

DiamondRock Hospitality Co
Form 10-Q
August 06, 2018

Table of Contents

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 June 30, 2018

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

(State of Incorporation)

20-1180098

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

2 Bethesda Metro Center, Suite 1400, Bethesda, Maryland 20814

(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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

Emerging growth company ☐ (Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards pursuant to Section 13(a) of the Exchange Act. ☐

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 207,840,943 shares of its \$0.01 par value common stock outstanding as of August 6, 2018.

Table of Contents
INDEX

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (unaudited):</u>	
<u>Condensed Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017</u>	<u>1</u>
Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2018 and 2017	<u>2</u>
Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2018 and 2017	<u>3</u>
<u>Notes to the Condensed Consolidated Financial Statements</u>	<u>5</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>17</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>32</u>
<u>Item 4. Controls and Procedures</u>	<u>33</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>34</u>
<u>Item 1A. Risk Factors</u>	<u>34</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>34</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>34</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>34</u>
<u>Item 5. Other Information</u>	<u>34</u>
<u>Item 6. Exhibits</u>	<u>35</u>

Table of Contents

PART I. FINANCIAL INFORMATION

Item I. Financial Statements

DIAMONDROCK HOSPITALITY COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(unaudited)

	June 30, 2018	December 31, 2017
ASSETS		
Property and equipment, net	\$2,806,510	\$ 2,692,286
Restricted cash	41,564	40,204
Due from hotel managers	100,253	86,621
Favorable lease assets, net	46,395	26,690
Prepaid and other assets	33,168	71,488
Cash and cash equivalents	134,552	183,569
Total assets	\$3,162,442	\$ 3,100,858
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Mortgage and other debt, net of unamortized debt issuance costs	\$636,139	\$ 639,639
Term loans, net of unamortized debt issuance costs	298,383	298,153
Total debt	934,522	937,792
Deferred income related to key money, net	11,937	14,307
Unfavorable contract liabilities, net	74,297	70,734
Deferred ground rent	90,254	86,614
Due to hotel managers	68,693	74,213
Dividends declared and unpaid	26,561	25,708
Accounts payable and accrued expenses	44,879	57,845
Total liabilities	1,251,143	1,267,213
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; 207,840,943 and 200,306,733 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	2,078	2,003
Additional paid-in capital	2,158,336	2,061,451
Accumulated deficit	(249,115)	(229,809)
Total stockholders' equity	1,911,299	1,833,645
Total liabilities and stockholders' equity	\$3,162,442	\$ 3,100,858

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

- 1 -

Table of Contents

DIAMONDROCK HOSPITALITY COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues:				
Rooms	\$175,058	\$177,483	\$304,036	\$315,315
Food and beverage	51,572	52,762	92,364	97,540
Other	11,319	13,027	23,079	26,627
Total revenues	237,949	243,272	419,479	439,482
Operating Expenses:				
Rooms	40,593	41,565	76,193	78,466
Food and beverage	31,701	33,064	59,155	62,530
Management fees	6,610	6,949	9,443	12,961
Other hotel expenses	89,243	78,608	162,706	150,267
Depreciation and amortization	26,033	25,585	50,935	49,948
Hotel acquisition costs	—	22	—	2,273
Corporate expenses	7,832	6,828	17,618	13,090
Gain on business interruption insurance	(2,000)	—	(8,027)	—
Total operating expenses, net	200,012	192,621	368,023	369,535
Operating profit	37,937	50,651	51,456	69,947
Interest and other income, net	(296)	(192)	(807)	(551)
Interest expense	10,274	9,585	20,151	19,098
Loss on early extinguishment of debt	—	274	—	274
Total other expenses, net	9,978	9,667	19,344	18,821
Income before income taxes	27,959	40,984	32,112	51,126
Income tax benefit (expense)	50	(4,389)	235	(5,644)
Net income	\$28,009	\$36,595	\$32,347	\$45,482
Earnings per share:				
Basic earnings per share	\$0.14	\$0.18	\$0.16	\$0.23
Diluted earnings per share	\$0.14	\$0.18	\$0.16	\$0.23

