

DiamondRock Hospitality Co  
Form 10-Q  
November 06, 2015

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 September 30, 2015

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 200,741,777 shares of its \$0.01 par value common stock outstanding as of November 6, 2015.

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 September 30, 2015 and December 31, 2014</u>	<u>1</u>
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2015 and 2014</u>	<u>2</u>
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2015 and 2014</u>	<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>16</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>31</u>
<u>Item 4. Controls and Procedures</u>	<u>31</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>32</u>
<u>Item 1A. Risk Factors</u>	<u>32</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>32</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>32</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>32</u>
<u>Item 5. Other Information</u>	<u>32</u>
<u>Item 6. Exhibits</u>	<u>33</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)

	September 30, 2015	December 31, 2014
<b>ASSETS</b>		
Property and equipment, net	\$2,885,190	\$2,764,393
Restricted cash	55,656	74,730
Due from hotel managers	102,222	79,827
Favorable lease assets, net	24,057	34,274
Prepaid and other assets	53,671	52,739
Deferred financing costs, net	7,574	8,023
Cash and cash equivalents	61,977	144,365
Total assets	\$3,190,347	\$3,158,351
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Mortgage debt	\$1,031,198	\$1,038,330
Senior unsecured credit facility	25,000	—
Total debt	1,056,198	1,038,330
Deferred income related to key money, net	20,722	21,561
Unfavorable contract liabilities, net	75,135	76,220
Due to hotel managers	68,399	59,169
Dividends declared and unpaid	25,540	20,922
Accounts payable and accrued expenses	121,600	113,162
Total liabilities	1,367,594	1,329,364
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; 200,741,777 and 199,964,041 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively	2,007	2,000
Additional paid-in capital	2,055,467	2,045,755
Accumulated deficit	(234,721	) (218,768
Total stockholders' equity	1,822,753	1,828,987
Total liabilities and stockholders' equity	\$3,190,347	\$3,158,351

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



Table of Contents

## DIAMONDROCK HOSPITALITY COMPANY

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Rooms	\$ 178,529	\$ 171,047	\$ 504,729	\$ 465,871
Food and beverage	47,256	45,504	155,662	146,297
Other	12,717	12,666	36,801	37,067
Total revenues	238,502	229,217	697,192	649,235
Operating Expenses:				
Rooms	42,415	42,534	122,872	121,783
Food and beverage	32,143	32,662	103,044	101,855
Management fees	7,562	8,330	22,665	22,083
Other hotel expenses	83,358	75,180	237,410	220,335
Depreciation and amortization	25,107	25,327	75,018	75,576
Impairment losses	—	—	10,461	—
Hotel acquisition costs	453	1,198	945	1,279
Corporate expenses	6,048	6,368	17,790	15,878
Gain on insurance proceeds	—	(554)	) —	(1,825)
Gain on litigation settlement, net	—	—	—	(10,999)
Total operating expenses, net	197,086	191,045	590,205	545,965
Operating profit	41,416	38,172	106,987	103,270
Interest income	(35)	) (156)	) (185)	) (2,766)
Interest expense	12,907	14,691	38,963	43,816
Loss (Gain) on sale of hotel property	—	40	—	(1,251)
Gain on hotel property acquisition	—	(23,894)	) —	(23,894)
Gain on prepayment of note receivable	—	—	—	(13,550)
Other income, net	(91)	) (50)	) (295)	) (50)
Total other expenses (income), net	12,781	(9,369)	) 38,483	2,305
Income before income taxes	28,635	47,541	68,504	100,965
Income tax expense	(4,171)	) (3,733)	) (8,576)	) (1,203)
Net income	\$ 24,464	\$ 43,808	\$ 59,928	\$ 99,762
Earnings per share:				
Basic earnings per share	\$ 0.12	\$ 0.22	\$ 0.30	\$ 0.51
Diluted earnings per share	\$ 0.12	\$ 0.22	\$ 0.30	\$ 0.51

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)

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$59,928	\$99,762
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	75,018	75,576
Corporate asset depreciation as corporate expenses	63	79
Gain on sale of hotel property	—	(1,251)
Gain on prepayment of note receivable	—	(13,550)
Loss on early extinguishment of debt	—	61
Gain on hotel property acquisition	—	(23,894)
Non-cash ground rent	4,454	4,880
Non-cash financing costs, debt premium and interest rate cap as interest	1,715	2,085
Amortization of note receivable discount as interest income	—	(1,075)
Impairment losses	10,461	—
Amortization of favorable and unfavorable contracts, net	(1,134)	(1,058)
Amortization of deferred income related to key money	(839)	(818)
Stock-based compensation	4,403	4,105
Changes in assets and liabilities:		
Prepaid expenses and other assets	(4,445)	687
Restricted cash	13,338	(13,003)
Due to/from hotel managers	(12,441)	(16,245)
Accounts payable and accrued expenses	7,300	(702)
Net cash provided by operating activities	157,821	115,639
Cash flows from investing activities:		
Hotel capital expenditures	(46,141)	(56,091)
Hotel acquisitions	(150,400)	(148,376)
Net proceeds from sale of hotel property	—	23,610
Note receivable principal repayments	—	64,500
Change in restricted cash	5,737	3,701
Net cash used in investing activities	(190,804)	(112,656)
Cash flows from financing activities:		
Scheduled mortgage debt principal payments	(10,075)	(10,966)
Proceeds from sale of common stock, net	7,796	—
Proceeds from mortgage debt	150,000	86,000
Repayments of mortgage debt	(146,876)	(41,315)
Draws on senior unsecured credit facility	135,000	41,320
Repayments of senior unsecured credit facility	(110,000)	(41,320)
Purchase of interest rate cap	(325)	—
Payment of financing costs	(1,182)	(3,330)

Edgar Filing: DiamondRock Hospitality Co - Form 10-Q

Payment of cash dividends	(71,008	) (56,989	)
Repurchase of common stock	(2,735	) (1,898	)
Net cash used in financing activities	(49,405	) (28,498	)
Net decrease in cash and cash equivalents	(82,388	) (25,515	)
Cash and cash equivalents, beginning of period	144,365	144,584	
Cash and cash equivalents, end of period	\$61,977	\$119,069	

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)

	Nine Months Ended September 30,	
	2015	2014
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	\$36,326	\$41,953
Cash paid for income taxes	\$798	\$266
Capitalized interest	\$—	\$914
Non-cash Financing Activities:		
Unpaid dividends	\$25,540	\$20,452

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. (“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, 2015, we owned 29 hotels with 10,928 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, FL; Fort Worth, Texas; Huntington Beach, California; Key West, Florida (2); Minneapolis, Minnesota; New York, New York (5); Orlando, Florida; Salt Lake City, Utah; San Diego, California; San Francisco, California; Sonoma, California; Washington D.C. (2); St. Thomas, U.S. Virgin Islands; and Vail, Colorado.

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, 2014, included in our Annual Report on Form 10-K filed on February 27, 2015.

In our opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly our financial position as of September 30, 2015, the results of our operations for the three and nine months ended September 30, 2015 and 2014 and cash flows for the nine months ended September 30, 2015 and 2014. 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.

#### 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.

## Table of Contents

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 have not recognized any impairment loss for our investment in hotel properties during any of the periods presented.

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. We have not classified any of our hotels as held for sale during any of the periods presented.

## Revenue Recognition

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

## 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 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 during the period

in which the new rate is enacted.

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 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, 2015 and December 31, 2014.

- 6-

---

## Table of Contents

### 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:

- 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.

### 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.

### Recently Issued Accounting Pronouncements

In September 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments, which eliminates the requirement for an acquirer in a business combination to account for measurement-period adjustments retrospectively. Instead, acquirers must recognize measurement-period adjustments during the period in which they determine the amounts, including the effect on earnings of any amounts they would have recorded in previous periods if the accounting had been completed at the acquisition date. This standard is effective for annual reporting periods beginning after December 15, 2015, with early adoption permitted. We are evaluating the effect of the ASU on our consolidated financial statements and related disclosures, but we do not believe it will have a material impact on the Company's financial position, results of operations or cash flows.

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-03, Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. This standard is effective for annual reporting periods beginning after December 15, 2015, with early adoption permitted. Adoption of this standard will only affect the

presentation of our balance sheet. Upon adoption we will reclassify deferred financing costs, net from total assets to be shown net of debt in the liabilities section of our balance sheet.

In February 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis, which changes the way reporting enterprises evaluate the consolidation of limited partnerships, variable interests and similar entities. This standard is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. We are evaluating the effect of the ASU on our consolidated financial statements and related disclosures, but we do not believe it will have a material impact on the Company's financial position, results of operations or cash flows.

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, which deferred the effectiveness of ASU No. 2014-09 to reporting periods beginning after December 15, 2017 and permitted early



Table of Contents

application for annual reporting periods beginning after December 15, 2016. We have not yet completed our assessment of the effect of the new standard on our financial statements, including possible transition alternatives.

## 3. Property and Equipment

Property and equipment as of September 30, 2015 and December 31, 2014 consists of the following (in thousands):

	September 30, 2015	December 31, 2014
Land	\$578,338	\$508,838
Land improvements	7,994	7,994
Buildings	2,532,599	2,427,274
Furniture, fixtures and equipment	452,464	430,873
CIP	15,272	13,784
	3,586,667	3,388,763
Less: accumulated depreciation	(701,477)	(624,370)
	\$2,885,190	\$2,764,393

As of September 30, 2015, we had accrued capital expenditures of \$5.2 million. As of December 31, 2014, we had accrued capital expenditures of \$6.2 million.

