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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 10-Q

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

For the quarterly period ended June 16, 2006

OR

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

Commission file number 001-32514

# DIAMONDROCK HOSPITALITY COMPANY

*(Exact Name of Registrant as Specified in Its Charter)*

**Maryland**

*(State of Incorporation)*

**20-1180098**

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

**6903 Rockledge Drive, Suite 800, Bethesda, Maryland**

*(Address of Principal Executive Offices)*

**20817**

*(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, and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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 70,146,152 shares of its \$0.01 par value common stock outstanding as of July 28, 2006.

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Item I. Financial Statements

**DIAMONDROCK HOSPITALITY COMPANY**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**June 16, 2006 and December 31, 2005**

	<b>June 16, 2006</b>	<b>December 31, 2005</b>
<b>(Unaudited )</b>		
<b>ASSETS</b>		
Property and equipment, at cost	\$ 1,369,558,094	\$ 899,309,856
Less: accumulated depreciation	(43,995,609)	(28,747,457)
	1,325,562,485	870,562,399
Deferred financing costs, net	3,602,955	2,846,661
Restricted cash	24,850,596	23,109,153
Due from hotel managers	50,301,469	38,964,986
Favorable lease asset, net	10,351,641	10,601,577
Prepaid and other assets	10,750,168	10,495,765
Cash and cash equivalents	108,881,304	9,431,741
	\$ 1,534,300,618	\$ 966,012,282
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
Debt, at face amount	\$ 662,787,831	\$ 428,394,735
Debt premium	2,707,592	2,782,322
	665,495,423	431,177,057
Total debt	665,495,423	431,177,057
Deferred income related to key money	10,176,580	10,311,322
Unfavorable contract liabilities, net	88,768,528	5,384,431
Due to hotel managers	28,164,208	22,790,896
Dividends declared and unpaid	12,765,312	8,896,101
Accounts payable and accrued expenses	30,120,132	24,064,047
	169,994,760	71,446,797
Total other liabilities	169,994,760	71,446,797
<b>Shareholders' Equity:</b>		
Preferred stock, \$.01 par value; 10,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$.01 par value; 100,000,000 shares authorized; 70,139,864 and 50,819,864 shares issued and outstanding at June 16, 2006 and December 31, 2005, respectively	701,399	508,199
Additional paid-in capital	731,100,540	491,951,223
Accumulated deficit	(32,991,504)	(29,070,994)
	698,810,435	463,388,428
Total shareholders' equity	698,810,435	463,388,428
Total liabilities and shareholders' equity	\$ 1,534,300,618	\$ 966,012,282

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

**DIAMONDROCK HOSPITALITY COMPANY**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Fiscal Quarters Ended June 16, 2006 and June 17, 2005 and the**  
**Periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005**

