required to make quarterly principal payments equal to 1.25% of the principal amount outstanding and are required to repay the aggregate principal amount outstanding on the maturity dates, from December 29, 2015 through February 27, 2017. During the three months ended June 30, 2014, we made no additional borrowings and made principal payments on outstanding borrowings of $1.6 million from the Real Estate Credit Facility. As of June 30, 2014, borrowings outstanding under the Real Estate Credit Facility totaled $66.3 million, with $3.5 million recorded as a current maturity of long-term debt in the accompanying Consolidated Balance Sheet.

The Real Estate Credit Facility also contains usual and customary provisions limiting our ability to engage in certain transactions, including limitations on our ability to incur additional debt, additional liens, make investments, and pay distributions to our stockholders. In addition, the Real Estate Credit Facility requires certain financial covenants that are identical to those contained in our Revolving Credit Facility.

Other Real Estate Related and Long-Term Debt. We have entered into separate term mortgage loans with four of our manufacturer-affiliated finance partners, Toyota Motor Credit Corporation, Mercedes-Benz Financial Services USA, LLC, BMW Financial Services NA, LLC and FMCC as well as several third party financial institutions (collectively, “Real Estate Notes”). The Real Estate Notes may be expanded for borrowings related to specific buildings and/or properties and are guaranteed by us. Each loan was made in connection with, and is secured by mortgage liens on the relevant real property owned by us that is mortgaged under the Real Estate Notes. The Real Estate Notes bear interest at fixed rates between 3.67% and 9.00%, and at variable indexed rates plus between 1.90% and 3.35% per annum. As of June 30, 2014, the aggregate outstanding balance under these Real Estate Notes was $263.6 million, with $18.3 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets.

We also entered into separate term mortgage loans in the U.K. with another third-party financial institution which are secured by our U.K. subsidiary properties. These mortgage loans (collectively, “Foreign Notes”) are being repaid in monthly installments that began in July 1998 and mature by November 2022. As of June 30, 2014, borrowings under the Foreign Notes totaled $30.2 million, with $4.0 million classified as a current maturity of long-term debt in the accompanying Consolidated Balance Sheets.

During the six months ended June 30, 2014, we entered into working capital loan agreements with a third-party financial institution in Brazil for R$22.0 million. The proceeds were used to partially pay off manufacturer affiliated floorplan borrowings. This loan is to be repaid in full by February 2017.

Convertible Notes. In connection with the issuance of the 3.00% Notes during 2010, we purchased ten-year call options on our common stock (“3.00% Purchased Options”). The total cost of the 3.00% Purchased Options was $45.9 million. The future income-tax deductions relating to the cost of the 3.00% Purchased Options will result in a tax benefit of approximately $17.2 million. The 3.00% Purchased Options have the economic benefit of decreasing the dilutive effect of the 3.00% Notes. Under the terms of the 3.00% Purchased Options, which become exercisable upon conversion of the 3.00% Notes, we have the right to receive a total of 3.1 million shares of our common stock at the conversion price then in effect. Subsequent to June 30, 2014, we settled 2.5 million of the 3% Purchased Options, congruent with the purchase of a majority of the 3.00% Notes in a tender offer, leaving us with the right to receive a total of 0.6 million shares of our common stock at the conversion price then in effect subsequent to June 30, 2014 purchase. The exercise price is subject to certain adjustments that mirror the adjustments to the conversion price of the 3.00% Notes (including payment of cash dividends). As of June 30, 2014, the conversion price was $37.13.

In addition to the purchase of the 3.00% Purchased Options, we sold warrants in separate transactions ("3.00% Warrants"). These 3.00% Warrants have a ten-year term and enable the holders to acquire shares of our common stock from us. The 3.00% Warrants are exercisable for a total of 3.1 million shares of our common stock at the conversion price then in effect. The exercise price is subject to adjustment for quarterly dividends, liquidation, bankruptcy, or a change in control of us and other conditions, including a failure by us to deliver registered securities to the purchasers upon exercise. Subject to these adjustments, the maximum amount of shares of our common stock that could be required to be issued under the 3.00%

Table of Contents

Warrants is 5.5 million shares. On exercise of the 3.00% Warrants, we will settle the difference between the then market price and the strike price of the 3.00% Warrants in shares of our common stock. The proceeds from the sale of the 3.00% Warrants were $29.3 million. As a result of our decision to pay cash dividends, the exercise price of the 3.00% Warrants was $54.55 as of June 30, 2014. If any cash dividend or distribution is made to all, or substantially all, holders of our common stock in the future, the conversion rate will be adjusted based on the formula defined in the 3.00% Notes Indenture.