## 4. Favorable Lease Assets

In connection with the acquisition of certain hotels, we have recognized intangible assets for favorable ground leases and tenant leases. Our favorable lease assets, net of accumulated amortization of \$2.5 million and \$3.0 million as of September 30, 2015 and December 31, 2014, respectively, consist of the following (in thousands):

	September 30, 2015	December 31, 2014
Westin Boston Waterfront Hotel Ground Lease	\$18,131	\$18,293
Westin Boston Waterfront Hotel Lease Right	—	9,045
Hilton Minneapolis Ground Lease	5,704	5,760
Lexington Hotel New York Tenant Leases	193	1,031
Hilton Boston Downtown Tenant Leases	29	145
	\$24,057	\$34,274

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 three months and nine months ended September 30, 2015 was approximately \$0.1 million and \$0.4 million, respectively.

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"). During the second quarter of 2015, we decided not to exercise the option to acquire the leasehold interest and recorded an impairment loss of \$9.6 million, which includes the write-off of \$0.6 million of other assets related to the lease right included within prepaid and other assets on the accompanying condensed consolidated balance sheets.

During the first quarter of 2015, we evaluated the Lexington Hotel New York favorable tenant leases for recoverability of the carrying value. The lease with one of the retail tenants at the Lexington Hotel New York was expected to terminate prior to the end of the lease term. We reviewed the favorable lease asset for impairment and concluded that the asset was not realizable and recorded an impairment loss of \$0.8 million during the first quarter of

2015. The lease terminated in June 2015.

## 5. Capital Stock

### Common Shares

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.

- 8-

---

Table of Contents

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. In January 2015, we sold 524,606 shares of our common stock at an average price of \$15.18 for net proceeds of \$7.8 million. We have not sold any additional shares since January 2015 and there is \$128.3 million remaining under the ATM program.

On November 4, 2015, our board of directors approved a share repurchase program authorizing us to repurchase up to \$150 million in shares of our common stock. Repurchases under this program will be 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 will depend 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 since the program started.

We have paid the following dividends to holders of our common stock during 2015 as follows:

Payment Date	Record Date	Dividend per Share
January 12, 2015	December 31, 2014	\$0.1025
April 10, 2015	March 31, 2015	\$0.1250
July 14, 2015	June 30, 2015	\$0.1250
October 13, 2015	September 30, 2015	\$0.1250

#### 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, 2015 and December 31, 2014, 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 September 30, 2015 and December 31, 2014, there were no operating partnership units held by unaffiliated third parties.

#### 6. Stock Incentive Plans

We are authorized to issue up to 8,000,000 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 3,923,651 shares as of September 30, 2015. 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.

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, 2015 to September 30, 2015 is as follows:

- 9-

---

Table of Contents

	Number of Shares	Weighted- Average Grant Date Fair Value
Unvested balance at January 1, 2015	514,419	\$10.82
Granted	216,159	14.48
Forfeited	(183	) 9.08
Vested	(255,828	) 10.39
Unvested balance at September 30, 2015	474,567	\$12.72

The remaining share awards are expected to vest as follows: 241,698 shares during 2016, 153,578 shares during 2017 and 79,291 shares during 2018. As of September 30, 2015, the unrecognized compensation cost related to restricted stock awards was \$4.4 million and the weighted-average period over which the unrecognized compensation expense will be recorded is approximately 24 months. We recorded \$0.7 million and \$1.0 million, respectively, of compensation expense related to restricted stock awards for each of the three months ended September 30, 2015 and 2014. We recorded \$2.1 million and \$2.4 million, respectively, of compensation expenses related to restricted stock awards for each of the nine months ended September 30, 2015 and 2014.

## Market Stock Units

Market stock units (“MSUs”) are restricted stock units that vest three years from the date of grant. The actual number of shares issued to each executive officer at the vesting date is based on the Company's total stockholder return over a three-year period. In March 2015, the remaining 99,047 outstanding MSUs vested, resulting in the issuance of 148,572 shares of common stock, before income tax withholding. There are no MSUs remaining following this vesting. We recorded no compensation expense related to MSUs for the three months ended September 30, 2015 and less than \$0.1 million for the nine months ended September 30, 2015. We recorded \$0.1 million and \$0.2 million of compensation expense related to MSUs for the three and nine months ended September 30, 2014, respectively.

## 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”). 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.

The fair values of the PSU awards are determined using a Monte Carlo simulation performed by a third-party valuation firm. The determination of the grant-date fair value of the awards granted during the nine months ended September 30, 2015 included the following assumptions:

Award Grant Date	Volatility	Risk-Free Rate	Fair Value at Grant Date
February 27, 2015	22.9	% 1.01	% \$12.13

Edgar Filing: DiamondRock Hospitality Co - Form 10-Q

The simulations also considered the share performance of the Company and the peer group. A summary of our PSUs from January 1, 2015 to September 30, 2015 is as follows:

	Number of Target Units	Weighted- Average Grant Date Fair Value
Unvested balance at January 1, 2015	436,170	\$ 10.95
Granted	218,467	12.13
Additional units from dividends	14,977	14.01
Unvested balance at September 30, 2015	669,614	\$ 11.40

- 10-

---

Table of Contents

The remaining target units are expected to vest as follows: 236,398 units during 2016, 210,756 units during 2017 and 222,460 units during 2018. As of September 30, 2015, the unrecognized compensation cost related to the PSUs was \$3.6 million and is expected to be recognized on a straight-line basis over a weighted average period of 23 months. We recorded \$0.6 million and \$0.4 million of compensation expense related to the PSUs for the three months ended September 30, 2015 and 2014, respectively. We recorded \$1.7 million and \$1.0 million of compensation expense related to the PSUs for the nine months ended September 30, 2015 and 2014, respectively.

## 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 September 30, 2015	2014	Nine Months Ended September 30, 2015	2014
Numerator:				
Net income	\$24,464	\$43,808	\$59,928	\$99,762
Denominator:				
Weighted-average number of common shares outstanding—basic	200,852,072	195,796,772	200,776,641	195,733,185
Effect of dilutive securities:				
Unvested restricted common stock	99,873	215,834	130,349	193,477
Unexercised stock appreciation rights	—	7,512	1,387	—
Shares related to unvested PSUs	215,714	414,655	215,714	414,655
Weighted-average number of common shares outstanding—diluted	201,167,659	196,434,773	201,124,091	196,341,317
Earnings per share:				
Basic earnings per share	\$0.12	\$0.22	\$0.30	\$0.51
Diluted earnings per share	\$0.12	\$0.22	\$0.30	\$0.51

We did not include unexercised stock appreciation rights of 20,770 and 262,461 for the three months ended September 30, 2015 and the nine months ended September 30, 2014, respectively, as they would be anti-dilutive.

## 8. Debt

The following table sets forth information regarding the Company's debt as of September 30, 2015 (dollars in thousands):

Table of Contents

Property	Principal Balance	Interest Rate	Maturity Date
Orlando Airport Marriott (1)	\$55,254	5.68%	January 2016
Chicago Marriott Downtown Magnificent Mile	202,604	5.975%	April 2016
Courtyard Manhattan / Fifth Avenue	48,480	6.48%	June 2016
		LIBOR + 2.25%	
Lexington Hotel New York	170,368	(2.447% at September 30, 2015)	October 2017 (2)
Marriott Salt Lake City Downtown	60,369	4.25%	November 2020
Hilton Minneapolis	91,231	5.464%	May 2021
Westin Washington D.C. City Center	69,250	3.99%	January 2023
The Lodge at Sonoma, a Renaissance Resort & Spa	29,679	3.96%	April 2023
Westin San Diego	67,963	3.94%	April 2023
Courtyard Manhattan / Midtown East	86,000	4.40%	August 2024
Renaissance Worthington	85,000	3.66%	May 2025
JW Marriott Denver at Cherry Creek	65,000	4.33%	July 2025
Total mortgage debt	1,031,198		
		LIBOR + 1.75%	
Senior unsecured credit facility	25,000	(1.94% at September 30, 2015)	January 2017 (3)
Total debt	\$1,056,198		
Weighted-Average Interest Rate		4.50%	

(1) The loan was prepaid on October 9, 2015, three months prior to the scheduled maturity date.

(2) 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.

(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, 2015, 12 of our 29 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. As of September 30, 2015, we are in compliance with the financial covenants of our mortgage debt.

On April 10, 2015, we repaid the \$52.6 million mortgage loan secured by the Renaissance Worthington three months prior to the scheduled maturity date. On April 14, 2015, we entered into a new \$85.0 million mortgage loan secured by the Renaissance Worthington. The new loan matures in 2025 and bears interest at a fixed rate of 3.66%. The new loan is interest-only for the first two years, after which principal will amortize on a 30-year schedule.



On May 11, 2015, we repaid the mortgage loan secured by the Frenchman's Reef & Morning Star Beach Resort three months prior to the scheduled maturity date. The loan had an outstanding principal balance of \$56.2 million and incurred interest at a fixed rate of 5.44%.

On July 1, 2015, we repaid the \$38.1 million mortgage loan secured by the JW Marriott Denver at Cherry Creek and entered into a new \$65.0 million mortgage loan. The new loan matures in 2025 and bears interest at a fixed rate of 4.33%. The new loan is interest-only for the first year, after which principal will amortize on a 30-year schedule.

On October 9, 2015, we repaid the mortgage loan secured by the Orlando Airport Marriott three months prior to the scheduled maturity date. The loan had an outstanding principal balance of \$55.3 million and incurred interest at a fixed rate of 5.68%.

Table of Contents

On October 27, 2015, we entered into a new \$205.0 million mortgage loan secured by the Westin Boston Waterfront Hotel. The new loan matures in 2025, bears interest at a fixed interest rate of 4.36% and will amortize on a 30-year schedule.

## Senior Unsecured Credit Facility

We are party to a \$200 million senior 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, 2015
Maximum leverage ratio (1)	60%	32.9%
Minimum fixed charge coverage ratio (2)	1.50x	3.5x
Minimum tangible net worth (3)	\$1.91 billion	\$2.52 billion
Secured recourse indebtedness	Less than 45% of Total Asset Value	32.1%

Leverage ratio is total indebtedness, as defined in the credit agreement, divided by total asset value, defined in the (1) credit agreement as a) total cash and cash equivalents and b) the value of our owned hotels based on hotel net operating income divided by a defined capitalization rate.

