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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2010

OR

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

COMMISSION FILE NO. 001-13393

CHOICE HOTELS INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

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

10750 COLUMBIA PIKE

SILVER SPRING, MD. 20901

(Address of principal executive offices)

(Zip Code)

(301) 592-5000

(Registrant s telephone number, including area code)

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

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

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

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

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

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

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

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED, IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

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

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

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

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED, IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

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

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

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

4

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED, IN THOUSANDS)

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

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

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

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Company Information and Significant Accounting Policies

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

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

Cash and Cash Equivalents

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

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

Derivatives

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

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

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

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

Variable Interest Entities

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

Recently Adopted Accounting Guidance

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

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

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

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

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

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

2. Other Current Assets

Other current assets consist of the following:

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

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

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

3. Notes Receivable

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

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

Forgivable Notes Receivable

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

Mezzanine and Other Notes Receivable

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

4. Receivable Marketing and Reservation Fees

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

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

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

5. Deferred Revenue

Deferred revenue consists of the following:

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

6. Debt

Debt consists of the following at:

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

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

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

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

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

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

The Company may redeem the Senior Notes at its option at a redemption price equal to the greater of (a) 100% of the principal amount of the notes to be redeemed and (b) the sum of the present values of the remaining scheduled principal and interest payments from the redemption date to the date of maturity discounted to the redemption date on a semi-annual basis at the Treasury rate, plus 45 basis points.

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

7. Acquisition of Choice Hospitality (India) Ltd.

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

8. Pension Plan

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

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

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

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

10

Table of Contents

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

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

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

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

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

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

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

9. Non-Qualified Retirement, Savings and Investment Plans

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