The 3.00% Purchased Options and 3.00% Warrant transactions were designed to increase the conversion price per share of our common stock, and therefore, mitigate the potential dilution of our common stock upon conversion of the 3.00% Notes, if any. As of June 30, 2014, the impact of the 3.00% Purchased Options and 3.00% Warrants increased the conversion price of our common stock under the 3.00% Notes from $37.13 to $54.55.

No shares of our common stock have been issued or received under the 3.00% Purchased Options or the 3.00% Warrants. For diluted earnings-per-share calculations, we are required to include the dilutive effect, if applicable, of the net shares issuable under the 3.00% Notes and the 3.00% Warrants as depicted in the table below under the heading "Potential Dilutive Shares." Although the 3.00% Purchased Options have the economic benefit of decreasing the dilutive effect of the 3.00% Notes, for diluted earnings-per-share calculation purposes, we cannot factor this benefit into our dilutive shares outstanding as their impact would be anti-dilutive. Based on the outstanding principal amount of our 3.00% Notes of $22.6 million at June 30, 2014, changes in the average price of our common stock impacted the share settlement of the 3.00% Notes, the 3.00% Purchased Options and the 3.00% Warrants as illustrated below:

Company Stock Price	Net Shares Issuable Under the 3.00% Notes	Share Entitlement Under the 3.00% Purchased Options	Shares Issuable Under the 3.00% Warrants	Net Shares Issuable	Potential Dilutive Shares
(Shares in thousands)					
$37.50	6	(6)	—	—	6
$40.00	44	(44)	—	—	44
$42.50	77	(77)	—	—	77
$45.00	106	(106)	—	—	106
$47.50	133	(133)	—	—	133
$50.00	156	(156)	—	—	156
$52.50	178	(178)	—	—	178
$55.00	197	(197)	5	5	202
$57.50	215	(215)	31	31	246
$60.00	232	(232)	55	55	287
$62.50	247	(247)	77	77	324
$65.00	260	(260)	98	98	358
$67.50	273	(273)	117	117	390
$70.00	285	(285)	134	134	419
$72.50	296	(296)	150	150	446
$75.00	307	(307)	166	166	473
$77.50	316	(316)	180	180	496
$80.00	326	(326)	193	193	519
$82.50	334	(334)	206	206	540
$85.00	342	(342)	218	218	560
$87.50	350	(350)	229	229	579
$90.00	357	(357)	239	239	596
$92.50	364	(364)	249	249	613
$95.00	370	(370)	259	259	629

$97.50	376	(376	) 268	268	644
$100.00	382	(382	) 276	276	658

On June 25, 2014, the Company purchased $92.5 million of the $115.0 million principal outstanding on its 3.00% Notes in a tender offer, leaving an outstanding balance of $22.6 million as of June 30, 2014. Consideration paid for this purchase was

Table of Contents

$210.4 million. In conjunction with the purchase, the Company recognized a loss of $23.6 million for the three months ended June 30, 2014. Subsequent to June 30, 2014, the Company settled the 3.00% Purchase Options and 3.00% Warrants in the same proportion as the amount of 3.00% Notes purchased. The net cash received as a result was $26.4 million.

In connection with the issuance of the 2.25% Notes in 2006, we purchased ten-year call options on our common stock (“2.25% Purchased Options”). Under the terms of the 2.25% Purchased Options, which become exercisable upon conversion of the 2.25% Notes, we have the right to receive a total of approximately 3.1 million shares of our common stock at a conversion price of $59.27 per share as of June 30, 2014, subject to adjustment for quarterly dividends in excess of $0.14 per common share. Subject to these adjustments, the maximum amount of shares of our common stock that could be required to be issued under the 2.25% Warrants is 6.2 million shares. The total cost of the 2.25% Purchased Options was $116.3 million. The cost of the 2.25% Purchased Options results in future income-tax deductions that we expect will total approximately $43.6 million.