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

- 2-

Table of Contents

DIAMONDROCK HOSPITALITY COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$ 32,347	\$ 45,482
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	50,935	49,948
Corporate asset depreciation as corporate expenses	106	32
Loss on early extinguishment of debt	—	274
Non-cash ground rent	3,478	3,164
Amortization of debt issuance costs	916	1,028
Amortization of favorable and unfavorable contracts, net	(979)	(956)
Amortization of deferred income related to key money	(2,370)	(1,042)
Stock-based compensation	4,413	3,340
Changes in assets and liabilities:		
Prepaid expenses and other assets	6,861	(3,261)
Due to/from hotel managers	(17,268)	(20,258)
Accounts payable and accrued expenses	(10,323)	5,623
Net cash provided by operating activities	68,116	83,374
Cash flows from investing activities:		
Hotel capital expenditures	(62,353)	(58,911)
Hotel acquisitions	(119,537)	(93,795)
Proceeds from property insurance	30,719	—
Net used in investing activities	(151,171)	(152,706)
Cash flows from financing activities:		
Scheduled mortgage debt principal payments	(6,781)	(5,870)
Proceeds from sale of common stock, net	92,899	—
Repayments of mortgage debt	—	(170,368)
Proceeds from senior unsecured term loan	—	200,000
Draws on senior unsecured credit facility	85,000	—
Repayments of senior unsecured credit facility	(85,000)	—
Payment of financing costs	—	(1,579)
Payment of cash dividends	(50,571)	(50,360)
Repurchase of common stock	(149)	(529)
Net cash provided by (used in) financing activities	35,398	(28,706)
Net decrease in cash, cash equivalents, and restricted cash	(47,657)	(98,038)
Cash, cash equivalents, and restricted cash at beginning of period	223,773	289,164
Cash, cash equivalents, and restricted cash at end of period	\$ 176,116	\$ 191,126

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

- 3-

Table of Contents

DIAMONDROCK HOSPITALITY COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - (CONTINUED)

(in thousands)

(unaudited)

Supplemental Disclosure of Cash Flow Information:

	Six Months Ended June 30,	
	2018	2017
Cash paid for interest	\$18,969	\$18,015
Cash paid for income taxes	\$1,803	\$1,770
Non-cash Investing and Financing Activities:		
Unpaid dividends	\$26,561	\$25,548
Loan assumed in hotel acquisition	\$2,943	\$—

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the condensed consolidated balance sheets to the amount shown within the condensed consolidated statements of cash flows:

	June 30,	December 31,
	2018	2017
Cash and cash equivalents	\$134,552	\$183,569
Restricted cash (1)	41,564	40,204
Total cash, cash equivalents, and restricted cash	\$176,116	\$223,773

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- (1) Restricted cash primarily consists of reserves for replacement of furniture and fixtures held by our hotel managers and cash held in escrow pursuant to lender requirements.

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

- 4-

Table of Contents

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 the majority of our hotels are operated under a brand owned by one of the leading global lodging brand companies (Marriott International, Inc. or Hilton Worldwide). 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 June 30, 2018, we owned 30 hotels with 9,949 guest rooms, located in the following markets: Atlanta, Georgia; Boston, Massachusetts (2); Burlington, Vermont; Charleston, South Carolina; Chicago, Illinois (2); Denver, Colorado (2); Fort Lauderdale, Florida; Fort Worth, Texas; Huntington Beach, California; Key West, Florida (2); New York, New York (4); Phoenix, Arizona; Salt Lake City, Utah; San Diego, California; San Francisco, California; Sedona, Arizona (2); Sonoma, California; South Lake Tahoe, California; Washington D.C. (2); St. Thomas, U.S. Virgin Islands; and Vail, Colorado. As of June 30, 2018, the Frenchman's Reef & Morning Star Marriott Beach Resort is closed as a result of damage incurred from Hurricanes Irma and Maria in September 2017.

We conduct our business through a traditional umbrella partnership real estate investment trust, 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, 2017, included in our Annual Report on Form 10-K filed on February 27, 2018.

In our opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly our financial position as of June 30, 2018, the results of our operations for the three and six months ended June 30, 2018 and 2017, and the cash flows for the six months ended June 30, 2018 and 2017. 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 Financial Accounting Standards

Board (“FASB”) Accounting Standards Codification (“ASC”) 810, Consolidation, the Company will consolidate the entity when it is determined to be the primary beneficiary of the entity. Our operating partnership meets the criteria of a variable interest entity. The Company is the primary beneficiary and, accordingly, we consolidate our operating partnership.

