

DiamondRock Hospitality Co  
Form 10-Q  
October 19, 2011

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 9, 2011

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 167,502,359 shares of its \$0.01 par value common stock outstanding as of October 19, 2011.

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 9, 2011 and December 31, 2010</u>	<u>1</u>
<u>Condensed Consolidated Statements of Operations for the Fiscal Quarters ended September 9, 2011 and September 10, 2010 and the Periods from January 1, 2011 to September 9, 2011 and January 1, 2010 to September 10, 2010</u>	<u>2</u>
<u>Condensed Consolidated Statements of Cash Flows for the Periods from January 1, 2011 to September 9, 2011 and January 1, 2010 to September 10, 2010</u>	<u>3</u>
<u>Notes to 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>18</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>34</u>
<u>Item 4. Controls and Procedures</u>	<u>34</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>35</u>
<u>Item 1A. Risk Factors</u>	<u>35</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>35</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>35</u>
<u>Item 4. [Removed and Reserved]</u>	<u>35</u>
<u>Item 5. Other Information</u>	<u>35</u>
<u>Item 6. Exhibits</u>	<u>36</u>
Exhibit 10.1	
Exhibit 31.1	
Exhibit 31.2	
Exhibit 32.1	
EX-101 INSTANCE DOCUMENT	
EX-101 SCHEMA DOCUMENT	
EX-101 CALCULATION LINKBASE DOCUMENT	
EX-101 LABELS LINKBASE DOCUMENT	
EX-101 PRESENTATION LINKBASE DOCUMENT	

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item I. Financial Statements

## DIAMONDROCK HOSPITALITY COMPANY

## CONDENSED CONSOLIDATED BALANCE SHEETS

As of September 9, 2011 and December 31, 2010

(in thousands, except share amounts)

	September 9, 2011 (Unaudited)	December 31, 2010
<b>ASSETS</b>		
Property and equipment, at cost	\$2,962,709	\$2,468,289
Less: accumulated depreciation	(462,986	) (396,686
	2,499,723	2,071,603
Deferred financing costs, net	6,720	5,492
Restricted cash	65,645	51,936
Due from hotel managers	65,454	50,715
Note receivable	56,247	57,951
Favorable lease assets, net	43,594	42,622
Prepaid and other assets	71,445	50,089
Cash and cash equivalents	28,777	84,201
Total assets	\$2,837,605	\$2,414,609
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
Mortgage debt	\$945,888	\$780,880
Senior unsecured credit facility	130,000	—
Total debt	1,075,888	780,880
Deferred income related to key money, net	22,216	19,199
Unfavorable contract liabilities, net	82,490	83,613
Due to hotel managers	42,487	36,168
Dividends declared and unpaid	13,569	—
Accounts payable and accrued expenses	91,397	81,232
Total other liabilities	252,159	220,212
<b>Stockholders' Equity:</b>		
Preferred stock, \$0.01 par value; 10,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$0.01 par value; 200,000,000 shares authorized; 167,502,359 and 154,570,543 shares issued and outstanding at September 9, 2011 and December 31, 2010, respectively	1,675	1,546
Additional paid-in capital	1,707,240	1,558,047
Accumulated deficit	(199,357	) (146,076
Total stockholders' equity	1,509,558	1,413,517
Total liabilities and stockholders' equity	\$2,837,605	\$2,414,609

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



Table of Contents

## DIAMONDROCK HOSPITALITY COMPANY

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the Fiscal Quarters Ended September 9, 2011 and September 10, 2010 and

the Periods from January 1, 2011 to September 9, 2011 and January 1, 2010 to September 10, 2010

(in thousands, except per share amounts)

	Fiscal Quarter Ended		Period From	
	September 9, 2011 (Unaudited)	September 10, 2010 (Unaudited)	January 1, 2011 to September 9, 2011 (Unaudited)	January 1, 2010 to September 10, 2010 (Unaudited)
Revenues:				
Rooms	\$125,100	\$99,703	\$316,284	\$267,081
Food and beverage	44,671	43,370	131,137	126,620
Other	9,224	8,040	23,347	21,364
Total revenues	178,995	151,113	470,768	415,065
Operating Expenses:				
Rooms	33,398	26,979	84,642	71,510
Food and beverage	31,024	30,534	91,276	86,748
Management fees	5,214	5,080	15,603	13,634
Other hotel expenses	64,296	55,613	170,227	152,232
Depreciation and amortization	23,801	21,297	66,835	59,278
Hotel acquisition costs	445	899	2,604	1,236
Corporate expenses	6,453	3,948	14,901	10,859
Total operating expenses	164,631	144,350	446,088	395,497
Operating profit	14,364	6,763	24,680	19,568
Other Expenses (Income):				
Interest income	(24	) (283	) (590	) (650
Interest expense	13,605	11,240	37,088	30,455
Total other expenses	13,581	10,957	36,498	29,805
Income (loss) before income taxes	783	(4,194	) (11,818	) (10,237
Income tax (expense) benefit	(1,798	) 660	(795	) (803
Net loss	\$(1,015	) \$(3,534	) \$(12,613	) \$(11,040
Loss per share:				
Basic and diluted loss per share	\$(0.01	) \$(0.02	) \$(0.08	) \$(0.08

