

DiamondRock Hospitality Co
Form 10-Q
November 08, 2013

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

FORM 10-Q

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

For the quarterly period ended September 30, 2013

OR

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

Commission file number 001-32514

DIAMONDROCK HOSPITALITY COMPANY

(Exact Name of Registrant as Specified in Its Charter)

Maryland

20-1180098

(State of Incorporation)

(I.R.S. Employer Identification No.)

3 Bethesda Metro Center, Suite 1500, Bethesda,

20814

Maryland

(Address of Principal Executive Offices)

(Zip Code)

(240) 744-1150

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The registrant had 195,470,791 shares of its \$0.01 par value common stock outstanding as of November 8, 2013.

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PART I. FINANCIAL INFORMATION

Item I. Financial Statements

DIAMONDROCK HOSPITALITY COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

As of September 30, 2013 and December 31, 2012

(in thousands, except share and per share amounts)

	September 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Property and equipment, at cost	\$3,207,378	\$3,131,175
Less: accumulated depreciation	(599,343)	(519,721)
	2,608,035	2,611,454
Deferred financing costs, net	7,947	9,724
Restricted cash	86,556	76,131
Due from hotel managers	80,690	68,532
Note receivable	49,356	53,792
Favorable lease assets, net	40,194	40,972
Prepaid and other assets	81,000	73,814
Cash and cash equivalents	43,448	9,623
Total assets	\$2,997,226	\$2,944,042
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Mortgage debt	\$ 1,060,299	\$968,731
Senior unsecured credit facility	—	20,000
Total debt	1,060,299	988,731
Deferred income related to key money, net	23,900	24,362
Unfavorable contract liabilities, net	78,633	80,043
Due to hotel managers	55,785	51,003
Dividends declared and unpaid	17,006	15,911
Accounts payable and accrued expenses	94,845	88,879
Total other liabilities	270,169	260,198
Stockholders' Equity:		
Preferred stock, \$0.01 par value; 10,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$0.01 par value; 400,000,000 shares authorized; 195,470,791 and 195,145,707 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	1,955	1,951
Additional paid-in capital	1,978,505	1,976,200
Accumulated deficit	(313,702)	(283,038)
Total stockholders' equity	1,666,758	1,695,113
Total liabilities and stockholders' equity	\$2,997,226	\$2,944,042

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

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DIAMONDROCK HOSPITALITY COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the Fiscal Quarters Ended September 30, 2013 and September 7, 2012 and

the Periods from January 1, 2013 to September 30, 2013 and January 1, 2012 to September 7, 2012

(in thousands, except per share amounts)

	Fiscal Quarter Ended		Period From	
	September 30, 2013 (Unaudited)	September 7, 2012 (Unaudited)	January 1, 2013 to September 30, 2013 (Unaudited)	January 1, 2012 to September 7, 2012 (Unaudited)
Revenues:				
Rooms	\$150,146	\$132,578	\$428,981	\$338,043
Food and beverage	47,522	40,791	149,743	117,415
Other	12,975	10,504	37,407	27,787
Total revenues	210,643	183,873	616,131	483,245
Operating Expenses:				
Rooms	40,521	35,428	116,091	92,386
Food and beverage	34,591	30,008	106,475	85,731
Management fees	7,178	5,744	19,410	15,313
Other hotel expenses	75,176	64,098	219,302	171,131
Depreciation and amortization	26,254	22,612	80,280	62,802
Impairment losses	—	30,376	—	30,844
Hotel acquisition costs	23	8,314	46	10,345
Corporate expenses	4,932	6,227	18,055	15,711
Total operating expenses	188,675	202,807	559,659	484,263
Operating profit (loss)	21,968	(18,934)	) 56,472	(1,018)
Other Expenses (Income):				
Interest income	(1,660)	) (60)	) (4,604)	) (278)
Interest expense	14,471	12,732	42,511	36,710
Gain on early extinguishment of debt	—	—	—	(144)
Total other expenses, net	12,811	12,672	37,907	36,288
Income (loss) from continuing operations before income taxes	9,157	(31,606)	) 18,565	(37,306)
Income tax (expense) benefit	(593)	) 916	944	4,992
Income (loss) from continuing operations	8,564	(30,690)	) 19,509	(32,314)
Loss from discontinued operations, net of income taxes	—	(14,089)	) —	(905)
Net income (loss)	\$8,564	\$(44,779)	) \$19,509	\$(33,219)
Earnings (loss) per share:				
Continuing operations	\$0.04	\$(0.16)	) \$0.10	\$(0.19)
Discontinued operations	—	(0.08)	) —	(0.00)
Basic and diluted earnings (loss) per share	\$0.04	\$(0.24)	) \$0.10	\$(0.19)

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

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DIAMONDROCK HOSPITALITY COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Periods from January 1, 2013 to September 30, 2013 and January 1, 2012 to September 7, 2012

(in thousands)

	Period From January 1, 2013 to September 30, 2013 (Unaudited)	January 1, 2012 to September 7, 2012 (Unaudited)	
Cash flows from operating activities:			
Net income (loss)	\$ 19,509	\$(33,219)
Adjustments to reconcile net income to net cash provided by operating activities:			
Real estate depreciation	80,280	64,149	
Corporate asset depreciation as corporate expenses	75	66	
Gain on sale of hotel properties	—	(9,541)
Gain on early extinguishment of debt	—	(144)
Non-cash ground rent	5,111	4,621	
Non-cash financing costs, debt premium and interest rate cap as interest	2,082	2,529	
Amortization of note receivable discount as interest income	(1,892)	—
Impairment losses	—	45,534	
Amortization of favorable and unfavorable contracts, net	(1,063	)	(1,296
Amortization of deferred income	(799	)	(658
Stock-based compensation	4,225	3,230	
Payment of litigation settlement	—	(1,709)
Changes in assets and liabilities:			
Prepaid expenses and other assets	(2,856	)	(1,261
Restricted cash	2,894	(1,532)
Due to/from hotel managers	(7,375	)	(15,281
Accounts payable and accrued expenses	(8	)	(10,822
Net cash provided by operating activities	100,183	44,666	
Cash flows from investing activities:			
Hotel capital expenditures	(75,256	)	(26,354
Hotel acquisitions	—	(415,188)
Net proceeds from sale of properties	—	92,120	
Mortgage loan principal payments	6,574	551	
Change in restricted cash	(13,319	)	(6,193
Purchase deposits	(5,000	)	(1,898
Receipt of deferred key money	338	479	
Net cash used in investing activities	(86,663	)	(356,483
Cash flows from financing activities:			
Scheduled mortgage debt principal payments	(10,161	)	(7,441
Repurchase of common stock and other	(1,952	)	(2,946
Proceeds from sale of common stock, net	—	199,831	
Proceeds from mortgage debt	102,000	170,368	
Prepayment of mortgage debt	—	(26,963)
Draws on senior unsecured credit facility	25,000	175,000	