Fixed charge coverage ratio is Adjusted EBITDA, defined in the credit agreement as EBITDA less FF&E reserves, (2) for the most recently ending 12 months, to fixed charges, which is 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.

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

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, 2015, the unencumbered borrowing base included five properties with a borrowing base value of \$319 million.

As of September 30, 2015, we had \$25.0 million outstanding under the facility and the Company's ratio of net indebtedness to EBITDA was 3.55x. Accordingly, interest on our current and future borrowings, if any, under the facility will be based on LIBOR plus 175 basis points for the next quarter. We incurred interest and unused credit facility fees on the facility of \$0.4 million and \$0.2 million for the three months ended September 30, 2015 and 2014, respectively. We incurred interest and unused credit facility fees on the facility of \$0.8 million and \$0.6 million for the nine months ended September 30, 2015 and 2014, respectively. Subsequent to September 30, 2015, we borrowed an incremental \$60.0 million on the facility to fund the prepayment of the mortgage loan secured by the Orlando Airport Marriott. Following the closing of the mortgage loan secured by the Westin Boston Waterfront Hotel, we repaid the \$85.0 million outstanding under the facility.

#### 9. Acquisitions

- 13-

---

Table of Contents

On February 6, 2015, we acquired the 157-room Shorebreak Hotel located in Huntington Beach, California for a contractual purchase price of \$58.5 million. Upon acquisition of the hotel, we entered into a 10-year management agreement with Kimpton Hotel and Restaurant Group, LLC. The management agreement provides for a base management fee of 1.25% of gross revenues during 2015 and 2.5% of gross revenues thereafter. The agreement also provides for an incentive management fee of 15% of hotel operating profit above an owner's priority determined in accordance with the terms of the management agreement.

We own a 95.5% undivided interest in the land underlying the hotel and lease the remaining 4.5% under a long-term ground lease, which expires in 2100, including extension options. In 2021 and at certain points thereafter, we have the option to purchase the 4.5% leasehold interest at the greater of the then current rent divided by 10% or fair market value. We reviewed the terms of the ground lease in conjunction with the hotel purchase accounting and concluded that the terms are unfavorable to us compared with a current market ground lease. As a result, we recorded a \$0.3 million unfavorable lease liability. We expect to exercise the leasehold purchase option in 2021. Accordingly, the unfavorable lease liability will be amortized over the remaining term through 2021.

On June 30, 2015, we acquired the 184-suite Sheraton Suites Key West located in Key West, Florida for a contractual purchase price of \$94.0 million. The acquisition was funded with a combination of corporate cash on hand and a draw on our senior unsecured credit facility. We assumed the existing management agreement with Ocean Properties, which expires in July 2027 and provides for a base management fee of 3.0% of gross revenues and an incentive management fee of 10% of hotel operating profit above an owner's priority determined in accordance with the terms of the management agreement.

The following table summarizes the preliminary estimated fair value of the assets acquired and liabilities assumed in our acquisitions (in thousands):

	Shorebreak Hotel	Sheraton Suites Key West
Land	\$ 19,908	\$ 49,592
Building and improvements	37,525	43,030
Furnitures, fixtures and equipment	1,338	1,378
Total fixed assets	58,771	94,000
Unfavorable lease liability	(349)	—
Other assets and liabilities, net	401	428
Total	\$ 58,823	\$ 94,428

We believe all material adjustments necessary to reflect the effects of the acquisitions have been made; however, the amounts recorded are based on a preliminary estimate of the fair value of the assets acquired and the liabilities assumed. We will finalize the recorded amounts upon the completion of our valuation analysis of the assets acquired and liabilities assumed.

Acquired properties are included in our results of operations from the date of acquisition. The following pro forma financial information presents our results of operations (in thousands, except per share data) as if the hotels acquired in 2015 and 2014 were acquired on January 1, 2014 and January 1, 2013, respectively. The pro forma financial information does not include the Hilton Garden Inn Times Square Central, since the hotel opened on September 1, 2014. The pro forma information is not necessarily indicative of the results that actually would have occurred nor does it indicate future operating results.

Three Months Ended September 30,      Nine Months Ending September 30,

Edgar Filing: DiamondRock Hospitality Co - Form 10-Q

	2015	2014	2015	2014
Revenues	\$238,502	\$245,358	\$708,750	\$711,481
Net income	\$24,464	\$44,624	\$63,481	\$110,724
Earnings per share:				
Basic earnings per share	\$0.12	\$0.23	\$0.32	\$0.57
Diluted earnings per share	\$0.12	\$0.23	\$0.32	\$0.56

- 14-

---

Table of Contents

For the three and nine months ended September 30, 2015, our condensed consolidated statements of operations include \$7.9 million and \$13.7 million, respectively, of revenues and \$2.3 million and \$3.0 million, respectively, of net income related to the operations of the Shorebreak Hotel and Sheraton Suites Key West.

## 10. Fair Value of Financial Instruments

The fair value of certain financial assets and liabilities and other financial instruments as of September 30, 2015 and December 31, 2014, in thousands, is as follows:

	September 30, 2015		December 31, 2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Debt	\$1,056,198	\$1,058,655	\$1,038,330	\$1,059,988

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 carrying value of our other financial instruments approximate fair value due to the short-term nature of these financial instruments.

## 11. Commitments and Contingencies

## 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.

## Income Taxes

The Frenchman's Reef & Morning Star Marriott Beach Resort is owned by a subsidiary that has elected to be treated as a TRS, and is subject to U.S. Virgin Island ("USVI") income taxes. We were party to a tax agreement with the USVI that reduced the income tax rate to approximately 7%. This agreement expired on February 14, 2015. The income tax expense related to the TRS that owns Frenchman's Reef reflects the statutory tax rate of 37.4% from February 15, 2015 through September 30, 2015. Subsequent to September 30, 2015, we were granted a 15-year extension of the tax agreement, which is retroactive to February 15, 2015. Accordingly, the income tax expense and deferred tax assets and liabilities will be adjusted during the fourth quarter to reflect the lower rate from February 15, 2015.

Table of Contents

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, 2014 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"). As of September 30, 2015, we owned a portfolio of 29 premium hotels and resorts that contain 10,928 guest rooms. 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 American markets with superior growth prospects and high barriers-to-entry. In addition, we are committed to maintaining a strong asset management discipline that focuses on maximizing returns through revenue management strategies, cost containment programs and capital improvements. We do all this while maintaining low leverage and balance sheet flexibility.

Our portfolio is concentrated in key gateway cities and destination resort locations. Each of our hotels is managed by a third party and the majority of our hotels 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 we own a portfolio of hotels that 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 increase our portfolio quality. We are committed to a conservative capital structure with prudent leverage. We regularly assess the availability and affordability of capital in order to maximize stockholder value and minimize enterprise risk. In addition, we are committed to following sound corporate governance practices and being open and transparent in our communications with our stockholders.

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;

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



Table of Contents

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, 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 72% of our total revenues for the nine months ended September 30, 2015 and is dictated by demand, as measured by occupancy, pricing, as measured by ADR, and our available supply of hotel rooms.

Our ADR, occupancy 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 our competitors. In addition, our ADR, occupancy 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."

Our Hotels

The following table sets forth certain operating information for the nine months ended September 30, 2015 for each of our hotels.

Table of Contents

Property	Location	Number of Rooms	Occupancy (%)	ADR(\$)	RevPAR(\$)	% Change from 2014 RevPAR (1)	
Chicago Marriott	Chicago, Illinois	1,200	75.6	% \$219.01	\$ 165.49	6.0	%
Hilton Minneapolis	Minneapolis, Minnesota	821	77.6	% 147.36	114.34	1.8	%
Westin Boston Waterfront Hotel	Boston, Massachusetts	793	80.8	% 240.01	193.90	7.8	%
Lexington Hotel New York	New York, New York	725	92.9	% 238.68	221.81	3.9	%
Salt Lake City Marriott Downtown	Salt Lake City, Utah	510	73.8	% 158.13	116.67	13.6	%
Renaissance Worthington	Fort Worth, Texas	504	70.3	% 181.28	127.47	4.1	%
Frenchman's Reef & Morning Star Marriott Beach Resort	St. Thomas, U.S. Virgin Islands	502	84.2	% 255.49	215.07	1.1	%
Orlando Airport Marriott	Orlando, Florida	485	78.5	% 119.41	93.74	10.9	%
Westin San Diego	San Diego, California	436	86.0	% 187.95	161.73	12.7	%
Westin Fort Lauderdale Beach Resort	Fort Lauderdale, Florida	432	86.4	% 182.12	157.31	4.1	%
Westin Washington, D.C. City Center	Washington, D.C.	410	82.8	% 215.77	178.60	16.2	%
Hilton Boston Downtown	Boston, Massachusetts	403	84.9	% 286.90	243.46	5.8	%
Vail Marriott Mountain Resort & Spa	Vail, Colorado	344	71.8	% 261.69	187.77	7.1	%
Marriott Atlanta Alpharetta	Atlanta, Georgia	318	74.9	% 164.07	122.89	4.6	%
Courtyard Manhattan/Midtown East	New York, New York	317	89.7	% 260.63	233.68	(6.3)	)%
The Gwen Chicago (2)	Chicago, Illinois	300	74.6	% 220.65	164.56	(11.4)	)%
Hilton Garden Inn Times Square Central (3)	New York, New York	282	97.0	% 242.32	235.05	52.3	%
Bethesda Marriott Suites	Bethesda, Maryland	272	67.1	% 169.30	113.62	5.1	%
Hilton Burlington	Burlington, Vermont	258	78.7	% 173.28	136.36	4.3	%
JW Marriott Denver at Cherry Creek	Denver, Colorado	196	80.9	% 271.88	219.84	3.6	%
Courtyard Manhattan/Fifth Avenue	New York, New York	185	88.8	% 261.65	232.22	(4.2)	)%
Sheraton Suites Key West (4)	Key West, Florida	184	80.3	% 222.73	178.95	14.0	%
The Lodge at Sonoma, a Renaissance Resort & Spa	Sonoma, California	182	83.9	% 276.28	231.66	9.5	%
Courtyard Denver Downtown	Denver, Colorado	177	80.8	% 204.66	165.31	4.2	%
Hilton Garden Inn Chelsea/New York City	New York, New York	169	94.4	% 221.78	209.44	1.5	%
Renaissance Charleston	Charleston, South Carolina	166	90.6	% 218.44	197.92	6.4	%
Shorebreak Hotel (5)	Huntington Beach, California	157	82.0	% 238.32	195.34	3.6	%

Edgar Filing: DiamondRock Hospitality Co - Form 10-Q

Inn at Key West	Key West, Florida	106	88.6	%	226.21	200.40	7.2	%
Hotel Rex	San Francisco, California	94	85.2	%	238.66	203.23	12.2	%
TOTAL/WEIGHTED AVERAGE		10,928	81.0	%	\$212.34	\$171.98	5.1	%

(1) The percentage change from 2014 RevPAR reflects the comparable period in 2014 to our 2015 ownership period, but excludes the Hilton Garden Inn Times Square Central from January 1, 2015 to August 31, 2015 since the hotel opened on September 1, 2014.