In addition to the purchase of the 2.25% Purchased Options, we sold warrants in separate transactions (“2.25% Warrants”). These 2.25% Warrants have a ten-year term and enable the holders to acquire shares of our common stock from us. The 2.25% Warrants are exercisable for a total of 3.1 million shares of our common stock at the conversion price then in effect, subject to adjustment for quarterly dividends in excess of $0.14 per common share, liquidation, bankruptcy, or a change in control of our company and other conditions. The proceeds from the sale of the 2.25% Warrants were $80.6 million. As a result of our decision to pay cash dividends in excess of $0.14 per common, share, the exercise price of the 2.25% Warrants was $80.09 as of June 30, 2014.

The 2.25% Purchased Option and 2.25% Warrant transactions were designed to increase the conversion price per share of our common stock, and therefore, mitigate the potential dilution of our common stock upon conversion of the 2.25% Notes, if any. As of June 30, 2014, the impact of the 2.25% Purchased Options and 2.25% Warrants increased the conversion price of our common stock under the 2.25% Notes from $59.27 to $80.09.

No shares of our common stock have been issued or received under the 2.25% Purchased Options or the 2.25% Warrants. For diluted earnings-per-share calculations, we are required to include the dilutive effect, if applicable, of the net shares issuable under the 2.25% Notes and the 2.25% Warrants as depicted in the table below under the heading "Potential Dilutive Shares." Although the 2.25% Purchased Options have the economic benefit of decreasing the dilutive effect of the 2.25% Notes, for diluted earnings-per-share calculations purposes, we cannot factor this benefit into our dilutive shares outstanding as their impact would be anti-dilutive. Based on the outstanding principal amount of our 2.25% Notes of $182.8 million as of June 30, 2014 changes in the average price of our common stock will impact the share settlement of the 2.25% Notes, the 2.25% Purchased Options and the 2.25% Warrants as illustrated below:

Company Stock Price	Net Shares Issuable Under the 2.25% Notes	Share Entitlement Under the 2.25% Purchased Options	Shares Issuable Under the 2.25% Warrants	Net Shares Issuable	Potential Dilutive Shares
(Shares in thousands)					
$57.00	—	—	—	—	—
$59.50	12	(12)	—	—	12
$62.00	136	(136)	—	—	136
$64.50	250	(250)	—	—	250
$67.00	356	(356)	—	—	356
$69.50	454	(454)	—	—	454
$72.00	545	(545)	—	—	545
$74.50	630	(630)	—	—	630
$77.00	710	(710)	—	—	710
$79.50	785	(785)	—	—	785
$82.00	855	(855)	72	72	927
$84.50	921	(921)	161	161	1,082

$87.00	983	(983)	245	245	1,228
$89.50	1,041	(1,041)	324	324	1,365
$92.00	1,097	(1,097)	399	399	1,496
$94.50	1,149	(1,149)	470	470	1,619
$97.00	1,199	(1,199)	537	537	1,736
$99.50	1,247	(1,247)	601	601	1,848
$102.00	1,292	(1,292)	662	662	1,954

54

Table of Contents

5.00% Senior Notes

On June 2, 2014, we issued 5.00% senior unsecured notes with a face amount of $350.0 million due to mature on June 1, 2022. The 5.00% Notes pay interest semiannually, in arrears, in cash on each June 1 and December 1, beginning December 1, 2014. Prior to June 1, 2017, we may redeem up to 35.0% of the 5.00% Notes using proceeds of certain equity offerings, subject to certain conditions at a redemption price equal to 105% of principal amount of the 5.00% Notes plus accrued and unpaid interest. In addition, prior to June 1, 2017, we may redeem some or all of the 5.00% Notes at a redemption price equal to 100% of the principal amount of the 5.00% Notes redeemed, plus an applicable make-whole premium, and plus accrued and unpaid interest. On or after June 1, 2017, we may redeem some or all of the 5.00% Notes at specified prices, plus accrued and unpaid interest. We may be required to purchase the 5.00% Notes if we sell certain assets or triggers the change in control provisions defined in the 5.00% Notes indenture. The 5.00% Notes are senior unsecured obligations and rank equal in right of payment to all of our existing and future senior unsecured debt and senior in right of payment to all of our future subordinated debt.