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.

Property and Equipment

- 5-

Table of Contents

Following the adoption of Accounting Standards Update (“ASU”) No. 2017-01, investments in hotel properties, land, land improvements, building and furniture, fixtures and equipment and identifiable intangible assets are generally accounted for as asset acquisitions and recorded at relative fair value based upon total accumulated cost of the acquisition. Direct acquisition-related costs are capitalized as a component of the acquired assets. 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 are 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 5 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 assets and related liabilities as held for sale on the balance sheet.

Revenue Recognition

Revenues from operations of the hotels are recognized when the goods or services are provided, and thereby the performance obligations are satisfied. Revenues consist of room sales, food and beverage sales, and other hotel department revenues, such as telephone, parking, gift shop sales and resort fees. Room revenue is generated through contracts with customers whereby the customer agrees to pay a daily rate for the right to use a hotel room. Our contract performance obligations are fulfilled at the end of the day that the customer is provided the room and revenue is recognized daily at the contract rate. Food and beverage revenue is generated through contracts with customers whereby the customer agrees to pay a contract rate for restaurant dining services or banquet services. Our contract performance obligations are fulfilled at the time that the food and beverage is provided to the customer or when the banquet facilities and related dining amenities are provided to the customer. We recognize food and beverage revenue upon the fulfillment of the contract with the customer. Other revenues are recognized at the point in time or over the time period that goods or services are provided to the customer. Certain ancillary services are provided by third parties and we assess whether we are the principal or agent in these arrangements. If we are the agent, revenue is recognized based upon the commission earned from the third party. If we are the principal, we recognize revenue based upon the gross sales price. Certain of our hotels have retail spaces, restaurants or other spaces which we lease to third parties. Lease revenue is recognized on a straight-line basis over the life of the lease and included in other operating revenues

in our condensed consolidated statements of operations.

Hotel operating revenues are disaggregated on the face of the condensed consolidated statements of operations into the categories of room revenue, food and beverage revenue, and other revenue to demonstrate how economic factors affect the nature, amount, timing, and uncertainty of revenue and cash flows.

The following table provides information about trade receivables and contract liabilities (in thousands):

	June 30, December	
	2018	31, 2017
Trade receivables (1)	\$27,435	\$ 17,919
Advance deposits as deferred revenue (2)	13,336	14,754

(1)Included within due from hotel managers on the accompanying condensed consolidated balance sheets.

(2)Included within due to hotel managers on the accompanying condensed consolidated balance sheets.

Table of Contents

Advance deposits are provided when a customer or group of customers provides a deposit for a future stay or banquet event at our hotels. Advance deposits are converted to revenue when the services are provided to the customer or when a customer with a noncancelable reservation fails to arrive for part or all of the reservation. Conversely, advance deposits are generally refundable upon guest cancelation of the related reservation within an established period of time prior to the reservation.

Earnings Per Share

Basic earnings per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income 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.

Stock-based Compensation

We account for stock-based employee compensation using the fair value based method of accounting. We record the cost of awards with service or market conditions 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 during the period in which the new rate is enacted. However, deferred tax assets are recognized only to the extent that it is more likely than not that they will be realized based on consideration of all available evidence, including the future reversals of existing taxable temporary differences, future projected taxable income and tax planning strategies. Valuation allowances are provided if, based upon the weight of the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

We have elected to be treated as a real estate investment trust ("REIT") under the provisions of the Internal Revenue Code of 1986, as amended (the "Code"), 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 primary 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 June 30, 2018 and December 31, 2017.

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 observability 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:

- 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

- 7-

Table of Contents

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.

Accounting for Impacts of Natural Disasters

Assets destroyed or damaged as a result of natural disasters or other involuntary events are written off or reduced in carrying value to their salvage value. When recovery of all or a portion of the amount of property damage loss or other covered expenses through insurance proceeds is demonstrated to be probable, a receivable is recorded and offsets the loss or expense up to the amount of the total loss or expense. No gain is recorded until all contingencies related to the insurance claim have been resolved. Income resulting from business interruption insurance is not recognized until all contingencies related to the insurance recoveries are resolved.