(2) The hotel formerly known as the Conrad Chicago converted to The Gwen, a Luxury Collection Hotel, on September 1, 2015.

(3) The hotel opened on September 1, 2014. The percentage change in RevPAR includes operations from September 1, 2015 to September 30, 2015 to reflect the comparable period in 2014.

(4) The hotel was purchased on June 30, 2015. The operating results reflect the period from June 30, 2015 through September 30, 2015.

(5) The hotel was purchased on February 6, 2015. The operating results reflect the period from February 6, 2015 through September 30, 2015.

#### Highlights and Recent Developments

**Hotel Acquisitions.** On February 6, 2015, we acquired the 157-room Shorebreak Hotel in Huntington Beach, California, for a contractual purchase price of \$58.5 million. On June 30, 2015, we acquired the 184-suite Sheraton Suites Key West located in Key West, Florida for a contractual purchase price of \$94.0 million.

**Hotel Financing Activity.** On April 14, 2015, we refinanced the Renaissance Worthington with a new mortgage loan. The new loan has a principal balance of \$85.0 million and bears interest at a fixed rate of 3.66%. On May 11, 2015, we repaid the mortgage loan secured by the Frenchman's Reef & Morning Star Beach Resort. On July 1, 2015, we refinanced the JW Marriott Denver at Cherry Creek with a new mortgage loan. The new loan has a principal balance of \$65.0 million and bears interest at a fixed rate of 4.33%. On October 9, 2015, we repaid the mortgage loan secured by the Orlando Airport Marriott. On October 27, 2015, we entered into a new mortgage loan secured by the Westin Boston Waterfront Hotel. The new loan has a principal balance of \$205.0 million and bears interest at a fixed rate of 4.36%.

Table of Contents

Hotel Rebranding. We executed a franchise agreement in April 2015 to affiliate the hotel formerly known as the Conrad Chicago with Starwood's Luxury Collection. The conversion to The Gwen, a Luxury Collection Hotel, occurred on September 1, 2015.

## Results of Operations

## Comparison of the Three Months Ended September 30, 2015 to the Three Months Ended September 30, 2014

Revenue. Revenue consists primarily of the room, food and beverage and other operating revenues from our hotels, as follows (dollars in millions):

	Three Months Ended September 30,		% Change	
	2015	2014		
Rooms	\$178.5	\$171.0	4.4	%
Food and beverage	47.3	45.5	4.0	%
Other	12.7	12.7	—	%
Total revenues	\$238.5	\$229.2	4.1	%

Our total revenues increased \$9.3 million from \$229.2 million for the three months ended September 30, 2014 to \$238.5 million for the three months ended September 30, 2015. This increase includes amounts that are not comparable quarter-over-quarter as follows:

- \$17.8 million decrease from the Los Angeles Airport Marriott, which was sold on December 18, 2014.
- \$0.8 million increase from the Inn at Key West, which was purchased on August 15, 2014.
- \$4.6 million increase from the Hilton Garden Inn Times Square Central, which opened on September 1, 2014.
- \$7.6 million increase from the Westin Fort Lauderdale Beach Resort, which was purchased on December 3, 2014.
- \$4.2 million increase from the Shorebreak Hotel, which was purchased on February 6, 2015.
- \$3.7 million increase from the Sheraton Suites Key West, which was purchased on June 30, 2015.

Excluding these non-comparable amounts our total revenues increased \$6.2 million, or 2.9%.

The following pro forma key hotel operating statistics for the three months ended September 30, 2015 and 2014 assume we owned each of our 29 hotels since January 1, 2014 and excludes the Hilton Garden Inn Times Square Central for the period from July 1, 2014 to August 31, 2014 since the hotel opened on September 1, 2014.

	Three Months Ended September 30,		% Change	
	2015	2014		
Occupancy %	82.7	% 83.5	% (0.8)	percentage points
ADR	\$213.93	\$207.26	3.2	%
RevPAR	\$176.92	\$173.07	2.2	%

Room revenue growth was driven by the transient segments, partially offset by a decline in group segment revenue. Revenue from the business transient segment experienced the highest growth at 9.5%, followed by leisure transient at 5.4% growth. Group revenue declined by 7.7%.

Food and beverage revenues increased \$1.8 million from the three months ended September 30, 2014, which includes amounts that are not comparable quarter-over-quarter as follows:

Edgar Filing: DiamondRock Hospitality Co - Form 10-Q

- \$4.4 million decrease from the Los Angeles Airport Marriott, which was sold on December 18, 2014.
- \$0.1 million increase from the Inn at Key West, which was purchased on August 15, 2014.
- \$2.3 million increase from the Westin Fort Lauderdale Beach Resort, which was purchased on December 3, 2014.
- \$0.8 million increase from the Shorebreak Hotel, which was purchased on February 6, 2015.
- \$0.4 million increase from the Sheraton Suites Key West, which was purchased on June 30, 2015.

- 19-

---

Table of Contents

Excluding these non-comparable amounts, food and beverage revenues increased \$2.6 million, or 6.3%, driven primarily by banquet revenue.

Other revenues, which primarily represent spa, parking, resort fees and attrition and cancellation fees, remained flat.

Hotel operating expenses. The operating expenses consisted of the following (dollars in millions):

	Three Months Ended September 30,			
	2015	2014	% Change	
Rooms departmental expenses	\$42.4	\$42.5	(0.2	)%
Food and beverage departmental expenses	32.1	32.7	(1.8	)
Other departmental expenses	4.4	4.7	(6.4	)
General and administrative	18.6	17.3	7.5	
Utilities	7.2	7.2	—	
Repairs and maintenance	9.4	9.3	1.1	
Sales and marketing	16.5	15.2	8.6	
Franchise fees	5.9	4.4	34.1	
Base management fees	5.9	5.6	5.4	
Incentive management fees	1.7	2.7	(37.0	)
Property taxes	13.5	10.2	32.4	
Other fixed charges	3.3	2.8	17.9	
Hotel pre-opening costs	0.8	0.4	100.0	
Ground rent—Contractual	2.4	2.2	9.1	
Ground rent—Non-cash	1.4	1.5	(6.7	)
Total hotel operating expenses	\$165.5	\$158.7	4.3	%

Our hotel operating expenses increased \$6.8 million from \$158.7 million for the three months ended September 30, 2014 to \$165.5 million for the three months ended September 30, 2015. The increase in hotel operating expenses includes amounts that are not comparable quarter-over-quarter as follows:

- \$13.4 million decrease from the Los Angeles Airport Marriott, which was sold on December 18, 2014.
- \$0.5 million increase from the Inn at Key West, which was purchased on August 15, 2014.
- \$2.8 million increase from the Hilton Garden Inn Times Square Central, which opened on September 1, 2014.
- \$6.1 million increase from the Westin Fort Lauderdale Beach Resort, which was purchased on December 3, 2014.
- \$2.5 million increase from the Shorebreak Hotel, which was purchased on February 6, 2015.
- \$2.4 million increase from Sheraton Suites Key West, which was purchased on June 30, 2015

Excluding the non-comparable amounts, hotel operating expenses increased \$5.9 million, or 4.1%, from the three months ended September 30, 2014. Franchise fees increased \$1.5 million, or 34.1%, primarily due to the opening of the Hilton Garden Inn Times Square Central, increasing franchise fees at the Lexington Hotel New York and the acquisitions of the Westin Fort Lauderdale Beach Resort and Sheraton Suites Key West. Incentive management fees decreased \$1.0 million, or 37%, primarily due to the amendment to the Chicago Marriott management agreement. Property taxes increased \$3.3 million, or 32.4%, primarily due to property tax reassessments at our properties, particularly the Chicago Marriott, as well as newly acquired hotels.

Depreciation and amortization. Depreciation and amortization is recorded on our hotel buildings over 40 years for the periods subsequent to acquisition. Depreciable lives of hotel furniture, fixtures and equipment are estimated as the time period between the acquisition date and the date that the hotel furniture, fixtures and equipment will be replaced.

Our depreciation and amortization expense decreased \$0.2 million from the three months ended September 30, 2014. The decrease is primarily due to an increase in fully depreciated furniture, fixtures and equipment, partially offset by depreciation from capital expenditures from our recent hotel renovations.

Hotel acquisition costs. We incurred \$0.5 million of hotel acquisition costs during the three months ended September 30, 2015, which was primarily related to additional transfer taxes on an acquired hotel. We incurred \$1.2 million of hotel acquisition costs during the three months ended September 30, 2014 associated with the acquisitions of the Inn at Key West and the Hilton Garden Inn Times Square Central.