	Fiscal Quarter Ended June 16, 2006	Fiscal Quarter Ended June 17, 2005	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Rooms	\$ 81,273,462	\$ 23,833,517	\$ 135,788,214	\$ 42,501,868
Food and beverage	36,675,546	7,791,155	60,745,508	14,205,252
Other	7,018,328	1,891,044	11,555,764	3,157,377
<b>Total revenues</b>	<b>124,967,336</b>	<b>33,515,716</b>	<b>208,089,486</b>	<b>59,864,497</b>
<b>Operating Expenses:</b>				
Rooms	18,134,354	5,598,776	30,968,994	10,586,057
Food and beverage	23,419,881	5,680,917	40,309,176	10,762,154
Management fees	4,780,449	1,210,846	7,696,845	2,109,011
Other hotel expenses	40,065,492	12,746,028	68,972,879	24,360,713
Depreciation and amortization	12,078,225	4,340,984	21,125,333	8,703,130
Corporate expenses	2,646,364	5,937,309	5,213,252	7,946,739
<b>Total operating expenses</b>	<b>101,124,765</b>	<b>35,514,860</b>	<b>174,286,479</b>	<b>64,467,804</b>
<b>Operating profit (loss)</b>	<b>23,842,571</b>	<b>(1,999,144)</b>	<b>33,803,007</b>	<b>(4,603,307)</b>
<b>Other Expenses (Income):</b>				
Interest income	(1,207,161)	(284,049)	(1,390,530)	(560,827)
Interest expense	9,324,262	3,630,470	15,131,967	6,484,739
<b>Total other expenses</b>	<b>8,117,101</b>	<b>3,346,421</b>	<b>13,741,437</b>	<b>5,923,912</b>
<b>Income (loss) before income taxes</b>	<b>15,725,470</b>	<b>(5,345,565)</b>	<b>20,061,570</b>	<b>(10,527,219)</b>
Income tax expense	1,828,790	478,990	1,798,876	558,847
<b>Net income (loss)</b>	<b>\$ 13,896,680</b>	<b>\$ (5,824,555)</b>	<b>\$ 18,262,694</b>	<b>\$ (11,086,066)</b>
<b>Earnings (loss) per share:</b>				
Basic and Diluted	\$ 0.20	\$ (0.20)	\$ 0.30	\$ (0.44)

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

**DIAMONDROCK HOSPITALITY COMPANY**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005**

	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005
	(Unaudited)	(Unaudited)
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 18,262,694	\$ (11,086,066)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Real estate depreciation	21,125,333	8,703,130
Corporate asset depreciation as corporate expenses	74,064	33,516
Non-cash straight line ground rent	3,412,369	3,180,110
Non-cash financing costs as interest	515,789	960,062
Market value adjustment to interest rate caps	16,070	(8,445)
Amortization of debt premium and unfavorable contract liabilities	(503,449)	(140,577)
Amortization of deferred income	(134,742)	(64,559)
Stock-based compensation	1,157,698	4,969,510
Deferred income tax benefit	(95,009)	558,847
Changes in assets and liabilities:		
Prepaid expenses and other assets	(175,464)	1,405,418
Due to/from hotel managers	(5,963,171)	(3,870,102)
Accounts payable and accrued expenses	(183,850)	(371,406)
<b>Net cash provided by operating activities</b>	<b>37,508,332</b>	<b>4,269,438</b>
<b>Cash flows from investing activities:</b>		
Hotel acquisitions	(145,566,189)	(72,153,996)
Hotel capital expenditures	(25,959,757)	(3,652,016)
Receipt of deferred Key Money	—	4,000,000
Change in restricted cash	475,338	879,924
Purchase deposits and pre-acquisition costs	—	(10,927,784)
<b>Net cash used in investing activities</b>	<b>(171,050,608)</b>	<b>(81,853,872)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from mortgage debt	271,000,000	44,000,000
Repayments of debt	(325,500,000)	(56,948,685)
Draws on senior secured credit facility	24,000,000	—
Proceeds from short-term loan	79,500,000	—
Repayments of senior secured credit facility	(33,000,000)	—
Scheduled mortgage debt principal payments	(1,606,904)	(1,387,854)
Payment of financing costs	(1,272,083)	(2,128,371)
Proceeds from sale of common stock	239,229,900	291,799,785
Payment of costs related to sale of common stock	(1,040,877)	(1,608,517)
Payment of dividends	(18,318,197)	—
<b>Net cash provided by financing activities</b>	<b>232,991,839</b>	<b>273,726,358</b>

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

**DIAMONDROCK HOSPITALITY COMPANY**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**  
**For the Periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005**

	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005
	(Unaudited)	(Unaudited)
Net increase in cash and cash equivalents	\$ 99,449,563	\$ 196,141,924
Cash and cash equivalents, beginning of period	9,431,741	76,983,107
Cash and cash equivalents, end of period	<u>\$ 108,881,304</u>	<u>\$ 273,125,031</u>
<b>Supplemental Disclosure of Cash Flow Information:</b>		
Cash paid for interest	\$ 14,807,568	\$ 5,962,359
Assumption of mortgage debt	\$ 220,000,000	\$ —
Cash paid for income taxes	\$ 926,060	\$ 1,114,363
Capitalized interest	<u>\$ 220,772</u>	<u>\$ —</u>