In September 2017, Hurricanes Irma and Maria caused significant damage to the Frenchman's Reef & Morning Star Marriott Beach Resort and the Havana Cabana Key West. We are pursuing insurance claims for the remediation of property damage and business interruption at these hotels. We received \$12.5 million and \$52.5 million of insurance proceeds under these claims during the three and six months ended June 30, 2018, respectively. For the three months ended June 30, 2018, we recognized a \$2.0 million gain on business interruption insurance on our accompanying condensed consolidated statement of operations, which is in addition to \$1.0 million of expense reimbursements from insurance recorded within other hotel expenses on our accompanying condensed consolidated statement of operations. For the six months ended June 30, 2018, we recognized a \$8.0 million gain on business interruption insurance on our accompanying condensed consolidated statement of operations, which is in addition to \$2.9 million of expense reimbursements from insurance recorded within other hotel expenses on our accompanying condensed consolidated statement of operations.

Recently Issued Accounting Pronouncements

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which clarifies the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions of assets or business combinations. As a result of the standard, we anticipate that the majority of our hotel acquisitions will be considered asset purchases as opposed to business combinations. However, the determination will be made on a transaction-by-transaction basis and we do not expect the determination to materially change the recognition of the assets and liabilities acquired. This standard is effective for annual periods beginning after December 15, 2017. We adopted ASU No. 2017-01 effective January 1, 2018. This standard will be applied on a prospective basis and, therefore, it does not affect the accounting for any of our transactions prior to January 1, 2018. Refer to Note 9 for more information about our two hotel property acquisitions during the six months ended June 30, 2018, which were both asset purchases.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires that the statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. This standard is effective for annual periods beginning after December 15, 2017. We adopted ASU No. 2016-18 effective January 1, 2018. The adoption of ASU No. 2016-18 changed the presentation of the statement of cash flows for the Company

and we utilized a retrospective transition method for each period presented within financial statements for periods subsequent to the date of adoption. Restricted cash reserves are included with cash and cash equivalents on our consolidated statements of cash flows for all periods presented. There was no impact to the condensed consolidated statements of income or the condensed consolidated balance sheets.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which clarifies and provides specific guidance on eight cash flow classification issues with an objective to reduce the current diversity in practice. This standard is effective for annual periods beginning after December 15, 2017. We adopted ASU No. 2016-15 effective January 1, 2018 and it did not have an impact on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which affects virtually all aspects of an entity's revenue recognition. The new standard sets forth five prescribed steps to determine the timing and amount of revenue to be recognized to appropriately depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date,

Table of Contents

which deferred the effectiveness of ASU No. 2014-09 to reporting periods beginning after December 15, 2017 and permitted early application for annual reporting periods beginning after December 15, 2016. We adopted the new standard effective January 1, 2018 under the cumulative effect transition method. No adjustment was recorded to the Company's opening balance of retained earnings on January 1, 2018 as there was no impact to net income for the Company.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which primarily changes the lessee's accounting for operating leases by requiring recognition of lease right-of-use assets and lease liabilities. This standard is effective for annual reporting periods beginning after December 15, 2018, with early adoption permitted. The primary impact of the new standard will be to the treatment of our ground leases, which represent a majority of all of our operating lease payments. We are continuing to evaluate the effect of ASU 2016-02 on our consolidated financial statements and related disclosures.

3. Property and Equipment

Property and equipment as of June 30, 2018 and December 31, 2017 consists of the following (in thousands):

	June 30, 2018	December 31, 2017
Land	\$617,695	\$602,879
Land improvements	7,994	7,994
Buildings and site improvements	2,538,664	2,414,216
Furniture, fixtures and equipment	458,667	423,987
Construction in progress	23,228	31,906
	3,646,248	3,480,982
Less: accumulated depreciation	(839,738)	(788,696)
	\$2,806,510	\$2,692,286

As of June 30, 2018 and December 31, 2017, we had accrued capital expenditures of \$9.4 million and \$11.7 million, respectively.