Table of Contents

Corporate expenses. Corporate expenses principally consist of employee-related costs, including base payroll, bonus and restricted stock. Corporate expenses also include corporate operating costs, professional fees and directors' fees. Our corporate expenses decreased \$0.4 million, from \$6.4 million for the three months ended September 30, 2014 to \$6.0 million for the three months ended September 30, 2015. The decrease is due primarily to severance costs of \$0.7 million of severance costs recognized during the three months ended September 30, 2014, partially offset by higher legal fees during the three months ended September 30, 2015.

Gain on insurance proceeds. The gain on insurance proceeds of \$0.6 million during the three months ended September 30, 2014 relates to proceeds received to recover property damage losses under our property insurance policy related to an electrical fire at the Lexington Hotel New York.

Interest income. Interest income decreased \$0.1 million from the three months ended September 30, 2014 to the three months ended September 30, 2015.

Interest expense. Our interest expense was \$12.9 million and \$14.7 million for the three months ended September 30, 2015 and 2014, respectively, and comprises the following (in millions):

	Three Months Ended September 30,	
	2015	2014
Mortgage debt interest	\$ 11.9	\$ 14.0
Credit facility interest and unused fees	0.4	0.2
Amortization of deferred financing costs and debt premium	0.5	0.7
Capitalized interest	—	(0.2)
Interest rate cap fair value adjustment	0.1	—
	\$ 12.9	\$ 14.7

The decrease in mortgage debt interest expense is attributable to the repayment of the mortgage loan secured by the Los Angeles Airport Marriott in connection with the sale of the hotel in the December 2014, the prepayment of the mortgage loan secured by Frenchman's Reef in May 2015, and the amendment to the mortgage loan secured by the Lexington Hotel New York in October 2014, which reduced the interest rate and lower interest rates on our refinanced mortgage loans.

Gain on hotel property acquisition. During the three months ended September 30, 2014, we recorded a gain of \$23.9 million related to our purchase of the Hilton Garden Inn Times Square Central in New York as the fair value of the hotel increased from our contractual purchase price determined at the time we entered into the purchase and sale agreement in 2011 to the fair value at the acquisition date of August 29, 2014.

Income taxes. We recorded income tax expense of \$4.2 million for the three months ended September 30, 2015 and \$3.7 million for the three months ended September 30, 2014. The income tax expense for the three months ended September 30, 2015 includes \$4.4 million of income tax expense on the \$11.0 million pre-tax income of our taxable REIT subsidiary, or TRS, \$0.4 million of foreign income tax benefit incurred on the \$1.0 million pre-tax loss of the TRS that owns Frenchman's Reef and \$0.2 million of state franchise taxes. The income tax expense for the three months ended September 30, 2014 includes \$3.9 million of income tax expense incurred on the \$9.4 million pre-tax income of our TRS, \$0.3 million of foreign income tax benefit, net, incurred on the \$1.4 million pre-tax loss of the TRS that owns Frenchman's Reef, and \$0.1 million of state franchise taxes.

The Frenchman's Reef & Morning Star Marriott Beach Resort is owned by a subsidiary that has elected to be treated as a TRS, and is subject to U.S. Virgin Island ("USVI") income taxes. We were party to a tax agreement with the USVI



that reduced the income tax rate to approximately 7%. This agreement expired on February 14, 2015. The income tax expense related to the TRS that owns Frenchman's Reef reflects the statutory tax rate of 37.4% from February 15, 2015 through September 30, 2015. Subsequent to September 30, 2015, we were granted a 15-year extension of the tax agreement, which is retroactive to February 15, 2015. Accordingly, the tax expense recorded at the statutory rate since February 15, 2015 will be reversed in the fourth quarter of 2015 to an amount which reflects the lower rate.

Comparison of the Nine Months Ended September 30, 2015 to the Nine Months Ended September 30, 2014

Revenue. Revenue consists primarily of the room, food and beverage and other operating revenues from our hotels, as follows (dollars in millions):

- 21-

---

Table of Contents

	Nine Months Ended September 30,		% Change	
	2015	2014		
Rooms	\$504.7	\$465.9	8.3	%
Food and beverage	155.7	146.3	6.4	%
Other	36.8	37.0	(0.5	)%
Total revenues	\$697.2	\$649.2	7.4	%

Our total revenues increased \$48.0 million from \$649.2 million for the nine months ended September 30, 2014 to \$697.2 million for the nine months ended September 30, 2015. This increase includes amounts that are not comparable period-over-period as follows:

- \$2.3 million decrease from the Oak Brook Hills Resort, which was sold on April 14, 2014.
- \$51.4 million decrease from the Los Angeles Airport Marriott, which was sold on December 18, 2014.
- \$5.9 million increase from the Inn at Key West, which was purchased on August 15, 2014.
- \$16.2 million increase from the Hilton Garden Inn Times Square Central, which opened on September 1, 2014.
- \$33.3 million increase from the Westin Fort Lauderdale Beach Resort, which was purchased on December 3, 2014.
- \$9.9 million increase from the Shorebreak Hotel, which was purchased on February 6, 2015.
- \$3.8 million increase from the Sheraton Suites Key West, which was purchased on June 30, 2015.

Excluding these non-comparable amounts our total revenues increased \$32.6 million, or 5.5%.

The following pro forma key hotel operating statistics for the nine months ended September 30, 2015 and 2014 assume we owned each of our 29 hotels since January 1, 2014 and excludes the Hilton Garden Inn Times Square Central for the period from January 1, 2014 to August 31, 2014 since the hotel opened on September 1, 2014.

	Nine Months Ended September 30,		% Change	
	2015	2014		
Occupancy %	80.8	% 80.1	% 0.7 percentage points	
ADR	\$212.58	\$203.81	4.3	%
RevPAR	\$171.75	\$163.28	5.2	%

Room revenue increased across all customer segments, with the exception of contract business. Revenue from the leisure transient segment experienced the highest growth at 10.9%. Business transient revenue increased 6.7% and group revenue increased 1.5%.

Food and beverage revenues increased \$9.4 million from the nine months ended September 30, 2014, which includes amounts that are not comparable period-over-period as follows:

- \$1.2 million decrease from the Oak Brook Hills Resort, which was sold on April 14, 2014.
- \$14.3 million decrease from the Los Angeles Airport Marriott, which was sold on December 18, 2014.
- \$0.5 million increase from the Inn at Key West, which was purchased on August 15, 2014.
- \$11.8 million increase from the Westin Fort Lauderdale Beach Resort, which was purchased on December 3, 2014.
- \$2.2 million increase from the Shorebreak Hotel, which was purchased on February 6, 2015.
- \$0.4 million increase from the Sheraton Suites Key West, which was purchased on June 30, 2015.

Excluding these non-comparable amounts, food and beverage revenues increased \$10.0 million, or 7.7%, driven primarily by banquet revenue.

Other revenues, which primarily represent spa, parking, resort fees and attrition and cancellation fees, decreased by \$0.2 million from the nine months ended September 30, 2014 primarily due to hotels sold during 2014, partially offset by the implementation of resort fees at certain hotels.

Hotel operating expenses. The operating expenses consisted of the following (dollars in millions):

- 22-

---

Table of Contents

	Nine Months Ended September 30,			
	2015	2014	% Change	
Rooms departmental expenses	\$122.9	\$121.8	0.9	%
Food and beverage departmental expenses	103.0	101.9	1.1	
Other departmental expenses	12.9	15.0	(14.0)	)
General and administrative	54.4	50.8	7.1	
Utilities	20.9	20.9	—	
Repairs and maintenance	27.4	27.4	—	
Sales and marketing	48.8	44.2	10.4	
Franchise fees	15.9	11.5	38.3	
Base management fees	17.3	16.0	8.1	
Incentive management fees	5.4	6.1	(11.5)	)
Property taxes	35.3	29.9	18.1	
Other fixed charges	9.1	8.6	5.8	
Hotel pre-opening costs	1.3	0.7	100.0	
Ground rent—Contractual	7.1	6.7	6.0	
Ground rent—Non-cash	4.3	4.6	(6.5)	)
Total hotel operating expenses	\$486.0	\$466.1	4.3	%

Our hotel operating expenses increased \$19.9 million from \$466.1 million for the nine months ended September 30, 2014 to \$486.0 million for the nine months ended September 30, 2015. The increase in hotel operating expenses includes amounts that are not comparable period-over-period as follows:

- \$3.8 million decrease from the Oak Brook Hills Resort, which was sold on April 14, 2014.
- \$39.6 million decrease from the Los Angeles Airport Marriott, which was sold on December 18, 2014.
- \$2.7 million increase from the Inn at Key West, which was purchased on August 15, 2014.
- \$9.9 million increase from the Hilton Garden Inn Times Square Central, which opened on September 1, 2014.
- \$22.4 million increase from the Westin Fort Lauderdale Beach Resort, which was purchased on December 3, 2014.
- \$6.3 million increase from the Shorebreak Hotel, which was purchased on February 6, 2015.
- \$2.4 million increase from the Sheraton Suites Key West, which was purchased on June 30, 2015.

Excluding the non-comparable amounts, hotel operating expenses increased \$19.6 million, or 4.7%, from the nine months ended September 30, 2014. Franchise fees increased \$4.4 million, or 38.3%, primarily due to the opening of the Hilton Garden Inn Times Square Central, increasing franchise fees at the Lexington Hotel New York and the acquisitions of the Westin Fort Lauderdale Beach Resort and Sheraton Suites Key West. Property taxes increased \$5.4 million, or 18.1%, primarily due to property tax reassessments at our properties, particularly the Chicago Marriott, as well as newly acquired hotels.

Depreciation and amortization. Depreciation and amortization is recorded on our hotel buildings over 40 years for the periods subsequent to acquisition. Depreciable lives of hotel furniture, fixtures and equipment are estimated as the time period between the acquisition date and the date that the hotel furniture, fixtures and equipment will be replaced. Our depreciation and amortization expense decreased \$0.6 million from the nine months ended September 30, 2014. The decrease is primarily due to an increase in fully depreciated furniture, fixtures and equipment, partially offset by depreciation on capital expenditures from our recent hotel renovations.