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

# DIAMONDROCK HOSPITALITY COMPANY

## Notes to the Condensed Consolidated Financial Statements (Unaudited)

### 1. Organization

DiamondRock Hospitality Company (the "Company") is a self-advised real estate company. We are committed to maximizing shareholder value through investing in premium full-service hotels and, to a lesser extent, premium urban select-service hotels. As of June 16, 2006, we owned seventeen hotels comprising 7,678 rooms. These hotels are geographically diversified across major markets in the United States, with a concentration in New York City, Los Angeles, Atlanta and Chicago.

We began operations in the third quarter of 2004, when we completed a private placement of our common stock and became a public company following our May 2005 initial public offering. On April 4, 2006, we completed a secondary offering of our common stock. We sold 19,320,000 shares of common stock at an offering price of \$13.00 per share, yielding net proceeds to us of \$238.2 million. As of June 16, 2006, we had 70,139,864 shares of stock outstanding.

We conduct our business through a traditional umbrella partnership REIT, or UPREIT, in which our hotels are owned by subsidiaries of our operating partnership, DiamondRock Hospitality Limited Partnership. We are the sole general partner of our operating partnership and currently own, either directly or indirectly, all of the limited partnership units of our operating partnership. In order for the income from our hotel investments to constitute "rents from real properties" for purposes of the gross income test required for REIT qualification, we must lease each of our hotels to a wholly owned subsidiary of our taxable REIT subsidiary, or TRS, or to an unrelated third party. However, we may structure our properties that are not subject to U.S. federal income tax differently from the structures we use for our U.S. properties. For example, the Frenchman's Reef & Morning Star Marriott Beach Resort is held by a United States Virgin Islands corporation that we have elected to be a TRS.

### 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 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, 2005 included in our Form 10-K dated March 13, 2006.

In our opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly our financial position as of June 16, 2006, the results of our operations for the fiscal quarters ended June 16, 2006 and June 17, 2005 and for the periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005, and cash flows for the periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005. Interim results are not necessarily indicative of full-year performance because of the impact of seasonal and short-term variations and the timing of the Company's acquisitions.

#### *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 International, the manager of most of our properties, uses a fiscal year ending on the Friday closest to December 31 and reports twelve weeks of operations for each of the first three quarters and sixteen or seventeen 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, our manager of the Vail Marriott, and Noble Management Group, LLC, our manager of the Westin Atlanta North at Perimeter, report results on a monthly basis. Additionally, the Company, as a REIT, is required by U.S. Federal tax laws to report results on a calendar year basis. As a result, the Company has adopted the reporting periods used by Marriott International for its domestic hotels, except that the fiscal year always ends on December 31 to comply with REIT rules. The first three fiscal quarters end on the same day as Marriott International's fiscal quarters but our fourth quarter ends on December 31 and our full year results, as reported in our 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) our 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 our calendar is we are unable to report any results for Frenchman's Reef, Vail Marriott, or Westin Atlanta North at Perimeter for the month of operations that ends after our fiscal quarter-end because neither Noble Management Group, LLC, Vail Resorts nor Marriott International make mid-month results available to us. As a result, our quarterly results of operations include results from Frenchman's Reef, the Vail Marriott, and the Westin Atlanta North at Perimeter as follows: first quarter (January, 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.

The Company's financial statements include all of the accounts of the Company and its subsidiaries in accordance with U.S. generally accepted accounting principles. All intercompany accounts and transactions have been eliminated in consolidation.