The 5.00% Notes are guaranteed by substantially all of our U.S. subsidiaries. The U.S. subsidiary guarantees rank equally in the right of payment to all of our U.S. subsidiary guarantor's existing and future subordinated debt. In addition, the 5.00% Notes are structurally subordinated to the liabilities of our non-guarantor subsidiaries.

In connection with the issuance of the 5.00% Notes, we entered into a registration rights agreement (the "Registration Rights Agreement") with the initial purchasers. Pursuant to the Registration Rights Agreement, we have agreed to file a registration statement with the Securities and Exchange Commission within 365 days of issuance, so that holders of the 5.00% Notes can exchange the 5.00% Notes for registered 5.00% Notes that have substantially identical terms as the 5.00% Notes. We will be required to pay additional interest on the 5.00% Notes if we fail to comply with our obligations to register the 5.00% Notes within the specified time period.

Underwriters' fees totaled $5.3 million, which were recorded as a reduction of the 5.00% Notes principal balance, are being amortized over a period of eight years. The 5.00% Notes are presented net of unamortized underwriter fee of $5.2 million as of June 30, 2014. At the time of issuance of the 5.00% Notes, we capitalized $1.5 million of debt issuance costs, which are included in Other Assets on the accompanying Consolidated Balance Sheet and amortized over a period of eight years. Unamortized debt issuance costs as of June 30, 2014 totaled $1.5 million.

Subsequent to June 30, 2014, we gave notice to holders that we will redeem all of the outstanding 2.25% Notes on September 4, 2014. As part of that transaction, we anticipate settling all of the related purchased options and warrants.

Stock Issuances. In 2013, we issued 1.39 million shares of treasury stock, as part of the consideration paid for UAB Motors. There have been no similar stock issuances in the six months ended June 30, 2014.

Stock Repurchases. From time to time, our Board of Directors authorizes us to repurchase shares of our common stock, subject to the restrictions of various debt agreements and our judgment. Currently, our Board of Directors has authorized us to repurchase up to $75.0 million of our common shares. As of June 30, 2014, we had repurchased 270,054 shares, at an average price of $62.74, for a total cost of $16.9 million, leaving $54.5 million of repurchase authorization remaining. Future repurchases are subject to the discretion of our Board of Directors after considering our results of operations, financial condition, cash flows, capital requirements, existing debt covenants, outlook for our business, general business conditions and other factors.

Dividends. The payment of dividends is subject to the discretion of our Board of Directors after considering the results of operations, financial condition, cash flows, capital requirements, outlook for our business, general business conditions, the political and legislative environments and other factors.

Further, we are limited under the terms of the Revolving Credit Facility and Real Estate Credit Facility in our ability to make cash dividend payments to our stockholders and to repurchase shares of our outstanding common stock, based primarily on our quarterly net income or loss. As of June 30, 2014, the Restricted Payment Basket under both facilities was $167.9 million and will increase in the future periods by 50.0% of our future cumulative net income, plus the net proceeds received from the sale of our capital stock, and decrease by the amount of future payments for cash dividends and share repurchases.

Non-GAAP Financial Measures

We have included certain non-GAAP financial measures as defined under SEC rules, which recharacterize certain items within the Statement of Cash Flows. These adjusted measures are not measures of financial performance under U.S. GAAP. As required by SEC rules, we provide reconciliations of these adjusted measures to the most directly comparable U.S. GAAP measures. We believe that these adjusted financial measures are relevant and useful to investors because they improve the transparency of our disclosure, provide a meaningful presentation of results from our core business operations and improve period-to-period comparability of our results from our core business operations. Our management uses these measures in conjunction with U.S. GAAP financial measures to assess our business, including in communications with our Board of Directors, investors and analysts concerning financial performance.