Impairment losses. During the nine months ended September 30, 2015, we recorded impairment losses of \$0.8 million for on the favorable lease asset related to a tenant lease at the Lexington Hotel New York and \$9.7 million on the

option to acquire a leasehold interest in a parcel of land adjacent to the Westin Boston Waterfront Hotel for the development of a new hotel.

Hotel acquisition costs. We incurred \$0.9 million of hotel acquisition costs during the nine months ended September 30, 2015 associated with the acquisitions of the Shorebreak Hotel and the Sheraton Suites Key West and additional transfer taxes on another acquired hotel. We incurred \$1.3 million of hotel acquisition costs during the nine months ended September 30, 2014 associated with the acquisitions of the Inn at Key West and the Hilton Garden Inn Times Square Central.

Corporate expenses. Corporate expenses principally consist of employee-related costs, including base payroll, bonus and restricted stock. Corporate expenses also include corporate operating costs, professional fees and directors' fees. Our corporate

- 23-

---

Table of Contents

expenses increased \$1.9 million period over period. The increase is due primarily to the reimbursement of \$1.8 million of previously incurred legal and other costs from the proceeds of the Westin Boston Waterfront litigation settlement in 2014.

Gain on insurance proceeds. The gain on insurance proceeds of \$1.8 million during the nine months ended September 30, 2014 relates to proceeds received to recover property damage losses under our property insurance policy related to an electrical fire at the Lexington Hotel New York.

Gain on litigation settlement. In May 2014, we settled a legal action alleging certain issues related to the original construction of the Westin Boston Waterfront Hotel with the contractors and their insurers for \$14.0 million in full and complete satisfaction of our claims against the contractors. The settlement resulted in a net gain of \$11.0 million. We recorded the settlement net of a \$1.2 million contingency fee paid to our legal counsel and \$1.8 million of legal fees and other costs incurred over the course of the legal proceedings, which were previously recorded as corporate expenses.

Interest income. Interest income decreased \$2.6 million from the nine months ended September 30, 2014 to the nine months ended September 30, 2015. The decrease is primarily due to interest income on the Allerton loan in 2014, which was prepaid on May 21, 2014.

Interest expense. Our interest expense was \$39.0 million and \$43.8 million for the nine months ended September 30, 2015 and 2014, respectively, and comprises the following (in millions):

	Nine Months Ended September 30,	
	2015	2014
Mortgage debt interest	\$36.2	\$41.8
Credit facility interest and unused fees	0.8	0.6
Amortization of deferred financing costs and debt premium	1.5	2.1
Capitalized interest	—	(0.7
Interest rate cap fair value adjustment	0.5	0.0
	\$39.0	\$43.8

The decrease in mortgage debt interest expense is related to the repayment of the mortgage loan secured by the Los Angeles Airport Marriott in connection with the sale of the hotel in December 2014, the prepayment of the mortgage loan secured by Frenchman's Reef in the May 2015, the amendment to the mortgage loan secured by the Lexington Hotel New York in October 2014, which reduced the interest rate and lower interest rates on our refinanced mortgage loans.

Gain on sale of hotel property. On April 14, 2014, we sold the Oak Brook Hills Resort for \$30.1 million, which resulted in a net gain of \$1.3 million.

Gain on hotel property acquisition. During the nine months ended September 30, 2014, we recorded a gain of \$23.9 million related to our purchase of the Hilton Garden Inn Times Square Central in New York as the fair value of the hotel increased from our contractual purchase price at the time we entered into the purchase and sale agreement in 2011 to the fair value at the closing date of August 29, 2014.

Gain on prepayment of note receivable. On May 21, 2014, we received \$58.5 million in the prepayment of the senior mortgage loan secured by Allerton Hotel. As a result of the prepayment, we recorded a gain of \$13.6 million.

Income taxes. We recorded income tax expense of \$8.6 million for the nine months ended September 30, 2015 and \$1.2 million for the nine months ended September 30, 2014. The income tax expense for the nine months ended September 30, 2015 includes \$6.8 million of income tax expense on the \$16.7 million pre-tax income of our TRS, \$1.5 million of foreign income tax expense incurred on the \$6.0 million pre-tax income of the TRS that owns Frenchman's Reef and \$0.3 million of state franchise taxes. The income tax expense for the nine months ended September 30, 2014 includes \$0.1 million of income tax benefit incurred on the \$0.2 million pre-tax loss of our TRS, offset by \$1.1 million of foreign income tax expense incurred on the \$5.4 million pre-tax income of the TRS that owns Frenchman's Reef and \$0.2 million of state franchise taxes.

The Frenchman's Reef & Morning Star Marriott Beach Resort is owned by a subsidiary that has elected to be treated as a TRS, and is subject to U.S. Virgin Island ("USVI") income taxes. We were party to a tax agreement with the USVI that reduced the income tax rate to approximately 7%. This agreement expired on February 14, 2015. The income tax expense related to the TRS that owns Frenchman's Reef reflects the statutory tax rate of 37.4% from February 15, 2015 through September 30, 2015.

## Table of Contents

Subsequent to September 30, 2015, we were granted a 15-year extension of the tax agreement, which is retroactive to February 15, 2015. Accordingly, the tax expense recorded at the statutory rate since February 15, 2015 will be reversed in the fourth quarter of 2015 to an amount which reflects the lower rate.

### Liquidity and Capital Resources

Our short-term liquidity requirements consist primarily of funds necessary to fund distributions to our stockholders to maintain our REIT status as well as to pay for operating expenses and capital expenditures directly associated with our hotels, funding of share repurchases, if any, under our share repurchase program, debt repayments upon maturity and scheduled debt payments of interest and principal. We currently expect that our available cash flows, which are generally provided through net cash from hotel operations, existing cash balances, equity issuances, proceeds from new financings and refinancings of maturing debt and, if necessary, short-term borrowings under our senior unsecured credit facility, will be sufficient to meet our short-term liquidity requirements.

Our long-term liquidity requirements consist primarily of funds necessary to pay for the costs of acquiring additional hotels, renovations, and other capital expenditures that need to be made periodically to our hotels, scheduled debt payments, debt maturities and making distributions to our stockholders. We expect to meet our long-term liquidity requirements through various sources of capital, including cash provided by operations, borrowings, issuances of additional equity and/or debt securities and proceeds from property dispositions. Our ability to incur additional debt is dependent upon a number of factors, including the state of the credit markets, our degree of leverage, the value of our unencumbered assets and borrowing restrictions imposed by existing lenders. Our ability to raise capital through the issuance of additional equity and/or debt securities is also dependent on a number of factors including the current state of the capital markets, investor sentiment and intended use of proceeds. We may need to raise additional capital if we identify acquisition opportunities that meet our investment objectives and require liquidity in excess of existing cash balances.

### Our Financing Strategy

Since our formation in 2004, we have been committed to a conservative capital structure with prudent leverage. The majority of our outstanding debt is fixed interest rate mortgage debt. We have a preference to maintain a significant portion of our portfolio as unencumbered assets in order to provide 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 have mortgage debt with significant upcoming maturities (approximately \$250 million in 2016, excluding regularly scheduled principal payments prior to maturity). We believe we have the ability to address these maturities, as well as other capital needs, with a combination of the following:

- proceeds from the financing of the Westin Boston Waterfront hotel or other unencumbered hotels;
- proceeds from the disposition of non-core hotels;
- capacity under our \$200 million senior unsecured credit facility; and



annual free cash flow from operations.

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 structure our hotel acquisitions to be straightforward and to fit within 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.

We believe that we maintain a reasonable amount of debt. As of September 30, 2015, we had \$1.1 billion of debt outstanding with a weighted average interest rate of 4.50% and a weighted average maturity date of approximately 4.5 years. We maintain one of the most durable and lowest levered balance sheets among our lodging REIT peers. We maintain balance sheet flexibility with limited near-term debt maturities, capacity under our senior unsecured credit facility and 17 of our 29 hotels unencumbered by mortgage debt. We remain committed to our core strategy of maintaining a simple capital structure with conservative leverage.

2015 Debt Maturities

- 25-

---

## Table of Contents

On April 14, 2015, we refinanced the Renaissance Worthington with a new 10-year mortgage loan. The new loan has a principal balance of \$85.0 million and bears interest at a fixed rate of 3.66%. The new loan is interest-only for the first two years after which principal will amortize on a 30-year schedule. The hotel was previously encumbered by a mortgage loan with an outstanding principal balance of \$52.6 million and a fixed interest rate of 5.40%, which was repaid in full on April 10, 2015.

On May 11, 2015, we repaid the mortgage loan secured by the Frenchman's Reef & Morning Star Beach Resort three months prior to the scheduled maturity date. The loan had an outstanding principal balance of \$56.2 million and a fixed interest rate of 5.44%.

On July 1, 2015, we refinanced the JW Marriott Denver at Cherry Creek with a new 10-year mortgage loan. The new loan has a principal balance of \$65.0 million and bears interest at a fixed rate of 4.33%. The new loan is interest-only for the first year, after which principal will amortize on a 30-year schedule. The hotel was previously encumbered by a \$38.1 million mortgage loan with an outstanding principal balance of \$38.1 million and a fixed interest rate of 6.47%, which was repaid in full on July 1, 2015.

On October 9, 2015, we repaid the mortgage loan secured by the Orlando Airport Marriott three months prior to the scheduled maturity date. The loan had an outstanding principal balance of \$55.3 million and a fixed interest rate of 5.68%.

On October 27, 2015, we entered into a new \$205 million mortgage loan secured by the Westin Boston Waterfront Hotel. The new loan has a term of 10 years, a fixed interest rate of 4.36% and will amortize on a 30-year schedule. The proceeds from the loan are expected to be utilized to prepay the mortgage loan secured by the Chicago Marriott in January 2016.

### Short-Term Borrowings

Other than borrowings under our senior unsecured credit facility, discussed below, we do not utilize short-term borrowings to meet liquidity requirements.