4. Favorable Lease Assets

In connection with the acquisition of certain hotels, we have recognized intangible assets for favorable leases. Our favorable lease assets, net of accumulated amortization of \$3.0 million and \$2.7 million as of June 30, 2018 and December 31, 2017, respectively, consist of the following (in thousands):

	June 30, 2018	December 31, 2017
Westin Boston Waterfront Hotel Ground Lease	\$17,534	\$17,643
Hotel Palomar Phoenix Ground Lease	19,913	—
Orchards Inn Sedona Annex Sublease	8,841	8,925
Lexington Hotel New York Tenant Leases	107	122
	\$46,395	\$26,690

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. We recorded \$0.2 million and \$0.1 million of amortization expense, respectively, for the three months ended June 30, 2018 and 2017. We recorded \$0.3 million and

\$0.2 million of amortization expense, respectively, for the six months ended June 30, 2018 and 2017.

In connection with our acquisition of the Hotel Palomar Phoenix on March 1, 2018, we recorded a \$20.0 million favorable lease asset. We determined the value using a discounted cash flow of the favorable difference between the contractual lease payments and estimated market rents. The market rents were estimated with the assistance of a third-party valuation firm and the discount rate was estimated using a risk adjusted rate of return. See Note 9 for further discussion of this favorable lease asset.

5. Capital Stock

Common Shares

- 9-

Table of Contents

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 an “at-the-market” equity offering program (the “ATM program”), pursuant to which we may issue and sell shares of our common stock from time to time, having an aggregate offering price of up to \$200 million. During the six months ended June 30, 2018, we sold 7,472,946 shares of common stock at an average price of \$12.56 for net proceeds of \$92.9 million under the ATM program. As of June 30, 2018, there is \$34.4 million remaining under the ATM program.

Our board of directors has approved a share repurchase program authorizing us to repurchase up to \$150 million in shares of our common stock. Repurchases under this program are made in open market or privately negotiated transactions as permitted by federal securities laws and other legal requirements. This authority may be exercised from time to time and in such amounts as market conditions warrant, and subject to regulatory considerations. The timing, manner, price and actual number of shares repurchased depends on a variety of factors including stock 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 during 2018 and we have \$150 million of authorized capacity remaining under our share repurchase program.

Dividends

We have paid the following dividends to holders of our common stock during 2018 as follows:

Payment Date	Record Date	Dividend per Share
January 12, 2018	December 29, 2017	\$ 0.125
April 12, 2018	March 29, 2018	\$ 0.125
July 12, 2018	June 29, 2018	\$ 0.125

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 June 30, 2018 and December 31, 2017, there were no shares of preferred stock outstanding.

Operating Partnership Units

Holders of operating partnership units 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 June 30, 2018 and December 31, 2017, there were no operating partnership units held by unaffiliated third parties.

6. Stock Incentive Plans

We are authorized to issue up to 6,082,664 shares of our common stock under our 2016 Equity Incentive Plan (the "2016 Plan"), of which we have issued or committed to issue 846,517 shares as of June 30, 2018. In addition to these shares, additional shares of common stock could be issued in connection with the performance stock unit awards as further described below. The 2016 Plan replaced the 2004 Stock Option and Incentive Plan, as amended (the "2004 Plan"). We no longer make share grants and issuances under the 2004 Plan, although awards previously made under the 2004 Plan that are outstanding will remain in effect in accordance with the terms of that plan and the applicable award agreements.

Restricted Stock Awards

Restricted stock awards issued to our officers and employees generally vest over a three-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

- 10-

Table of Contents

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, 2018 to June 30, 2018 is as follows:

	Number of Shares	Weighted- Average Grant Date Fair Value
Unvested balance at January 1, 2018	630,962	\$ 10.66
Granted	349,091	10.19
Vested	(338,209)	10.94
Unvested balance at June 30, 2018	641,844	\$ 10.25

The remaining share awards are expected to vest as follows: 310,117 shares during 2019, 215,368 shares during 2020, and 116,359 during 2021. As of June 30, 2018, the unrecognized compensation cost related to restricted stock awards was \$5.5 million and the weighted-average period over which the unrecognized compensation expense will be recorded is approximately 26 months. We recorded \$0.8 million of compensation expense related to restricted stock awards for each of the three months ended June 30, 2018 and 2017. We recorded \$2.1 million and \$1.5 million, respectively, of compensation expense related to restricted stock awards for the six months ended June 30, 2018 and 2017. The compensation expense for the six months ended June 30, 2018 includes \$0.6 million related to the accelerated vesting of awards in connection with the departure of our former Chief Financial Officer. Subsequent to June 30, 2018, we entered into a settlement agreement with our former Chief Financial Officer, in which he forfeited certain of his equity awards. As a result, the compensation expense previously recorded related to the forfeited awards will be reversed.