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

Table of Contents

## DIAMONDROCK HOSPITALITY COMPANY

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Periods from January 1, 2011 to September 9, 2011 and January 1, 2010 to September 10, 2010

(in thousands)

	Period From January 1, 2011 to September 9, 2011 (Unaudited)	January 1, 2010 to September 10, 2010 (Unaudited)	
Cash flows from operating activities:			
Net loss	\$(12,613	)	\$(11,040 )
Adjustments to reconcile net loss to net cash provided by operating activities:			
Real estate depreciation	66,835		59,278
Corporate asset depreciation as corporate expenses	59		110
Non-cash ground rent	4,878		5,104
Non-cash financing costs and debt premium as interest	1,068		804
Non-cash reversal of penalty interest	—		(3,134 )
Amortization of unfavorable contract liabilities	(1,284	)	(1,203 )
Amortization of deferred income	(414	)	(390 )
Stock-based compensation	3,339		2,794
Changes in assets and liabilities:			
Prepaid expenses and other assets	(1,371	)	2,482
Restricted cash	(5,225	)	(3,892 )
Due to/from hotel managers	(7,438	)	(11,765 )
Accounts payable and accrued expenses	(4,564	)	3,368
Net cash provided by operating activities	43,270		42,516
Cash flows from investing activities:			
Hotel capital expenditures	(35,403	)	(16,154 )
Hotel acquisitions	(385,472	)	(265,998 )
Purchase of mortgage loan	—		(60,615 )
Cash received from mortgage loan	1,704		1,250
Change in restricted cash	(3,164	)	(11,290 )
Purchase deposits	(20,000	)	—
Receipt of deferred key money	3,430		—
Net cash used in investing activities	(438,905	)	(352,807 )
Cash flows from financing activities:			
Scheduled mortgage debt principal payments	(6,217	)	(4,121 )
Repurchase of common stock	(3,849	)	(3,961 )
Proceeds from sale of common stock, net	149,674		209,817
Proceeds from mortgage loan financing	100,000		—
Draw on senior unsecured credit facility	130,000		—
Payment of financing costs	(2,457	)	(3,220 )
Payment of cash dividends	(26,940	)	(4,323 )
Net cash provided by financing activities	340,211		194,192
Net decrease in cash and cash equivalents	(55,424	)	(116,099 )
Cash and cash equivalents, beginning of period	84,201		177,380

Cash and cash equivalents, end of period	\$28,777	\$61,281
--	----------	----------

-3-

---

Table of Contents

Supplemental Disclosure of Cash Flow Information:

Cash paid for interest	\$39,436	\$33,381
Cash paid for income taxes	\$629	\$642
Capitalized interest	\$1,036	\$—
Non-cash Financing Activities:		
Assumption of mortgage debt	\$71,421	\$—
Unpaid dividends	\$13,569	\$—

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



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 26 premium hotels and resorts as well as a senior mortgage loan secured by another hotel. Our hotels are concentrated in key gateway cities and in destination resort locations and most are operated under a brand owned by one of the leading global lodging brand companies (Marriott International, Inc. (“Marriott”), Starwood Hotels & Resorts Worldwide, Inc. (“Starwood”), or Hilton Worldwide (“Hilton”). We are an owner, as opposed to an operator, of the hotels in our portfolio. As an owner, we receive all of the operating profits or losses generated by our hotels after we pay fees to the hotel managers, which are based on the revenues and profitability of the hotels.

As of September 9, 2011, we owned 26 hotels with 11,828 rooms, located in the following markets: Atlanta, Georgia (3); Austin, Texas; Boston, Massachusetts; Charleston, South Carolina; Chicago, Illinois (2); Denver, Colorado (2); Fort Worth, Texas; Lexington, Kentucky; Los Angeles, California (2); Minneapolis, Minnesota; New York, New York (4); Oak Brook, Illinois; Orlando, Florida; Salt Lake City, Utah; Sonoma, California; Washington D.C.; St. Thomas, U.S. Virgin Islands; and Vail, Colorado. We also own a senior mortgage loan secured by a 443-room hotel located in Chicago, Illinois.

We conduct our business through a traditional umbrella partnership REIT, or UPREIT, in which our hotel properties are owned by our operating partnership, DiamondRock Hospitality Limited Partnership, or subsidiaries of our operating partnership. The Company is the sole general partner of the operating partnership and currently owns, either directly or indirectly, all of the limited partnership units of the 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 consolidated financial statements and notes thereto as of and for the year ended December 31, 2010, included in our Annual Report on Form 10-K filed on March 1, 2011.