### Senior Unsecured Credit Facility

We are party to a five-year, \$200 million senior unsecured credit facility expiring in January 2017. Information about our senior unsecured credit facility is found in Note 8 to the accompanying condensed consolidated financial statements. As of September 30, 2015, we had \$25.0 million of borrowings under our senior unsecured credit facility. Subsequent to September 30, 2015, we borrowed an incremental \$60.0 million on the facility to fund the prepayment of the mortgage loan secured by the Orlando Airport Marriott. Following the closing of the mortgage loan secured by the Westin Boston Waterfront Hotel, we repaid the \$85.0 million outstanding under the facility.

### Sources and Uses of Cash

Our principal sources of cash are net cash flow from hotel operations and borrowings under mortgage debt and our senior unsecured credit facility. Our principal uses of cash are acquisitions of hotel properties, debt service, debt maturities, capital expenditures, operating costs, corporate expenses and dividends. As of September 30, 2015, we had \$62.0 million of unrestricted corporate cash and \$55.7 million of restricted cash, as well as additional borrowing capacity under our senior unsecured credit facility.

Our net cash provided by operations was \$157.8 million for the nine months ended September 30, 2015. Our cash from operations generally consists of the net cash flow from hotel operations offset by cash paid for corporate expenses and other working capital changes.

Our net cash used in investing activities was \$190.8 million for the nine months ended September 30, 2015, which consisted of \$150.4 million paid for the acquisitions of the Shorebreak Hotel and the Sheraton Suites Key West and capital expenditures at our hotels of \$46.1 million, partially offset by the net return of \$5.7 million from lender reserves.

Our net cash used in financing activities was \$49.4 million for the nine months ended September 30, 2015 and consisted primarily of \$146.9 million of repayments of mortgage debt, \$71.0 million of dividend payments, \$2.7 million paid to repurchase shares upon the vesting of restricted stock for the payment of tax withholding obligations and \$10.1 million of scheduled mortgage debt principal payments, partially offset by net draws of \$25.0 million on our senior unsecured credit facility, \$150.0 million of proceeds from new mortgage debt and \$7.8 million in net proceeds from our ATM program.

We currently anticipate our significant sources of cash for the remainder of the year ending December 31, 2015 will be the net cash flow from hotel operations and proceeds from financing activity.

Table of Contents

We expect our estimated uses of cash for the remainder of the year ending December 31, 2015 will comprise of the prepayment of the \$55.3 million mortgage loan secured by the Orlando Airport Marriott, capital expenditures, as more fully described below, regularly scheduled debt service payments, dividends and corporate expenses. We have \$128.3 million remaining under our ATM program, but we do not intend to utilize the program at this time.

## Dividend Policy

We intend to distribute to our stockholders dividends at least equal to our REIT taxable income so as to avoid paying corporate income tax and excise tax on our earnings (other than the earnings of our TRS), which are all subject to tax at regular corporate rates) and to qualify for the tax benefits afforded to REITs under the Code. In order to qualify as a REIT under the Code, we generally must make distributions to our stockholders each year in an amount equal to at least:

90% of our REIT taxable income determined without regard to the dividends paid deduction and excluding net capital gains, plus

90% of the excess of our net income from foreclosure property over the tax imposed on such income by the Code, minus

any excess non-cash income.

The timing and frequency of distributions will be authorized by our board of directors and declared by us based upon a variety of factors, including our financial performance, restrictions under applicable law and our current and future loan agreements, our debt service requirements, our capital expenditure requirements, the requirements for qualification as a REIT under the Code and other factors that our board of directors may deem relevant from time to time.

We have paid the following dividends to holders of our common stock during 2015:

Payment Date	Record Date	Dividend per Share
January 12, 2015	December 31, 2014	\$0.1025
April 10, 2015	March 31, 2015	\$0.1250
July 14, 2015	June 30, 2015	\$0.1250
October 13, 2015	September 30, 2015	\$0.1250

## Capital Expenditures

The management and franchise agreements for each of our hotels provide for the establishment of separate property improvement funds to cover, among other things, the cost of replacing and repairing furniture, fixtures and equipment at our hotels and other routine capital expenditures. Contributions to the property improvement fund are calculated as a percentage of hotel revenues. In addition, we may be required to pay for the cost of certain additional improvements that are not permitted to be funded from the property improvement fund under the applicable management or franchise agreement. As of September 30, 2015, we have set aside \$46.4 million for capital projects in property improvement funds and lender-held escrows, which are included in restricted cash.

We spent approximately \$46.1 million on capital improvements at our hotels during the nine months ended September 30, 2015, which includes the following significant projects:

**Hilton Boston Downtown:** We renovated approximately 90 rooms at the hotel, creating an incremental 41 guest rooms, as a return on investment project. The project was completed during the second quarter of 2015.

**Chicago Marriott Downtown:** We commenced a multi-year guest room renovation at the hotel. Marriott is contributing to the cost of the renovation through an amendment to the hotel's management agreement to reduce management fees for the remaining term of the management agreement, which is discussed further below. The first phase of the guest room renovation, which consisted of 140 rooms, was completed during the first quarter of 2015. We also added Marriott's new prototype F&B grab-and-go outlet in the hotel's lobby. The second phase of the guest room renovation will be completed during the seasonally slow winter months over the next three years and is not expected to result in material disruption.

We are also in the planning stages of additional significant projects, which include the following:

- 27-

---

## Table of Contents

**The Lodge at Sonoma:** We expect to renovate the guest rooms at the hotel during the seasonally slow winter months of 2016 and 2017.

**The Gwen, a Luxury Collection Hotel:** We expect to renovate and reposition the hotel formerly known as the Conrad Chicago during the next two seasonally slow winter seasons in connection with the rebranding. The renovation is expected to cost \$25 million.

In connection with the Chicago Marriott Downtown renovation discussed above, we entered into an amendment to our management agreement with Marriott for the hotel. Under the amendment, we committed to completing the multi-year renovation at the hotel in exchange for adjustments to the incentive management fee ("IMF") calculation under the hotel management agreement. The amendment, which became effective on April 1, 2015, reduces IMF for the remaining term of the management agreement. The reduction is achieved by reducing the percentage of operating profit paid to Marriott from 20% to 18% and deducting base management fees and certain owner-funded capital from operating profit for purposes of calculating IMF. The amendment is expected to reduce management fees by approximately \$1.8 million in 2015.

### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

### Non-GAAP Financial Measures

We use the following non-GAAP financial measures that we believe are useful to investors as key measures of our operating performance: EBITDA, Adjusted EBITDA, FFO and Adjusted FFO. These measures should not be considered in isolation or as a substitute for measures of performance in accordance with U.S. GAAP. EBITDA, Adjusted EBITDA, FFO and Adjusted FFO, as calculated by us, may not be comparable to other companies that do not define such terms exactly as the Company.

### EBITDA and FFO

EBITDA represents net income excluding: (1) interest expense; (2) provision for income taxes, including income taxes applicable to sale of assets; and (3) depreciation and amortization. We believe EBITDA is useful to an investor in evaluating our operating performance because it helps investors evaluate and compare the results of our operations from period to period by removing the impact of our capital structure (primarily interest expense) and our asset base (primarily depreciation and amortization) from our operating results. In addition, covenants included in our debt agreements use EBITDA as a measure of financial compliance. We also use EBITDA as one measure in determining the value of hotel acquisitions and dispositions.

The Company computes FFO in accordance with standards established by the National Association of Real Estate Investment Trusts ("NAREIT"), which defines FFO as net income determined in accordance with U.S. GAAP, excluding gains or losses from sales of properties and impairment losses, plus depreciation and amortization. The Company believes that the presentation of FFO provides useful information to investors regarding its operating performance because it is a measure of the Company's operations without regard to specified non-cash items, such as real estate depreciation and amortization and gains or losses on the sale of assets. The Company also uses FFO as one measure in assessing its results.

### Adjustments to EBITDA and FFO

We adjust EBITDA and FFO when evaluating our performance because we believe that the exclusion of certain additional recurring and non-recurring items described below provides useful supplemental information to investors regarding our ongoing operating performance and that the presentation of Adjusted EBITDA and Adjusted FFO, when combined with U.S. GAAP net income, EBITDA and FFO, is beneficial to an investor's complete understanding of our operating performance. We adjust EBITDA and FFO for the following items:

**Non-Cash Ground Rent:** We exclude the non-cash expense incurred from the straight line recognition of rent from our ground lease obligations and the non-cash amortization of our favorable lease assets.

**Non-Cash Amortization of Favorable and Unfavorable Contracts:** We exclude the non-cash amortization of the favorable and unfavorable contract assets recorded in conjunction with certain acquisitions. The amortization of the favorable and unfavorable contracts does not reflect the underlying operating performance of our hotels.

**Cumulative Effect of a Change in Accounting Principle:** Infrequently, the Financial Accounting Standards Board (FASB) promulgates new accounting standards that require the consolidated statement of operations to reflect the cumulative

Table of Contents

effect of a change in accounting principle. We exclude the effect of these one-time adjustments because they do not reflect our actual performance for that period.

• **Gains or Losses from Early Extinguishment of Debt:** We exclude the effect of gains or losses recorded on the early extinguishment of debt because we believe they do not accurately reflect the underlying performance of the Company.

• **Acquisition Costs:** We exclude acquisition transaction costs expensed during the period because we believe they do not reflect the underlying performance of the Company.

• **Allerton Loan:** We excluded the gain from the prepayment of the loan in 2014.

• **Other Non-Cash and /or Unusual Items:** From time to time we incur costs or realize gains that we do not believe reflect the underlying performance of the Company. Such items include, but are not limited to, hotel pre-opening costs, hotel manager transition costs, lease preparation costs, contract termination fees, severance costs, gains or losses from legal settlements, bargain purchase gains and insurance proceeds.

In addition, to derive Adjusted EBITDA we exclude gains or losses on dispositions and impairment losses because we believe that including them in EBITDA does not reflect the ongoing performance of our hotels. Additionally, the gain or loss on dispositions and impairment losses represent either accelerated depreciation or excess depreciation in previous periods, and depreciation is excluded from EBITDA.