#### *Earnings (Loss) Per Share*

Basic earnings (loss) per share is calculated by dividing net income (loss), adjusted for dividends on unvested stock grants, by the weighted-average common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income (loss), adjusted for dividends on unvested stock grants, by the weighted-average 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*

The Company accounts for stock-based employee compensation using the fair value based method of accounting described in Statement of Financial Accounting Standards No. 123 (revised 2004) ("SFAS 123R"), *Share-Based Payment*. The Company records the cost of awards with service conditions based on the grant-date fair value of the award (with limited exceptions). 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. No awards with performance-based or market-based conditions have been issued.

#### *Key Money*

Key money received in conjunction with entering into hotel management agreements is deferred and amortized over the term of the hotel management agreement. Key money is classified as deferred income in the accompanying condensed consolidated balance sheets and amortized against management fees on the accompanying condensed consolidated statements of operations.

#### *Yield Support*

Marriott has provided the Company with operating cash flow guarantees for certain hotels to fund shortfalls of actual hotel operating income compared to a negotiated target net operating income. We refer to these guarantees as "Yield Support". Yield Support received is recognized over the period earned if the Yield Support is not refundable and there is reasonable uncertainty of receipt at inception of the management agreement. Yield Support is recorded as an offset to base management fees.

#### *Straight-Line Rent*

The Company records rent expense on leases that provide for minimum rental payments that increase in pre-established amounts over the remaining term of the lease on a straight-line basis as required by U.S. generally accepted accounting principles.



## Use of Estimates

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles 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.

### 3. Property and Equipment

Property and equipment as of June 16, 2006 (unaudited) and December 31, 2005 consists of the following:

	June 16, 2006	December 31, 2005
Land	\$ 169,856,000	\$ 125,466,000
Land improvements	5,593,922	5,593,922
Buildings	1,089,061,333	689,789,027
Furniture, fixtures and equipment	100,409,681	73,864,151
Corporate office equipment and CIP	4,637,158	4,596,756
	1,369,558,094	899,309,856
Less: accumulated depreciation	(43,995,609)	(28,747,457)
	\$ 1,325,562,485	\$ 870,562,399

### 4. Capital Stock

#### Common Shares

The Company is authorized to issue up to 100,000,000 shares of common stock, \$.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 the Company's common stock are entitled to receive dividends out of assets legally available for the payment of dividends when authorized by the Company's board of directors.

On April 4, 2006, the Company completed a secondary offering of our common stock. We sold 19,320,000 shares of common stock, including 2,520,000 shares of common stock exercised in the underwriters' over-allotment, at the offering price of \$13.00 per share. The net proceeds to us, after deduction of offering costs, were \$238.2 million.

#### Preferred Shares

The Company is authorized to issue up to 10,000,000 shares of preferred stock, \$.01 par value per share. The Company's board of directors is required to set for each class or series of preferred stock the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications, and terms or conditions of redemption. As of June 16, 2006 and December 31, 2005, there were no shares of preferred stock outstanding.

### 5. Stock Incentive Plan

Effective January 1, 2006, the Company adopted the provisions of SFAS 123R. There was no financial statement impact of this adoption.

As of June 16, 2006, the Company has issued or committed to issue 1,147,108 shares of our common stock under our 2004 Stock Option and Incentive Plan, including 747,000 shares of restricted common stock and a commitment to issue 400,108 units of deferred common stock.

As of June 16, 2006, the Company's officers and employees have been awarded 747,000 shares of restricted common stock. The aggregate fair value of these awards on the respective grants dates was \$7,503,150. The weighted average grant date fair value of these awards was \$10.04 per share. As of June 16, 2006, none of these awards have vested. The share awards will vest as follows; 483,000 shares during 2006, 249,000 shares during 2007 and 15,000 shares during 2008. None of the recipients was required to pay for such shares of common stock. As of June 16, 2006, the Company's directors have been awarded 34,000 shares of common stock. Shares issued to our directors were fully vested upon issuance. Shares issued to our officers and employees vest over a three-year period from the date of the grant. We recorded compensation expense related to the restricted common stock of officers, directors and employees of \$580,534 and \$684,415 during the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively and \$1,157,698 and \$1,233,260 during the periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005, respectively, which is included in corporate expenses in the accompanying statements of operations. As of June 16, 2006, the unrecognized compensation cost related to the share awards was \$2,935,344 and the weighted average period over which the unrecognized compensation expense will be recorded is approximately 14 months.