In our opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly our financial position as of September 9, 2011, the results of our operations for our fiscal quarters ended September 9, 2011 and September 10, 2010 and the periods from January 1, 2011 to September 9, 2011 and January 1, 2010 to September 10, 2010, and our cash flows for the periods from January 1, 2011 to September 9, 2011 and January 1, 2010 to September 10, 2010. 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.

## Reporting Periods

The results we report in our condensed consolidated statements of operations are based on results of our hotels reported to us by our hotel managers. Our hotel managers use different reporting periods. Marriott, the manager of most of our properties, uses a fiscal year ending on the Friday closest to December 31 and reports 12 weeks of operations for each of the first three quarters and 16 or 17 weeks for the fourth quarter of the year for its domestic managed hotels. In contrast, Marriott, for its non-domestic hotels (including Frenchman's Reef), Vail Resorts, manager of the Vail Marriott, Davidson Hotels & Resorts, manager of the Atlanta Westin North at Perimeter, Hilton Hotels Corporation, manager of the Conrad Chicago and Hilton Minneapolis, Westin Hotel Management, L.P., manager of the Westin Boston Waterfront Hotel, Alliance Hospitality Management, manager of the Hilton Garden Inn Chelsea/New York City, Sage Hospitality, manager of the JW Marriott Denver at Cherry Creek and the Courtyard Denver Downtown, and Highgate Hotels, manager of the Radisson Lexington Hotel New York, report results on a monthly basis. Additionally, as a REIT, we are required by U.S. federal tax laws to report results on a calendar year basis. As a result, we have

-5-

---

## Table of Contents

adopted the reporting periods used by Marriott for its domestic hotels, except that our fiscal year always ends on December 31 to comply with REIT rules. Our first three fiscal quarters end on the same day as Marriott's fiscal quarters but our fourth quarter ends on December 31 and the full year results, as reported in the statement of operations, always include the same number of days as the calendar year.

Two consequences of the reporting cycle we have adopted are: (1) quarterly start dates will usually differ between years, except for the first quarter which always commences on January 1, and (2) the first and fourth quarters of operations and year-to-date operations may not include the same number of days as reflected in prior years.

While the reporting calendar we adopted is more closely aligned with the reporting calendar used by the manager of most of our properties, one final consequence of the calendar is that we are unable to report any results for Frenchman's Reef, Vail Marriott, Atlanta Westin North at Perimeter, Conrad Chicago, Westin Boston Waterfront Hotel, Hilton Minneapolis, Hilton Garden Inn Chelsea/New York City, JW Marriott Denver at Cherry Creek, Courtyard Denver Downtown or Radisson Lexington Hotel New York for the month of operations that ends after our fiscal quarter-end because none of Westin Hotel Management, L.P., Hilton Hotels Corporation, Davidson Hotels & Resorts, Alliance Hospitality Management, Vail Resorts, Sage Hospitality, Highgate Hotels nor Marriott (with respect to Frenchman's Reef) make mid-month results available to us. As a result, our quarterly results of operations include results from these hotels as follows: first quarter (January and February), second quarter (March to May), third quarter (June to August) and fourth quarter (September to December). While this does not affect full-year results, it does affect the reporting of quarterly results.

## Property and Equipment

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

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

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

We will classify a hotel as held for sale in the period that we have made the decision to dispose of the hotel, a binding agreement to purchase the property has been signed under which the buyer has committed a significant amount of nonrefundable cash and no significant financing or other contingencies exist which could cause the transaction to not

be completed in a timely manner. If these criteria are met, we will record an impairment loss if the fair value less costs to sell is lower than the carrying amount of the hotel and will cease recording depreciation expense. We will classify the loss, together with the related operating results, as discontinued operations on the statements of operations and classify the assets and related liabilities as held for sale on the balance sheet.

#### Note Receivable

We initially record acquired notes receivable at cost. Notes receivable are evaluated for collectability and if collectability of the original amounts due is in doubt, the value is adjusted for impairment. Our impairment analysis considers the anticipated cash receipts as well as the underlying value of the collateral. If collectability is in doubt, the note is placed in non-accrual status. No interest is recorded on such notes until the timing and amounts of cash receipts can be reasonably estimated. We record cash payments received on non-accrual notes receivable as a reduction in basis. We continually assess the current facts and circumstances to determine whether we can reasonably estimate cash flows. If we can reasonably estimate the timing and amount of cash flows to be collected, then income recognition becomes possible.

## Table of Contents

### Revenue Recognition

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

### Earnings (Loss) 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 stock grants or shares issuable in the event of conversion of operating partnership units. No adjustment is made for shares that are anti-dilutive during a period.

### Stock-based Compensation

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

### Income Taxes

We account for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those tempora