The following table reconciles cash flow provided by (used in) operating, investing and financing activities on a U.S. GAAP basis to the corresponding adjusted amounts (dollars in thousands):

	Six Months Ended June 30,		
	2014	2013	% Change
CASH FLOWS FROM OPERATING ACTIVITIES			
Net cash provided by operating activities	$130,933	$87,308	50.0 %
Change in floorplan notes payable-credit facilities, excluding floorplan offset account and net acquisition and disposition	(24,222)	75,336	
Change in floorplan notes payable-manufacturer affiliates associated with net acquisition and disposition related activity	(19,530)	(8,061)	
Adjusted net cash provided by operating activities	$87,181	$154,583	(43.6)%
CASH FLOWS FROM INVESTING ACTIVITIES			
Net cash used in investing activities	$(194,363)	$(58,580)	231.8 %
Change in cash paid for acquisitions, associated with floorplan notes payable	40,162	12,774	
Change in proceeds from disposition of franchises, property and equipment, associated with floorplan notes payable	(8,283)	(27,398)	
Adjusted net cash used in investing activities	$(162,484)	$(73,204)	122.0 %
CASH FLOWS FROM FINANCING ACTIVITIES			
Net cash provided by (used in) financing activities	$63,423	$(21,897)	(389.6)%
Change in net borrowings and repayments on floorplan notes payable-credit facilities, excluding net activity associated with our floorplan offset account	11,873	(52,651)	
Adjusted net cash provided by (used in) financing activities	$75,296	$(74,548)	(201.0)%

55

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to a variety of market risks, including interest rate risk and foreign currency exchange rate risk. We address these risks through a program of risk management, which includes the use of derivative instruments. The following quantitative and qualitative information is provided about financial instruments to which we are a party at June 30, 2014, and from which we may incur future gains or losses from changes in market interest rates and foreign currency exchange rates. We do not enter into derivative or other financial instruments for speculative or trading purposes.

Hypothetical changes in interest rates and foreign currency exchange rates chosen for the following estimated sensitivity analysis are considered to be reasonable near-term changes generally based on consideration of past fluctuations for each risk category. However, since it is not possible to accurately predict future changes in interest rate and foreign currency exchange rates, these hypothetical changes may not necessarily be an indicator of probable future fluctuations.

The following information about our market-sensitive financial instruments constitutes a “forward-looking statement.”

As of June 30, 2014, the outstanding principal amounts of our 2.25% Notes, 3.00% Notes, and 5.00% Notes totaled $182.8 million, $22.6 million and $350.0 million, respectively, and had fair values of $261.2 million, $52.9 million and $351.8 million, respectively. The carrying amounts of our 2.25% Notes, 3.00% Notes, and 5.00% Notes were $164.6 million, $16.9 million and $344.8 million, respectively, at June 30, 2014.

Interest Rates. We have interest rate risk in our variable-rate debt obligations. Our policy is to monitor the effects of market changes in interest rates and manage our interest rate exposure through the use of a combination of fixed and floating-rate debt and interest rate swaps.

As of June 30, 2014, we had $1,514.4 million of variable-rate borrowings. Based on the aggregate amount of variable-rate borrowings outstanding as of June 30, 2014, and before the impact of our interest rate swaps described below, a 100 basis-point change in interest rates would have resulted in an approximate $15.1 million change to our annual interest expense. After consideration of the interest rate swaps described below, a 100 basis-point change would have yielded a net annual change of $10.6 million in annual interest expense based on the variable borrowings outstanding as of June 30, 2014. This interest rate sensitivity increased from June 30, 2013 primarily as a result of the increase in variable-rate floorplan borrowings.

Our exposure to changes in interest rates with respect to our variable-rate floorplan borrowings is partially mitigated by manufacturers’ interest assistance, which in some cases is influenced by changes in market based variable interest rates. We reflect interest assistance as a reduction of new vehicle inventory cost until the associated vehicle is sold. During the three months ended June 30, 2014, we recognized $11.5 million of interest assistance as a reduction of new vehicle cost of sales. For the past three years, the reduction to our new vehicle cost of sales has ranged from 87.3% of our floorplan interest expense for the first quarter of 2013 to 115.9% for the third quarter of 2012 and was 111.7% for the second quarter of 2014. In the U.S., manufacturer's interest assistance was 136.1% of floorplan interest expense in the second quarter of 2014. Although we can provide no assurance as to the amount of future interest assistance, it is our expectation, based on historical data that an increase in prevailing interest rates would result in increased assistance from certain manufacturers.