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Repayments of senior unsecured credit facility	(45,000) (155,000)
Payment of financing costs	(538) (4,412)
Purchase of interest rate cap	—	(934)
Payment of cash dividends	(49,044	) (40,373)
Net cash provided by financing activities	20,305	307,130	
Net increase (decrease) in cash and cash equivalents	33,825	(4,687)
Cash and cash equivalents, beginning of period	9,623	26,291	
Cash and cash equivalents, end of period	\$43,448	\$21,604	

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Supplemental Disclosure of Cash Flow Information:

Cash paid for interest	\$40,503	\$38,236
Cash paid for income taxes	\$724	\$1,192
Capitalized interest	\$1,164	\$802
Non-cash Financing Activities:		
Unpaid dividends	\$17,006	\$15,871
Buyer assumption of mortgage debt on sale of hotels	\$—	\$180,000
Issuance of common stock in connection with acquisition of hotel portfolio	\$—	\$75,000

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

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DIAMONDROCK HOSPITALITY COMPANY

Notes to the Condensed Consolidated Financial Statements
(Unaudited)

1. Organization

DiamondRock Hospitality Company (the “Company” or “we”) is a lodging-focused real estate company that owns a portfolio of premium hotels and resorts. Our hotels are concentrated in key gateway cities and in destination resort locations and most are operated under a brand owned by one of the leading global lodging brand companies (Marriott International, Inc. (“Marriott”), Starwood Hotels & Resorts Worldwide, Inc. (“Starwood”), or Hilton Worldwide (“Hilton”). We are an owner, as opposed to an operator, of the hotels in our portfolio. As an owner, we receive all of the operating profits or losses generated by our hotels after we pay fees to the hotel managers, which are based on the revenues and profitability of the hotels.

As of September 30, 2013, we owned 27 hotels with 11,608 guest rooms, located in the following markets: Atlanta, Georgia; Boston, Massachusetts (2); Burlington, Vermont; Charleston, South Carolina; Chicago, Illinois (2); Denver, Colorado (2); Fort Worth, Texas; Los Angeles, California (2); Minneapolis, Minnesota; New York, New York (4); Oak Brook, Illinois; Orlando, Florida; Salt Lake City, Utah; San Diego, California; San Francisco, California; Sonoma, California; St. Thomas, U.S. Virgin Islands; Vail, Colorado; and Washington D.C. (2). We also own a senior mortgage loan secured by a 443-room hotel located in Chicago, Illinois and have the right to acquire, upon completion, a 282-room hotel under development in New York City.

We conduct our business through a traditional umbrella partnership REIT, or UPREIT, in which our hotel properties are owned by our operating partnership, DiamondRock Hospitality Limited Partnership, or subsidiaries of our operating partnership. The Company is the sole general partner of our operating partnership and currently owns, either directly or indirectly, all of the limited partnership units of our operating partnership.

2. Summary of Significant Accounting Policies

Basis of Presentation

We have condensed or omitted certain information and footnote disclosures normally included in financial statements presented in accordance with U.S. generally accepted accounting principles, or U.S. GAAP, in the accompanying unaudited condensed consolidated financial statements. We believe the disclosures made are adequate to prevent the information presented from being misleading. However, the unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2012, included in our Annual Report on Form 10-K filed on March 1, 2013.

In our opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly our financial position as of September 30, 2013 and the results of our operations for the fiscal quarters ended September 30, 2013 and September 7, 2012 and the periods from January 1, 2013 to September 30, 2013 and January 1, 2012 to September 7, 2012, and our cash flows for the periods from January 1, 2013 to September 30, 2013 and January 1, 2012 to September 7, 2012. Interim results are not necessarily indicative of full-year performance because of the impact of seasonal and short-term variations.

Our financial statements include all of the accounts of the Company and its subsidiaries in accordance with U.S. GAAP. All intercompany accounts and transactions have been eliminated in consolidation. If the Company determines that it has an interest in a variable interest entity within the meaning of the FASB ASC 810, Consolidation, the Company will consolidate the entity when it is determined to be the primary beneficiary of the entity.

Change in Reporting Periods

Effective January 1, 2013, we report quarterly operating results on a calendar cycle, which is now consistent with all of our hotel managers. We continue to report our annual financial statements on a calendar year basis. Historically, our quarterly operating results have been reported based on a 52-53 week fiscal calendar used by Marriott, the manager of 14 of our hotels. Beginning in 2013, Marriott converted to reporting results based on a 12-month calendar year. Previously, Marriott's fiscal year consisted of thirteen 4-week accounting periods, ended on the Friday closest to December 31, and included twelve weeks of operations for each of the first three quarters and sixteen weeks for the fourth quarter. Accordingly, our first three quarters in 2012 ended on March 23, June 15 and September 7. In contrast, the managers of our other hotels, such as Hilton, Starwood and other independent managers, reported results on a monthly basis. Our 2012 quarterly results of operations included results from our non-Marriott-

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managed hotels as follows: first quarter (January to February), second quarter (March to May), third quarter (June to August) and fourth quarter (September to December).

The following table illustrates the change in our reporting periods:

Quarter	2012 Reporting Calendar		2013 Reporting Calendar	
1st	Marriott-managed hotels	January 1 - March 23	All Hotels	January 1 - March 31
	Non-Marriott-managed hotels	January 1 - February 29		
2nd	Marriott-managed hotels	March 24 - June 15	All Hotels	April 1 - June 30
	Non-Marriott-managed hotels	March 1 - May 31		
3rd	Marriott-managed hotels	June 16 - September 7	All Hotels	July 1 - September 30
	Non-Marriott-managed hotels	June 1 - August 31		
4th	Marriott-managed hotels	September 8 - December 31	All Hotels	October 1 - December 31
	Non-Marriott-managed hotels	September 1 - December 31		

We will not restate the previously filed 2012 quarterly financial statements because Marriott did not provide us operating results for 2012 on a daily basis. Because we rely upon our hotel managers for the hotel operating results used in our financial statements, the unavailability of this information on a calendar quarter basis for 2012 made restating our financial statements unfeasible. Accordingly, our 2012 reported quarterly operating results are not comparable to our 2013 quarterly operating results.

Property and Equipment

Investments in hotel properties, land, land improvements, building and furniture, fixtures and equipment and identifiable intangible assets are recorded at fair value upon acquisition. Property and equipment purchased after the hotel acquisition date is recorded at cost. Replacements and improvements are capitalized, while repairs and maintenance are expensed as incurred. Upon the sale or retirement of a fixed asset, the cost and related accumulated depreciation is removed from the Company's accounts and any resulting gain or loss is included in the statements of operations.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 15 to 40 years for buildings, land improvements, and building improvements and 1 to 10 years for furniture, fixtures and equipment. Leasehold improvements are amortized over the shorter of the lease term or the useful lives of the related assets.