In addition, to derive Adjusted FFO we exclude any fair value adjustments to debt instruments. Specifically, we exclude the impact of the non-cash amortization of the debt premium recorded in conjunction with the acquisition of the JW Marriott Denver at Cherry Creek and fair market value adjustments to the Company's interest rate cap agreement.

The following table is a reconciliation of our U.S. GAAP net income to EBITDA and Adjusted EBITDA (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	\$24,464	\$43,808	\$59,928	\$99,762
Interest expense	12,907	14,691	38,963	43,816
Income tax expense	4,171	3,733	8,576	1,203
Real estate related depreciation and amortization	25,107	25,327	75,018	75,576
EBITDA	66,649	87,559	182,485	220,357
Non-cash ground rent	1,467	1,588	4,454	4,880
Non-cash amortization of favorable and unfavorable contracts, net	(407)	(353)	(1,134)	(1,058)
Loss (Gain) on sale of hotel property	—	40	—	(1,251)
Gain on hotel property acquisition	—	(23,894)	—	(23,894)
Loss on early extinguishment of debt	—	61	—	61
Gain on insurance proceeds	—	(554)	—	(1,825)
Gain on litigation settlement (1)	—	—	—	(10,999)
Gain on prepayment of note receivable	—	—	—	(13,550)
Hotel acquisition costs	453	1,198	945	1,279
Hotel manager transition and pre-opening costs	754	381	1,287	667
Impairment losses	—	—	10,461	—



Edgar Filing: DiamondRock Hospitality Co - Form 10-Q

Reversal of previously recognized Allerton income	—	—	—	(453)	)
Severance costs	428	788	428	788	
Adjusted EBITDA	\$69,344	\$66,814	\$198,926	\$175,002	

---

(1) Includes \$14.0 million of settlement proceeds, net of a \$1.2 million contingency fee paid to our legal counsel and \$1.8 million of legal fees and other costs incurred over the course of the legal proceedings. The \$1.8 million of legal fees and other costs were previously recorded as corporate

Table of Contents

expenses and the repayment of those costs through the settlement proceeds is recorded as a reduction of corporate expenses during the nine months ended September 30, 2014.

The following table is a reconciliation of our U.S. GAAP net income to FFO and Adjusted FFO (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	\$24,464	\$43,808	\$59,928	\$99,762
Real estate related depreciation and amortization	25,107	25,327	75,018	75,576
Impairment losses	—	—	10,461	—
Loss (Gain) on sale of hotel property	—	40	—	(1,251)
FFO	49,571	69,175	145,407	174,087
Non-cash ground rent	1,467	1,588	4,454	4,880
Non-cash amortization of favorable and unfavorable contracts, net	(407)	(353)	(1,134)	(1,058)
Gain on hotel property acquisition	—	(23,894)	—	(23,894)
Loss on early extinguishment of debt	—	61	—	61
Gain on insurance proceeds	—	(554)	—	(1,825)
Gain on litigation settlement (1)	—	—	—	(10,999)
Gain on prepayment of note receivable	—	—	—	(13,550)
Hotel acquisition costs	453	1,198	945	1,279
Hotel manager transition and pre-opening costs	754	381	1,287	667
Reversal of previously recognized Allerton income	—	—	—	(453)
Severance costs	428	788	428	788
Fair value adjustments to debt instruments	49	(90)	115	(265)
Adjusted FFO	\$52,315	\$48,300	\$151,502	\$129,718

(1) Includes \$14.0 million of settlement proceeds, net of a \$1.2 million contingency fee paid to our legal counsel and \$1.8 million of legal fees and other costs incurred over the course of the legal proceedings. The \$1.8 million of legal fees and other costs were previously recorded as corporate expenses and the repayment of those costs through the settlement proceeds is recorded as a reduction of corporate expenses during the nine months ended September 30, 2014.

#### Use and Limitations of Non-GAAP Financial Measures

Our management and board of directors use EBITDA, Adjusted EBITDA, FFO and Adjusted FFO to evaluate the performance of our hotels and to facilitate comparisons between us and other lodging REITs, hotel owners who are not REITs and other capital intensive companies. The use of these non-GAAP financial measures has certain limitations. These non-GAAP financial measures as presented by us, may not be comparable to non-GAAP financial measures as calculated by other real estate companies. These measures do not reflect certain expenses or expenditures

that we incurred and will incur, such as depreciation, interest and capital expenditures. We compensate for these limitations by separately considering the impact of these excluded items to the extent they are material to operating decisions or assessments of our operating performance. Our reconciliations to the most comparable U.S. GAAP financial measures, and our consolidated statements of operations and cash flows, include interest expense, capital expenditures, and other excluded items, all of which should be considered when evaluating our performance, as well as the usefulness of our non-GAAP financial measures.

These non-GAAP financial measures are used in addition to and in conjunction with results presented in accordance with U.S. GAAP. They should not be considered as alternatives to operating profit, cash flow from operations, or any other operating performance measure prescribed by U.S. GAAP. These non-GAAP financial measures reflect additional ways of viewing our operations that we believe, when viewed with our U.S. GAAP results and the reconciliations to the corresponding U.S. GAAP financial measures, provide a more complete understanding of factors and trends affecting our business than could be obtained

- 30-

---

## Table of Contents

absent this disclosure. We strongly encourage investors to review our financial information in its entirety and not to rely on a single financial measure.

### Critical Accounting Policies

Our unaudited condensed consolidated financial statements have been prepared in conformity with U.S. GAAP, which requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of our financial statements and the reported amounts of revenues and expenses during the reporting period. While we do not believe that the reported amounts would be materially different, application of these policies involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. We evaluate our estimates and judgments on an ongoing basis. We base our estimates on experience and on various other assumptions that we believe to be reasonable under the circumstances. All of our significant accounting policies, including certain critical accounting policies, are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014.

### Inflation

Operators of hotels, in general, possess the ability to adjust room rates daily to reflect the effects of inflation. However, competitive pressures may limit the ability of our management companies to raise room rates.

### Seasonality

The operations of hotels historically have been seasonal depending on location, and accordingly, we expect some seasonality in our business. In general, our hotels have lower revenue, operating income and cash flows during the first quarter of each year and higher revenue, operating income and cash flows during the third quarter of each year.

### New Accounting Pronouncements Not Yet Implemented

See Note 2, "Summary of Significant Accounting Policies," to our condensed consolidated interim financial statements for additional information relating to recently issued accounting pronouncements.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk includes risks that arise from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market sensitive instruments. In pursuing our business strategies, the primary market risk to which we are currently exposed, and, to which we expect to be exposed in the future, is interest rate risk. The face amount of our outstanding debt as of September 30, 2015 was \$1.1 billion, of which \$195.4 million was variable rate. If market rates of interest on our variable rate debt fluctuate by 25 basis points, interest expense would increase or decrease, depending on rate movement, future earnings and cash flows, by \$0.5 million annually.

We use our interest rate cap to manage interest rate risk related to our variable rate debt secured by the Lexington Hotel New York. The change in fair value of our interest rate cap is a non-cash transaction and is recorded as a credit or charge to interest expense.

### Item 4. Controls and Procedures

The Company's management has evaluated, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as required by paragraph (b) of Rules 13a-15 and 15d-15 under the Exchange Act, and has concluded that as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective to give reasonable assurances that information we disclose in reports filed with the Securities and Exchange Commission is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There was no change in the Company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act during the Company's most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

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.

## Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

## Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Dollar Amount that May Yet be Purchased Under the Plans or Programs (in thousands) <sup>(1)</sup>
July 1 - July 31, 2015	—	\$	—	\$100,000
August 1 - August 31, 2015	—	\$	—	\$100,000
September 1 - September 30, 2015	—	\$	—	\$100,000

<sup>(1)</sup> Represents amounts available under the Company's prior \$100 million share repurchase program. No shares were repurchased under this program prior to its termination. On November 4, 2015, the Company's board of directors authorized a new \$150 million share repurchase program, which replaces the existing program. The share repurchase program may be suspended or terminated at any time without prior notice.

## Item 3. Defaults Upon Senior Securities

Not applicable.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

None.



Table of Contents

Item 6. Exhibits

(a) Exhibits

The following exhibits are filed as part of this Form 10-Q:

Exhibit

- 3.1.1 Articles of Amendment and Restatement of the Articles of Incorporation of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Registration Statement on Form S-11 filed with the Securities and Exchange Commission (File No. 333-123065))
- 3.1.2 Amendment to the Articles of Amendment and Restatement of the Articles of Incorporation of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 10, 2007)
- 3.1.3 Amendment to the Articles of Amendment and Restatement of the Articles of Incorporation of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 9, 2012)
- 3.1.4 Articles Supplementary of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Current Report of Form 8-K filed with the Securities and Exchange Commission on February 26, 2014)
- 3.2.1 Third Amended and Restated Bylaws of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 17, 2009)
- 3.2.2 Amendment to the Third Amended and Restated Bylaws of DiamondRock Hospitality Company (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 3, 2014)
- 4.1 Form of Certificate for Common Stock for DiamondRock Hospitality Company (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 5, 2010)
- 31.1\* Certification of Chief Executive Officer Required by Rule 13a-14(a) and Rule 15d-14(a) of the Exchange Act
- 31.2\* Certification of Chief Financial Officer Required by Rule 13a-14(a) and Rule 15d-14(a) of the Exchange Act
- 32.1\* Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Attached as Exhibit 101 to this report are the following materials from DiamondRock Hospitality Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2015 formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated



Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows, and (iv) the related notes to these condensed consolidated financial statements.

\* Filed herewith

- 33-

---

Table of Contents

SIGNATURES

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

DiamondRock Hospitality Company

November 6, 2015

/s/ Sean M. Mahoney

Sean M. Mahoney  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)

/s/ Briony R. Quinn  
Briony R. Quinn  
Chief Accounting Officer and Corporate Controller  
(Principal Accounting Officer)

- 34-