We use interest rate swaps to adjust our exposure to interest rate movements when appropriate, based upon market conditions. As of June 30, 2014, we held interest rate swaps with aggregate notional amounts of $450.0 million that fixed our underlying one-month LIBOR at a weighted average rate of 2.6%. These hedge instruments are designed to convert floating rate vehicle floorplan payables under our Revolving Credit Facility and variable rate Real Estate Credit Facility borrowings to fixed rate debt. We entered into these swaps with several financial institutions that have investment grade credit ratings, thereby minimizing the risk of credit loss. We reflect the current fair value of all derivatives on our Consolidated Balance Sheets. The fair value of interest rate swaps is impacted by the forward one-month LIBOR curve and the length of time to maturity of the swap contracts. The related gains or losses on these transactions are deferred in stockholders’ equity as a component of accumulated other comprehensive loss. As of June 30, 2014, net unrealized losses, net of income taxes, totaled $16.7 million. These deferred gains and losses are recognized in income in the period in which the related items being hedged are recognized in expense. However, to

the extent that the change in value of a derivative contract does not perfectly offset the change in the value of the items being hedged, that ineffective portion is immediately recognized in the results of operations. All of our interest rate hedges are designated as cash flow hedges. As of June 30, 2014, all of our derivative contracts were determined to be effective. As of June 30, 2014, a 100 basis-point change in the interest rates of our swaps would have resulted in a $4.5 million change to our annual interest expense. In addition to the $450.0 million of swaps in effect as of June 30, 2014, we also held ten interest rate swaps with forward start dates between December 2014 and December 2016 and expiration dates between December 2017 and December 2019. As of June 30, 2014, the aggregate notional value of these forward-starting swaps was $525.0 million and the weighted average interest rate was 2.7%. The combination of these swaps is structured such that the notional value in effect at any given time through December 2019 does not exceed $600.0 million.

Table of Contents

A summary of our interest rate swaps, including those in effect, as well as forward-starting, follows (dollars in millions).

	2014	2015	2016	2017	2018	2019
Notional amount in effect at the end of period	$550	$550	$600	$350	$200	$—
Weighted average interest rate during the period	2.63 %	2.56 %	2.76 %	2.69 %	2.77 %	2.52 %

Foreign Currency Exchange Rates. As of June 30, 2014, we had dealership operations in the U.K. and Brazil. The functional currency of our U.K. subsidiaries is the British pound sterling (£) and of our Brazil subsidiaries is the Brazilian real (R$). We intend to remain permanently invested in these foreign operations and, as such, do not hedge against foreign currency fluctuations that may impact our investment in our U.K. and Brazil subsidiaries. If we change our intent with respect to such international investment, we would expect to implement strategies designed to manage those risks in an effort to mitigate the effect of foreign currency fluctuations on our earnings and cash flows. A 10% increase in average exchange rates for the British pound sterling versus the U.S. dollar would have resulted in a $45.4 million increase to our revenues for the six months ended June 30, 2014. A 10% increase in average exchange rates for the Brazilian real versus the U.S. dollar would have resulted in a $34.4 million increase to our revenues for the six months ended June 30, 2014.

For additional information about our market sensitive financial instruments please see Part II, “Item 7. Management’s Discussion & Analysis of Financial Condition and Results of Operations," "Item 7A. Quantitative and Qualitative Disclosures About Market Risk” and Note 4 to “Item 8. Financial Statements and Supplementary Data” in our 2013 Form 10-K.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), we have evaluated, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by us in reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure and is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. Based upon that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of June 30, 2014 at the reasonable assurance level.

Our management, including the principal executive officer and the principal financial officer, does not expect that our disclosure controls and procedures can prevent all possible errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that objectives of the control system are met. There are inherent limitations in all control systems, including the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Additionally, controls can be circumvented by the intentional acts of one or more persons. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and while our disclosure controls and procedures are designed to be effective under circumstances where they should reasonably be expected to operate effectively, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in any control system, misstatements due to possible errors or fraud may occur and not be detected.

Changes in Internal Control over Financial Reporting

During the three months ended June 30, 2014, there was no change in our system of internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

57

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are not party to any legal proceedings, including class action lawsuits that, individually or in the aggregate, are reasonably expected to have a material adverse effect on our results of operations, financial condition or cash flows. For a discussion of our legal proceedings, see Part I, "Item 1. Financial Information," Notes to Consolidated Financial Statements, Note 11, "Commitments and Contingencies."