We review our investments in hotel properties for impairment whenever events or changes in circumstances indicate that the carrying value of the hotel properties may not be recoverable. Events or circumstances that may cause a review include, but are not limited to, adverse changes in the demand for lodging at the properties due to declining national or local economic conditions and/or new hotel construction in markets where the hotels are located. When such conditions exist, management performs an analysis to determine if the estimated undiscounted future cash flows from operations and the proceeds from the ultimate disposition of a hotel, less costs to sell, exceed its carrying value. If the estimated undiscounted future cash flows are less than the carrying amount of the asset, an adjustment to reduce the carrying amount to the related hotel's estimated fair market value is recorded and an impairment loss is recognized.

We will classify a hotel as held for sale in the period that we have made the decision to dispose of the hotel, a binding agreement to purchase the property has been signed under which the buyer has committed a significant amount of nonrefundable cash and no significant financing or other contingencies exist which could cause the transaction to not be completed in a timely manner. If these criteria are met, we will record an impairment loss if the fair value less costs

to sell is lower than the carrying amount of the hotel and related assets and will cease recording depreciation expense. We will classify the loss, together with the related operating results, as discontinued operations on the statements of operations and classify the assets and related liabilities as held for sale on the balance sheet.

Note Receivable

Notes receivable are carried at cost, net of any premiums or discounts which are recognized as an adjustment of yield over the remaining life of the note using the effective interest rate method. Notes receivable are evaluated for collectability and if collectability of the original amounts due is in doubt, the value is adjusted for impairment. Our impairment analysis considers the anticipated cash receipts as well as the underlying value of the collateral. If collectability is in doubt, the note is placed in non-accrual status. No interest is recorded on such notes until the timing and amounts of cash receipts can be reasonably estimated.

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We record cash payments received on non-accrual notes receivable as a reduction in basis. We continually assess the current facts and circumstances to determine whether we can reasonably estimate cash flows. If we can reasonably estimate the timing and amount of cash flows to be collected, then income recognition becomes possible.

Revenue Recognition

Revenues from operations of the hotels are recognized when the services are provided. Revenues consist of room sales, golf sales, food and beverage sales, and other hotel department revenues, such as telephone, parking, gift shop sales and resort fees.

Earnings (Loss) Per Share

Basic earnings (loss) per share is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding during the period. Diluted earnings (loss) per share is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding during the period plus other potentially dilutive securities such as equity awards or shares issuable in the event of conversion of operating partnership units. No adjustment is made for shares that are anti-dilutive during a period.

Comprehensive Income (Loss)

We do not have any items of comprehensive income (loss) other than net income (loss). If we do incur any additional items of comprehensive income (loss), such that a statement of comprehensive income would be necessary, such statement will be reported as one statement with the condensed consolidated statement of operations.

Stock-based Compensation

We account for stock-based employee compensation using the fair value based method of accounting. We record the cost of stock-based awards based on the grant-date fair value of the award. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render the requisite service.

Income Taxes

We account for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in earnings in the period when the new rate is enacted.

We have elected to be treated as a REIT under the provisions of the Internal Revenue Code of 1986, as amended, which requires that we distribute at least 90% of our taxable income annually to our stockholders and comply with certain other requirements. In addition to paying federal and state taxes on any retained income, we may be subject to taxes on "built-in gains" on sales of certain assets. Our taxable REIT subsidiaries will generally be subject to federal, state, local, and/or foreign income taxes.

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.

We had no accruals for tax uncertainties as of September 30, 2013 and December 31, 2012.

Fair Value Measurements

In evaluating fair value, U.S. GAAP outlines a valuation framework and creates a fair value hierarchy that distinguishes between market assumptions based on market data (observable inputs) and a reporting entity’s own assumptions about market data (unobservable inputs). The hierarchy ranks the quality and reliability of inputs used to determine fair value, which are then classified and disclosed in one of the three categories. The three levels are as follows:

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- Level 1 - Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 - Inputs include quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets in markets that are not active and model-derived valuations whose inputs are observable
- Level 3 - Model-derived valuations with unobservable inputs

Intangible Assets and Liabilities

Intangible assets and liabilities are recorded on non-market contracts assumed as part of the acquisition of certain hotels. We review the terms of agreements assumed in conjunction with the purchase of a hotel to determine if the terms are favorable or unfavorable compared to an estimated market agreement at the acquisition date. Favorable lease assets or unfavorable contract liabilities are recorded at the acquisition date and amortized using the straight-line method over the term of the agreement. We do not amortize intangible assets with indefinite useful lives, but we review these assets for impairment annually or at interim periods if events or circumstances indicate that the asset may be impaired.

Straight-Line Rental Income and Expense

We record rental income and expense on a straight-line basis for leases that provide for minimum rental payments that increase in pre-established amounts over the remaining term of the lease.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of our note receivable and cash and cash equivalents. We perform periodic evaluations of the underlying hotel property securing the note receivable. See further discussion in Note 5. We maintain cash and cash equivalents with various financial institutions. We perform periodic evaluations of the relative credit standing of these financial institutions and limit the amount of credit exposure with any one institution.

Use of Estimates

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

Risks and Uncertainties

The state of the overall economy can significantly impact hotel operational performance and thus, impact our financial position. Should any of our hotels experience a significant decline in operational performance, it may affect our ability to make distributions to our stockholders and service debt or meet other financial obligations.

3. Property and Equipment

Property and equipment as of September 30, 2013 and December 31, 2012 consists of the following (in thousands):

	September 30, 2013	December 31, 2012
Land	\$402,198	\$402,198

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Land improvements	7,994	7,994
Buildings	2,369,198	2,360,648
Furniture, fixtures and equipment	407,422	340,462
CIP and corporate office equipment	20,566	19,873
	3,207,378	3,131,175
Less: accumulated depreciation	(599,343)	) (519,721)
	\$2,608,035	\$2,611,454

As of September 30, 2013, we had accrued capital expenditures of \$3.9 million. As of December 31, 2012, we had accrued capital expenditures of \$3.0 million.

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4. Favorable Lease Assets

In connection with the acquisition of certain hotels, we recognized intangible assets for favorable ground leases and tenant leases. Our favorable lease assets, net of accumulated amortization, as of September 30, 2013 and December 31, 2012 consist of the following (in thousands):

	September 30, 2013	December 31, 2012
Westin Boston Waterfront Ground Lease	\$18,564	\$18,726
Westin Boston Waterfront - Lease Right	9,045	9,045
Minneapolis Hilton Ground Lease	5,854	5,910
Oak Brook Hills Marriott Resort Ground Lease	5,166	5,489
Lexington Hotel New York Tenant Leases	1,212	1,323
Hilton Boston Downtown Tenant Leases	353	479
	\$40,194	\$40,972

The favorable lease assets are recorded at the acquisition date and are generally amortized using the straight-line method over the remaining non-cancelable term of the lease agreement. Amortization expense for the period from January 1, 2013 to September 30, 2013 was approximately \$0.8 million.