Performance Stock Units

Performance stock units (“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”). For the PSUs issued in 2015 and vesting in 2018, 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 of publicly traded lodging REITs 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. For the PSUs issued in 2016 and vesting in 2019, the calculation of total stockholder return relative to the total stockholder return of a peer group over a three-year performance period remained in effect for 75% of the number of PSUs to be earned in the performance period. The remaining 25% is determined based on achieving improvement in market share for each of our hotels over the three-year performance period based on a report prepared for each hotel by STR Global, a well-recognized and universally accepted benchmarking service for the hospitality industry. For the PSUs issued in 2017 and 2018 and vesting in 2020 and 2021, respectively, the calculation of total stockholder return relative to the total stockholder return of a peer group over a three-year performance period applies to 50% of the number of PSUs to be earned in the performance period. The remaining 50% is determined based on achieving improvement in market share for each of our hotels over the three-year performance period.

We measure compensation expense for the PSUs based upon the fair market value of the award at the grant date. Compensation expense is recognized on a straight-line basis over the three-year performance period and is included in

corporate expenses in the accompanying condensed consolidated statements of operations. The grant date fair value of the portion of the PSUs based on our relative total stockholder return is determined using a Monte Carlo simulation performed by a third-party valuation firm. The grant date fair value of the portion of the PSUs based on improvement in market share for each of our hotels is the closing price of our common stock on the grant date.

On March 2, 2018, our board of directors granted 264,509 PSUs to our executive officers. The grant date fair value of the portion of the PSUs based on our relative total stockholder return was \$9.52 using the assumptions of volatility of 26.9% and a risk-free rate of 2.40%. The grant date fair value of the portion of the PSUs based on hotel market share was \$10.18, the closing stock price of our common stock on such date. On April 2, 2018, our board of directors granted 28,602 PSUs to our new Chief Financial Officer. The grant date fair value of the portion of the PSUs based on our relative total stockholder return was \$9.00 using the assumptions of volatility of 26.9% and a risk-free rate of 2.37%. The grant date fair value of the portion of the PSUs based on hotel market share was \$10.32, the closing stock price of our common stock on such date.

Table of Contents

A summary of our PSUs from January 1, 2018 to June 30, 2018 is as follows:

	Number of Target Units	Weighted- Average Grant Date Fair Value
Unvested balance at January 1, 2018	785,797	\$ 10.42
Granted	293,111	9.82
Additional units from dividends	18,260	11.13
Vested (1)	(218,514)	11.98
Unvested balance at June 30, 2018	878,654	\$ 9.85

(1) The number of shares of common stock earned for the PSUs vested in 2018 was equal to 51.75% of the PSU Target Award.

The remaining target units are expected to vest as follows: 301,189 units during 2019, 281,270 units during 2020 and 296,195 units during 2021. The number of shares earned upon vesting is subject to the attainment of the performance goals described above. As of June 30, 2018, the unrecognized compensation cost related to the PSUs was \$4.3 million and is expected to be recognized on a straight-line basis over a weighted average period of 26 months. We recorded \$0.6 million of compensation expense related to the PSUs for each of the three months ended June 30, 2018 and 2017. We recorded \$1.7 million and \$1.2 million, respectively, of compensation expense related to the PSUs for the six months ended June 30, 2018 and 2017. The compensation expense for the six months ended June 30, 2018 includes \$0.6 million related to the accelerated vesting of awards in connection with the departure of our former Chief Financial Officer. Subsequent to June 30, 2018, we entered into a settlement agreement with our former Chief Financial Officer, in which he forfeited certain of his equity awards. As a result, the compensation expense previously recorded related to the forfeited awards will be reversed.

7. Earnings Per Share

Basic earnings per share is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings per share is calculated by dividing net income 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 per share (in thousands, except share and per share data):

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2018	2017	2018	2017
Numerator:				
Net income	\$28,009	\$36,595	\$32,347	\$45,482
Denominator:				
Weighted-average number of common shares outstanding—basic	203,574	203,282		