Item 1A. Risk Factors

There have been no material changes in our risk factors as previously disclosed in "Item 1A. Risk Factors" of our 2013 Form 10-K. Readers should carefully consider the factors discussed in Part 1, "Item 1A. Risk Factors" in our 2013 Form 10-K, which could materially affect our business, financial condition or future results. The risks described in our 2013 Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

Item 6. Exhibits

Those exhibits to be filed by Item 601 of Regulation S-K are listed in the Exhibit Index immediately preceding the exhibits filed herewith and such listing is incorporated herein by reference.

Table of Contents

SIGNATURE

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

Group 1 Automotive, Inc.

By: /s/ John C. Rickel

John C. Rickel
Senior Vice President and Chief Financial Officer
(Duly Authorized Officer and Principal Financial and Accounting Officer)

Date: August 4, 2014

Table of Contents

EXHIBIT INDEX

Exhibit Number		Description
1.1	—	Purchase Agreement dated as of May 16, 2014, by and among Group 1 Automotive, Inc., the guarantors party thereto and J.P. Morgan Securities LLC, as representative of the initial purchasers named therein (incorporated by reference to Exhibit 1.1 to Group 1 Automotive, Inc.'s Current Report on Form 8-K (File No. 001-13461) filed May 21, 2014)
3.1	—	Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 of Group 1 Automotive, Inc.'s Registration Statement on Form S-1 (Registration No. 333-29893) filed June 24, 1997)
3.2	—	Amended and Restated Bylaws of Group 1 Automotive, Inc. (incorporated by reference to Exhibit 3.1 of Group 1 Automotive, Inc.'s Current Report on Form 8-K (File No. 001-13461) filed November 13, 2007)
4.1	—	Indenture, dated as of June 2, 2014, by and among Group 1 Automotive, Inc., the guarantors party thereto and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 to Group 1 Automotive, Inc.'s Current Report on Form 8-K (File No. 001-13461) filed June 2, 2014)
4.2	—	Form of 5.000% Senior Notes due 2022 (included as Exhibit A to Exhibit 4.1)
4.3	—	Registration Rights Agreement, dated as of June 2, 2014, by and among Group 1 Automotive, Inc., the guarantors party thereto and J.P. Morgan Securities LLC, as representative of the initial purchasers named therein (incorporated by reference to Exhibit 4.3 to Group 1 Automotive, Inc.'s Current Report on Form 8-K (File No. 001-13461) filed June 2, 2014)
10.1	—	Group 1 Automotive, Inc. 2014 Long Term Incentive Plan (incorporated by reference to Appendix A to Group 1 Automotive, Inc.'s definitive proxy statement on Schedule 14A filed April 10, 2014)
10.2	—	Partial Unwind Agreement between Group 1 Automotive, Inc. and JPMorgan Chase Bank, National Association, dated June 25, 2014 (incorporated by reference to Exhibit 10.1 to Group 1 Automotive, Inc.'s Current Report on Form 8-K (File No. 001-13461) filed June 26, 2014)
10.3	—	Partial Unwind Agreement between Group 1 Automotive, Inc. and Bank of America, N.A., dated June 25, 2014 (incorporated by reference to Exhibit 10.2 to Group 1 Automotive, Inc.'s Current Report on Form 8-K (File No. 001-13461) filed June 26, 2014)
10.4**	—	First Amendment to Ninth Amended and Restated Revolving Credit Agreement, dated effective May 13, 2014, among Group 1 Automotive, Inc., the Subsidiary Borrowers listed therein, the Lenders listed therein, JPMorgan Chase Bank, N.A., as Administrative Agent, Comerica Bank, as Floor Plan Agent, Bank of America, N.A., as Syndication Agent, U.S. Bank, N.A. and Wells Fargo Bank, N.A., as Co-Documentation Agents and Capital One National Association and Compass Bank, as Managing Agents
31.1**	—	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2**	—	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1**	—	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	—	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS**	—	XBRL Instance Document
101.SCH**	—	XBRL Taxonomy Extension Schema Document

101.CAL**	—	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	—	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	—	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	—	XBRL Taxonomy Extension Presentation Linkbase Document

** Filed or furnished herewith