We own a favorable lease asset related to the right to acquire a leasehold interest in a parcel of land adjacent to the Westin Boston Waterfront Hotel for the development of a 320 to 350 room hotel (the "lease right"). The option expires in 2016. We do not amortize the lease right but review the asset for impairment annually or at interim periods if events or circumstances indicate that the asset may be impaired. No impairment loss was recorded for the period from January 1, 2013 to September 30, 2013. An impairment loss of \$0.5 million was recorded during the period from January 1, 2012 to September 7, 2012.

The fair value of the lease right is a Level 3 measurement under the fair value hierarchy (see Note 2) and is derived from a discounted cash flow model using the favorable difference between the estimated participating rents or actual rents in accordance with the lease terms and the estimated market rents. The discount rate is estimated using a risk adjusted rate of return, the estimated participating rents are estimated based on a hypothetical hotel comparable to our Westin Boston Waterfront Hotel, and market rents are based on comparable long-term ground leases in the City of Boston.

5. Note Receivable

We own a senior mortgage loan secured by the 443-room Allerton Hotel in Chicago, Illinois (the "Allerton Loan"), which we acquired in 2010. On January 18, 2013, we closed on a settlement of the bankruptcy and related litigation involving the Allerton Loan. As a result of the settlement, we received a \$5.0 million cash principal payment and entered into a new \$66.0 million mortgage loan with a four-year term (plus a one-year extension option), bearing annual interest at a fixed rate of 5.5%. Principal payments are based on a 30-year amortization schedule, but are only due to the extent there is available cash flow from operations. Based on the settlement, we changed the classification of the Allerton Loan from non-accrual to accrual status. The settlement is considered a restructuring of the original loan. Therefore, the carrying basis of the previous note receivable remains the carrying basis of the new note receivable. The discount resulting from the difference between our carrying basis and the \$66.0 million new Allerton Loan is recorded as interest income on a level yield basis over the anticipated term of the loan, which includes the one-year extension option. We received a \$1.5 million principal payment in May 2013.

We recorded \$1.6 million of interest income on the Allerton Loan for the quarter ended September 30, 2013, of which \$0.7 million is the amortization of the discount and the remainder is contractual interest income. We recorded \$4.4 million of interest income on the Allerton Loan for the period from January 1, 2013 to September 30, 2013, of which \$1.9 million is the amortization of the discount and the remainder is contractual interest income. We recorded no interest income in 2012 due to the non-accrual status of the Allerton Loan.

6. Capital Stock

Common Shares

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We are authorized to issue up to 400 million shares of common stock, \$0.01 par value per share. Each outstanding share of common stock entitles the holder to one vote on all matters submitted to a vote of stockholders. Holders of our common stock are entitled to receive dividends out of assets legally available for the payment of dividends when authorized by our board of directors.

We have paid the following dividends to holders of our common stock during 2013 as follows:

Payment Date	Record Date	Dividend per Share
January 10, 2013	December 31, 2012	\$0.080
April 12, 2013	March 28, 2013	\$0.085
July 11, 2013	June 28, 2013	\$0.085
October 10, 2013	September 30, 2013	\$0.085

On August 5, 2013, our board of directors voted to authorize us to purchase up to \$100 million in shares of our common stock. Repurchases under this program will be made in open market or privately negotiated transactions. This authority may be exercised from time to time and in such amounts as market conditions warrant, and subject to regulatory considerations. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, market conditions, and other corporate liquidity requirements and priorities. The share repurchase program may be suspended or terminated at any time without prior notice. We have not repurchased any shares of our common stock since the program started.

Preferred Shares

We are authorized to issue up to 10 million shares of preferred stock, \$0.01 par value per share. Our board of directors is required to set for each class or series of preferred 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. As of September 30, 2013 and December 31, 2012, there were no shares of preferred stock outstanding.

Operating Partnership Units

Holders of operating partnership units would have certain redemption rights, which would enable them to cause our operating partnership to redeem their units in exchange for cash per unit equal to the market price of our common stock, at the time of redemption, or, at our option for shares of our common stock on a one-for-one basis. The number of shares issuable upon exercise of the redemption rights will be adjusted upon the occurrence of stock splits, mergers, consolidations or similar pro-rata share transactions, which otherwise would have the effect of diluting the ownership interests of the limited partners or our stockholders. As of September 30, 2013 and December 31, 2012, there were no operating partnership units held by unaffiliated third parties.

7. Stock Incentive Plans

We are authorized to issue up to 8 million shares of our common stock under our 2004 Stock Option and Incentive Plan, as amended (the "Incentive Plan"), of which we have issued or committed to issue 3,457,829 shares as of September 30, 2013. In addition to these shares, additional shares of common stock could be issued in connection with the market stock unit awards and performance stock unit awards as further described below.

Restricted Stock Awards

Restricted stock awards issued to our officers and employees generally vest over a 3-year period from the date of the grant based on continued employment. We measure compensation expense for the restricted stock awards based upon the fair market value of our common stock at the date of grant. Compensation expense is recognized on a straight-line basis over the vesting period and is included in corporate expenses in the accompanying condensed consolidated statements of operations. A summary of our restricted stock awards from January 1, 2013 to September 30, 2013 is as follows:

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	Number of Shares	Weighted- Average Grant Date Fair Value
Unvested balance at January 1, 2013	676,111	\$10.10
Granted	301,806	9.18
Additional shares from dividends	1,040	9.30
Forfeited	(16,934	) 9.65
Vested	(400,722	) 9.94
Unvested balance at September 30, 2013	561,301	\$9.74

The remaining share awards are expected to vest as follows: 270,440 during 2014, 193,200 during 2015, and 97,661 during 2016. As of September 30, 2013, the unrecognized compensation cost related to restricted stock awards was \$3.9 million and the weighted-average period over which the unrecognized compensation expense will be recorded is approximately 23 months. We recorded \$0.7 million and \$0.8 million, respectively, of compensation expense related to restricted stock awards for each of the fiscal quarters ended September 30, 2013 and September 7, 2012. For the periods from January 1, 2013 to September 30, 2013 and January 1, 2012 to September 7, 2012, we recorded \$2.7 million and \$2.3 million, respectively, of compensation expense related to restricted stock awards. The compensation expense for the period from January 1, 2013 to September 30, 2013 includes \$0.7 million related to the accelerated vesting of awards in connection with the retirement of our Chief Operating Officer on May 1, 2013.

Market Stock Units

We have awarded our executive officers market stock units (“MSUs”). MSUs are restricted stock units that vest three years from the date of grant. A summary of our MSUs from January 1, 2013 to September 30, 2013 is as follows:

	Number of Units	Weighted- Average Grant Date Fair Value
Unvested balance at January 1, 2013	258,842	\$11.31
Additional units from dividends	5,104	9.75
Vested	(90,620	) 9.86
Unvested balance at September 30, 2013	173,326	\$12.02

As of September 30, 2013, the unrecognized compensation cost related to the MSUs was \$0.5 million and is expected to be recognized on a straight-line basis over a weighted average period of 14 months. For the fiscal quarters ended September 30, 2013 and September 7, 2012, we recorded approximately \$0.1 million and \$0.2 million, respectively, of compensation expense related to the MSUs. For the periods from January 1, 2013 to September 30, 2013 and January 1, 2012 to September 7, 2012, we recorded \$0.7 million and \$0.6 million, respectively, of compensation expense related to the MSUs. The compensation expense for the period from January 1, 2013 to September 30, 2013 includes \$0.2 million related to the accelerated vesting of awards in connection with the retirement of our Chief Operating Officer on May 1, 2013.

Performance Stock Units

Beginning in 2013, we awarded our executive officers performance stock units (“PSUs”). PSUs are restricted stock units that vest three years from the date of grant. Each executive officer is granted a target number of PSUs (the “PSU Target

Award”). The actual number of shares of common stock issued to each executive officer is subject to the achievement of certain levels of total stockholder return relative to the total stockholder return of a peer group over a three-year performance period. There will be no payout of shares of our common stock if our total stockholder return falls below the 30th percentile of the total stockholder returns of the peer group. The maximum number of shares of common stock issued to an executive officer is equal to 150% of the PSU Target Award and is earned if our total stockholder return is equal to or greater than the 75th percentile of the total stockholder returns of the peer group. The fair values of the PSU awards are determined using a Monte Carlo simulation. A summary of our PSUs from January 1, 2013 to September 30, 2013 is as follows:

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	Number of Units	Weighted- Average Grant Date Fair Value
Unvested balance at January 1, 2013	—	\$—
Granted	217,949	9.64
Additional units from dividends	3,504	10.09
Unvested balance at September 30, 2013	221,453	\$9.65

As of September 30, 2013, the unrecognized compensation cost related to the PSUs was \$1.7 million and is expected to be recognized on a straight-line basis over a period of 29 months. For the fiscal quarter ended September 30, 2013, we recorded approximately \$0.2 million of compensation expense related to the PSUs. For the period from January 1, 2013 to September 30, 2013, we recorded approximately \$0.4 million of compensation expense related to the PSUs.

8. Earnings (Loss) Per Share

Basic earnings (loss) per share is calculated by dividing net income (loss) available to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings (loss) per share is calculated by dividing net income (loss) available to common stockholders that has been adjusted for dilutive securities, by the weighted-average number of common shares outstanding including dilutive securities.

The following is a reconciliation of the calculation of basic and diluted earnings (loss) per share (in thousands, except share and per share data):

	Quarter Ended September 30, 2013	September 7, 2012	Period from January 1, 2013 to September 30, 2013	January 1, 2012 to September 7, 2012
Numerator:				
Income (loss) from continuing operations	\$8,564	\$(30,690)	) \$19,509	\$(32,314)
Loss from discontinued operations	—	(14,089)	) —	(905)
Net income (loss)	\$8,564	\$(44,779)	) \$19,509	\$(33,219)
Denominator:				
Weighted-average number of common shares outstanding—basic	195,546,384	187,010,360	195,455,225	174,241,316
Effect of dilutive securities:				
Unvested restricted common stock	151,878	—	119,848	—
Shares related to unvested MSUs and PSUs	162,099	—	171,950	—
Weighted-average number of common shares outstanding—diluted	195,860,361	187,010,360	195,747,023	174,241,316
Basic earnings (loss) per share:				
Continuing operations	\$0.04	\$(0.16)	) \$0.10	\$(0.19)
Discontinued operations	—	(0.08)	) —	(0.00)
Total	\$0.04	\$(0.24)	) \$0.10	\$(0.19)
Diluted earnings (loss) per share:				
Continuing operations	\$0.04	\$(0.16)	) \$0.10	\$(0.19)
Discontinued operations	—	(0.08)	) —	(0.00)
Total	\$0.04	\$(0.24)	) \$0.10	\$(0.19)

We did not include 262,461 unexercised stock appreciation rights in our calculation of diluted earnings (loss) per share for each period presented as they would be anti-dilutive.

9. Debt

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The following table sets forth information regarding the Company's debt as of September 30, 2013, in thousands:

Property	Principal Balance	Interest Rate	Maturity Date
Courtyard Manhattan / Midtown East	\$41,635	8.81%	October 2014
Marriott Salt Lake City Downtown	27,401	5.50%	January 2015
Courtyard Manhattan / Fifth Avenue	49,742	6.48%	June 2016
Renaissance Worthington	54,035	5.40%	July 2015
Frenchman's Reef & Morning Star Marriott Beach Resort	57,933	5.44%	August 2015
Marriott Los Angeles Airport	82,600	5.30%	July 2015
Orlando Airport Marriott	56,986	5.68%	January 2016
Chicago Marriott Downtown Magnificent Mile	209,208	5.975%	April 2016
Hilton Minneapolis	95,557	5.464%	May 2021
JW Marriott Denver at Cherry Creek	40,056	6.47%	July 2015
		LIBOR + 3.00%	
Lexington Hotel New York	170,368	(3.183% at September 30, 2013)	March 2015 (1)
Westin Washington D.C. City Center	72,858	3.99%	January 2023
The Lodge at Sonoma, a Renaissance Resort & Spa	30,784	3.96%	April 2023
Westin San Diego	70,503	3.94%	April 2023
Debt premium (2)	633		
Total mortgage debt	1,060,299		
		LIBOR + 1.90%	
Senior unsecured credit facility	—	(2.15% at September 30, 2013)	January 2017 (3)
Total debt	\$1,060,299		
Weighted-Average Interest Rate		5.24%	

(1) The loan may be extended for two additional one-year terms subject to the satisfaction of certain conditions and the payment of an extension fee.

(2) Recorded upon our assumption of the JW Marriott Denver at Cherry Creek mortgage debt in 2011.

(3) The credit facility may be extended for an additional year upon the payment of applicable fees and the satisfaction of certain customary conditions.

Mortgage Debt

We have incurred limited recourse, property specific mortgage debt secured by certain of our hotels. In the event of default, the lender may only foreclose on the secured assets; however, in the event of fraud, misapplication of funds or other customary recourse provisions, the lender may seek payment from us. As of September 30, 2013, 14 of our 27 hotels were secured by mortgage debt. Our mortgage debt contains certain property specific covenants and restrictions, including minimum debt service coverage ratios that trigger "cash trap" provisions as well as restrictions on incurring additional debt without lender consent.

The Lexington Hotel New York mortgage loan contains a financial covenant requiring a minimum debt service coverage ratio ("DSCR"), as defined in the loan agreement, of 1.1 times. As of September 30, 2013, the DSCR was 0.7 times, as a result of the ongoing renovation at the hotel. Under the loan agreement, we have the ability to cure the default by depositing the amount of the DSCR shortfall, approximately \$2.0 million, into a reserve with the lender. If we do not fund the DSCR shortfall and cure the default, the loan becomes due and payable. We will fund the DSCR shortfall and cure the default during the fourth quarter of 2013. The reserve will be released back to us when the DSCR is above 1.1 times for two consecutive quarters. In addition, as of June 30, 2013, the cash trap provision was triggered on the loan.

As of September 30, 2013, we are in compliance with the covenants of our other mortgage debt.

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On October 24, 2013, we entered into a new \$63 million mortgage loan secured by the Salt Lake City Marriott. The new loan has a term of seven years and bears interest at a fixed rate of 4.25%. As part of the financing, we prepaid the \$27.3 million mortgage loan previously secured by the hotel through defeasance, which had a maturity date of January 2015. The cost to defease the loan was approximately \$1.5 million.

Senior Unsecured Credit Facility

We are party to a \$200 million unsecured credit facility, which expires in January 2017. The maturity date of the facility may be extended for an additional year upon the payment of applicable fees and the satisfaction of certain other customary conditions. We also have the right to increase the amount of the facility up to \$400 million with lender approval. Interest is paid on the periodic advances under the facility at varying rates, based upon LIBOR, plus an agreed upon additional margin amount. The applicable margin is based upon the Company's ratio of net indebtedness to EBITDA, as follows:

Ratio of Net Indebtedness to EBITDA	Applicable Margin	
Less than 4.00 to 1.00	1.75	%
Greater than or equal to 4.00 to 1.00 but less than 5.00 to 1.00	1.90	%
Greater than or equal to 5.00 to 1.00 but less than 5.50 to 1.00	2.10	%
Greater than or equal to 5.50 to 1.00 but less than 6.00 to 1.00	2.20	%
Greater than or equal to 6.00 to 1.00 but less than 6.50 to 1.00	2.50	%
Greater than or equal to 6.50 to 1.00	2.75	%

In addition to the interest payable on amounts outstanding under the facility, we are required to pay an amount equal to 0.35% of the unused portion of the facility if the unused portion of the facility is greater than 50% or 0.25% if the unused portion of the facility is less than or equal to 50%.

The facility contains various corporate financial covenants. A summary of the most restrictive covenants is as follows:

	Covenant	Actual at September 30, 2013
Maximum leverage ratio (1)	60%	43.0%
Minimum fixed charge coverage ratio (2)	1.50x	2.36x
Minimum tangible net worth (3)	\$1.857 billion	\$2.267 billion
Secured recourse indebtedness (4)	Less than 50% of Total Asset Value	39%

(1) Leverage ratio is total indebtedness, as defined in the credit agreement which includes our commitment on the Times Square development hotel, divided by total asset value, defined in the credit agreement as a) total cash and cash equivalents plus b) the value of our owned hotels based on hotel net operating income divided by a defined capitalization rate, and (c) the book value of the Allerton Loan.

(2) Fixed charge coverage ratio is Adjusted EBITDA, defined in the credit agreement as EBITDA less FF&E reserves, for the most recently ending 12 months, to fixed charges, defined in the credit agreement as interest expense, all regularly scheduled principal payments and payments on capitalized lease obligations, for the same most recently ending 12-month period.

(3) Tangible net worth, as defined in the credit agreement, is (i) total gross book value of all assets, exclusive of depreciation and amortization, less intangible assets, total indebtedness, and all other liabilities, plus (ii) 75% of net

proceeds from future equity issuances.

- (4) After December 31, 2013, the secured recourse indebtedness covenant threshold will decrease to 45% of Total Asset Value, as defined in the credit agreement.

The facility requires us to maintain a specific pool of unencumbered borrowing base properties. The unencumbered borrowing base assets must include a minimum of five properties with an unencumbered borrowing base value, as defined in the credit agreement, of not less than \$250 million. As of September 30, 2013, the unencumbered borrowing base included six properties with a borrowing base value of \$366 million.

As of September 30, 2013, we had no borrowings outstanding under the facility and the Company's ratio of net indebtedness to EBITDA was 4.6x. Accordingly, interest on any draws under the facility will be based on LIBOR plus 190 basis points for the next fiscal quarter. We incurred interest and unused credit facility fees on the facility of \$0.2 million and \$0.7 million for the fiscal

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quarters ended September 30, 2013 and September 7, 2012, respectively, and \$0.7 million and \$1.7 million for the periods from January 1, 2013 to September 30, 2013 and January 1, 2012 to September 7, 2012, respectively.

10. Discontinued Operations

We sold four hotels during 2012 in two separate transactions. In March 2012, we sold a three-hotel portfolio, which consisted of the Griffin Gate Marriott Resort and Spa, the Renaissance Waverly, and the Renaissance Austin and in October 2012 we sold the Atlanta Westin North at Perimeter. The operating results of these hotels and the gain (loss) on the sales are reported in discontinued operations on the accompanying condensed consolidated statements of operations.

The following table summarizes the components of discontinued operations in the condensed consolidated statements of operations for the periods presented (unaudited; in thousands, except per share data):

	Quarter Ended September 7, 2012	Period from January 1, 2012 to September 7, 2012	
Hotel revenues	\$4,129	\$31,329	
Hotel operating expenses	(2,890)	(23,254))
Operating income	1,239	8,075	
Depreciation and amortization	(449)	(1,346))
Interest income	—	1	
Interest expense	—	(2,297))
Impairment loss	(14,690)	(14,690))
(Loss) gain on sale of hotel properties	(336)	9,541)
Income tax benefit (expense)	147	(189))
Loss from discontinued operations	\$(14,089)	\$(905))
Basic and diluted loss from discontinued operations per share	\$(0.08)	\$(0.00))

We have entered into an agreement to sell the 487-room Torrance Marriott South Bay to an unaffiliated third party for a contractual sales price of \$74 million. The sale is expected to close during the fourth quarter of 2013, subject to the satisfaction of customary closing conditions. As of September 30, 2013, the hotel was not classified as held for sale as the buyer was still in its due diligence period and its deposit was refundable. Accordingly, the hotel is reported in continuing operations for all periods presented. Subsequent to September 30, 2013, the buyer completed its due diligence and its deposit has become non-refundable.

11. Fair Value of Financial Instruments

The fair value of certain financial assets and liabilities and other financial instruments as of September 30, 2013 and December 31, 2012, in thousands, are as follows:

	September 30, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Note receivable	\$49,356	\$64,500	\$53,792	\$57,000
Debt	\$1,060,299	\$1,067,349	\$988,731	\$1,035,450

The fair value of our mortgage debt is a Level 2 measurement under the fair value hierarchy (see Note 2). We estimate the fair value of our mortgage debt by discounting the future cash flows of each instrument at estimated market rates.

The fair value of our note receivable is a Level 2 measurement under the fair value hierarchy. We estimate the fair value of our note receivable by discounting the future cash flows related to the note at estimated market rates. The underlying collateral of the note receivable has a fair value greater than the carrying value of the note receivable. The carrying value of our other financial instruments approximate fair value due to the short-term nature of these financial instruments.

12. Commitments and Contingencies

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Litigation

We are subject to various claims, lawsuits and legal proceedings, including routine litigation arising in the ordinary course of business, regarding the operation of our hotels and company matters. While it is not possible to ascertain the ultimate outcome of such matters, management believes that the aggregate amount of such liabilities, if any, in excess of amounts covered by insurance will not have a material adverse impact on our financial condition or results of operations. The outcome of claims, lawsuits and legal proceedings brought against the Company, however, is subject to significant uncertainties.

Performance Termination Provisions Under Management Agreements

Our management agreements provide us with termination rights upon a manager's failure to meet certain financial performance criteria and decision not to cure the failure by making a cure payment. The Oak Brook Hills Marriott Resort, Orlando Airport Marriott, and the Hilton Garden Inn Chelsea/New York City each failed its performance test at the end of 2012. The following are the actions we have taken as a result of these performance test failures:

Oak Brook Hills Marriott Resort: We terminated the management agreement effective in November 2013. We intend to enter into a short-term management agreement with another manager to operate the hotel as an independent hotel.

Hilton Garden Inn Chelsea/New York City: We amended the management agreement to reduce the base management fee to 2% of gross revenues for the remainder of the term.

Orlando Airport Marriott: We determined that no action would be taken.

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

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and includes this statement for purposes of complying with these safe harbor provisions. These forward-looking statements are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions, whether in the negative or affirmative. Forward-looking statements are based on management's current expectations and assumptions and are not guarantees of future performance. Factors that may cause actual results to differ materially from current expectations include, but are not limited to, the risks discussed herein and the risk factors discussed from time to time in our periodic filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended December 31, 2012 as updated by our Quarterly Reports on Form 10-Q. Accordingly, there is no assurance that the Company's expectations will be realized. Except as otherwise required by the federal securities laws, the Company disclaims any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained in this report to reflect events, circumstances or changes in expectations after the date of this report.

Overview

DiamondRock Hospitality Company is a lodging-focused Maryland corporation operating as a real estate investment trust (REIT). We own a portfolio of 27 premium hotels and resorts that contain 11,608 guest rooms. We also hold the senior note on a mortgage loan secured by an additional hotel and have the right to acquire, upon completion, a hotel under development. As an owner, rather than an operator, of lodging properties, we receive all of the operating profits or losses generated by the hotels after the payment of fees due to hotel managers, which are calculated based on the revenues and profitability of each hotel.

Our vision is to be the premier allocator of capital in the lodging industry. Our mission is to deliver long-term stockholder returns through a combination of dividends and enduring capital appreciation. Our strategy is to utilize disciplined capital allocation and focus on the acquisition, ownership and innovative asset management of high-quality lodging properties in North America with superior growth prospects and high barriers to entry.

We differentiate ourselves from our competitors by adhering to three basic principles in executing our strategy:

- focus on high-quality urban and destination resort hotels;
- promote innovative approaches to asset management; and
- maintain a conservative capital structure.

Our portfolio is concentrated in key gateway cities and destination resorts. Each of our hotels is managed by a third party and most are operated under a brand owned by one of the leading global lodging brand companies (Marriott International, Inc. ("Marriott"), Starwood Hotels & Resorts Worldwide, Inc. ("Starwood") or Hilton Worldwide ("Hilton")).

We critically evaluate each of our hotels to ensure that our portfolio conforms to our vision, supports our mission and corresponds with our strategy. On a regular basis, we analyze our portfolio to identify opportunities to invest capital in certain projects or market non-core assets for sale in order to recycle capital for additional acquisitions, renovation projects, or other capital requirements.

We are committed to a conservative capital structure with prudent leverage. We regularly assess the availability and affordability of capital in order to maximize the Company's value and minimize enterprise risk. In addition, we are committed to being open and transparent in our communications with stockholders and adopting and following sound corporate governance practices.

High Quality Urban- and Destination Resort-Focused Branded Hotel Real Estate

We own 27 premium hotels and resorts throughout North America and the U.S. Virgin Islands. Our hotels and resorts are primarily categorized as upper upscale as defined by Smith Travel Research and are generally located in high barrier-to-entry markets with multiple demand generators.

Our properties are concentrated in key gateway cities (primarily New York City, Chicago, Boston and Los Angeles) and in destination resort locations (such as the U.S. Virgin Islands and Vail, Colorado). We consider lodging properties located in gateway

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cities and resort destinations to be the most capable of creating dynamic cash flow growth and achieving superior long-term capital appreciation. We also believe that these locations are better insulated from new supply due to relatively high barriers-to-entry, including expensive construction costs and limited development sites.

A core tenet of our strategy is to leverage our relationships with the top internationally-recognized hotel brands. We believe that the premier global hotel brands create significant value as a result of each brand's ability to produce incremental revenue with the result being that branded hotels are able to generate greater profits than similar unbranded hotels. The dominant global hotel brands typically have very strong reservation and reward systems and sales organizations, and most of our hotels are operated under a brand owned by one of the top global lodging brand companies (Marriott, Starwood or Hilton). We are primarily interested in owning hotels that are currently operated under, or can be converted to, a globally-recognized brand.

In addition to leveraging global brands, we are interested in creating relationships with select non-branded boutique hotels in urban markets. We would consider opportunities to acquire other non-branded hotels located in top-tier or unique markets as we believe that the returns on certain of these hotels may be higher than if the hotels were operated under a globally-recognized brand.

Innovative Asset Management

We believe that we create significant value in our portfolio by utilizing our management team's extensive experience and encouraging innovative asset management strategies. Our senior management team has established a broad network of hotel industry contacts and relationships, including relationships with hotel owners, financiers, operators, project managers and contractors and other key industry participants.

We use our broad network of hotel industry contacts and relationships to maximize the value of our hotels. Under the federal income tax rules governing REITs, we are required to engage a hotel manager that is an eligible independent contractor to manage each of our hotels pursuant to a management agreement with one of our subsidiaries. Our philosophy is to negotiate management agreements that give us the right to exert significant influence over the management of our properties, annual budgets and all capital expenditures (all, to the extent permitted under the REIT rules), and then to use those rights to continually monitor and improve the performance of our properties. We cooperatively partner with our hotel managers in an attempt to increase operating results and long-term asset values at our hotels. In addition to working directly with the personnel at our hotels, our senior management team also has long-standing professional relationships with our hotel managers' senior executives, and we work directly with these senior executives to improve the performance of our portfolio.

We continue to explore strategic options to maximize the growth of revenue and profitability. We persist in impressing upon our hotel managers the importance of maximizing hotel revenues and property-level profits. We maintain our practice of working closely with managers to optimize business at our hotels in order to maximize revenue and we remain committed to the objective of maintaining conservative corporate expenses.

We believe we can create significant value in our portfolio through innovative asset management strategies such as rebranding, renovating and repositioning and we engage in a process of regular evaluations of our portfolio in order to determine if there are opportunities to employ these value-add strategies.

Conservative Capital Structure

Our current debt outstanding consists of primarily fixed interest rate mortgage debt with no significant maturities until late 2014 and no outstanding borrowings under our senior unsecured credit facility, which bears interest at what we believe is an attractive floating rate. We prefer that a significant portion of our portfolio remains unencumbered by debt in order to provide maximum balance sheet flexibility. In addition, to the extent that we incur additional debt, our preference is non-recourse secured mortgage debt. We expect that our strategy will enable us to maintain a balance sheet with an appropriate amount of debt throughout all phases of the lodging cycle. We believe that it is not prudent to increase the inherent risk of highly cyclical lodging fundamentals through the use of a highly leveraged capital structure.

We prefer a relatively simple but efficient capital structure. We have not invested in joint ventures and have not issued any operating partnership units or preferred stock. We endeavor to structure our hotel acquisitions so that they will not overly complicate our capital structure; however, we will consider a more complex transaction if we believe that the projected returns to our stockholders will significantly exceed the returns that would otherwise be available.

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Key Indicators of Financial Condition and Operating Performance

We use a variety of operating and other information to evaluate the financial condition and operating performance of our business. These key indicators include financial information that is prepared in accordance with U.S. GAAP, as well as other financial information that is not prepared in accordance with U.S. GAAP. In addition, we use other information that may not be financial in nature, including statistical information and comparative data. We use this information to measure the performance of individual hotels, groups of hotels and/or our business as a whole. We periodically compare historical information to our internal budgets as well as industry-wide information. These key indicators include:

Occupancy percentage;

Average Daily Rate (or ADR);

Revenue per Available Room (or RevPAR);

Earnings Before Interest, Income Taxes, Depreciation and Amortization (or EBITDA) and Adjusted EBITDA; and

Funds From Operations (or FFO) and Adjusted FFO.

Occupancy, ADR and RevPAR are commonly used measures within the hotel industry to evaluate operating performance. RevPAR, which is calculated as the product of ADR and occupancy percentage, is an important statistic for monitoring operating performance at the individual hotel level and across our business as a whole. We evaluate individual hotel RevPAR performance on an absolute basis with comparisons to budget and prior periods, as well as on a company-wide and regional basis. ADR and RevPAR include only room revenue. Room revenue comprised approximately 70% of total revenues for the period from January 1, 2013 to September 30, 2013 and is dictated by demand, as measured by occupancy percentage, pricing, as measured by ADR, and our available supply of hotel rooms.

Our ADR, occupancy percentage and RevPAR performance may be impacted by macroeconomic factors such as U.S. economic conditions generally, regional and local employment growth, personal income and corporate earnings, office vacancy rates and business relocation decisions, airport and other business and leisure travel, new hotel construction and the pricing strategies of competitors. In addition, our ADR, occupancy percentage and RevPAR performance is dependent on the continued success of our hotels' global brands.

We also use EBITDA, Adjusted EBITDA, FFO and Adjusted FFO as measures of the financial performance of our business. See "Non-GAAP Financial Measures."

Change in Reporting Periods

Effective January 1, 2013, we report quarterly operating results on a calendar cycle, which is now consistent with all of our hotel managers. We continue to report our annual financial statements on a calendar year basis. Historically, our quarterly operating results have been reported based on a 52-53 week fiscal calendar used by Marriott, the manager of 14 of our hotels. Beginning in 2013, Marriott converted to reporting results based on a 12-month calendar year. Previously, Marriott's fiscal year consisted of thirteen 4-week accounting periods, ended on the Friday closest to December 31, and included twelve weeks of operations for each of the first three quarters and sixteen weeks for the fourth quarter. Accordingly, our first three quarters in 2012 ended on March 23, June 15 and September 7. In contrast,

the managers of our other hotels, such as Hilton, Starwood and other independent managers, reported results on a monthly basis. Our 2012 quarterly results of operations included results from our non-Marriott-managed hotels as follows: first quarter (January to February), second quarter (March to May), third quarter (June to August) and fourth quarter (September to December).

The following table illustrates the change in our reporting periods:

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Quarter	2012 Reporting Calendar		2013 Reporting Calendar	
1st	Marriott-managed hotels	January 1 - March 23	All Hotels	January 1 - March 31
	Non-Marriott-managed hotels	January 1 - February 29		
2nd	Marriott-managed hotels	March 24 - June 15	All Hotels	April 1 - June 30
	Non-Marriott-managed hotels	March 1 - May 31		
3rd	Marriott-managed hotels	June 16 - September 7	All Hotels	July 1 - September 30
	Non-Marriott-managed hotels	June 1 - August 31		
4th	Marriott-managed hotels	September 8 - December 31	All Hotels	October 1 - December 31
	Non-Marriott-managed hotels	September 1 - December 31		

We will not restate the previously filed 2012 quarterly financial statements because Marriott did not provide us operating results for 2012 on a daily basis. Because we rely upon our hotel managers for the hotel operating results used in our financial statements, the unavailability of this information on a calendar quarter basis for 2012 made restating our financial statements unfeasible. Accordingly, our 2012 reported quarterly operating results are not comparable to our 2013 quarterly operating results.

Our Hotels

The following table sets forth certain operating information for the period from January 1, 2013 to September 30, 2013 for each of our hotels.

Property	Location	Number of Rooms	Occupancy (%)	ADR(\$)	RevPAR(\$)	% Change from 2012 Pro Forma RevPAR (1)
Chicago Marriott	Chicago, Illinois	1,198	76.6	% \$205.34	\$ 157.32	