At the time of our initial public offering, the Company made a commitment to issue 382,500 shares of deferred stock units to the Company's senior executive officers. These deferred stock units are fully vested and represent the promise of the Company to issue a number of shares of the Company's common stock to each senior executive officer upon the earlier of (i) a change of control or (ii) five years after the date of grant, which was the initial public offering completion date (the "Deferral Period"). However, if an executive's service with the Company is terminated for "cause" prior to the expiration of the Deferral Period, all deferred stock unit awards will be forfeited. The executive officers are restricted from transferring these shares until the fifth anniversary of the initial public offering completion date. As of June 16, 2006, the Company has a commitment to issue 400,108 shares under this plan. The share commitment increased from 382,500 to 400,108 since our initial public offering because current dividends are not paid out but instead are effectively reinvested at the dividend payment date's closing price of our common stock. No expense has been recognized during the fiscal quarter ended June 16, 2006 or the period from January 1, 2006 to June 16, 2006 for these awards. During the fiscal quarter ended June 17, 2005, the Company recorded \$3,736,250 of stock based compensation expense related to these awards, which is included in corporate expenses in the accompanying statements of operations.

In total, for the periods from January 1, 2006 to June 16, 2006, and January 1, 2005 to June 17, 2005, the Company recorded \$1,157,698 and \$4,969,510, respectively and \$580,534 and \$4,420,665 during the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively, of stock-based compensation expense, which is included in corporate expenses in the accompanying statements of operations.

## 6. Earnings Per Share

Basic earnings per share is calculated by dividing net income (loss) available to common shareholders by the weighted-average number of common shares outstanding. Diluted earnings per share is calculated by dividing net income (loss) available to common shareholders, that has been adjusted for dilutive securities, by the weighted-average number of common shares outstanding including dilutive securities. No affect is shown for securities that are anti-dilutive.

The following is a reconciliation of the calculation of basic and diluted earnings per share:

Basic Earnings per Share Calculation:	Fiscal Quarter Ended June 16, 2006	Fiscal Quarter Ended June 17, 2005	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Numerator:				
Net income (loss)	\$ 13,896,680	\$ (5,824,555)	\$ 18,262,694	\$ (11,086,066)
Dividends on unvested restricted common stock	(134,460)	(24,059)	(268,920)	(24,059)
Net income (loss) after dividends on unvested restricted common stock	\$ 13,762,220	\$ (5,848,614)	\$ 17,993,774	\$ (11,110,125)
Weighted-average number of common shares outstanding—basic	69,383,184	28,990,963	60,349,939	25,005,531
Basic earnings (loss) per share	\$ 0.20	\$ (0.20)	\$ 0.30	\$ (0.44)

Diluted Earnings per Share Calculation:	Fiscal Quarter Ended June 16, 2006	Fiscal Quarter Ended June 17, 2005	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Numerator:				
Net income (loss)	\$ 13,896,680	\$ (5,824,555)	\$ 18,262,694	\$ (11,086,066)
Dividends on unvested restricted common stock	(134,460)	(24,059)	(268,920)	(24,059)
Net income (loss) after dividends on unvested restricted common stock	\$ 13,762,220	\$ (5,848,614)	\$ 17,993,774	\$ (11,110,125)
Weighted-average number of common shares outstanding—basic	69,383,184	28,990,963	60,349,939	25,005,531
Unvested restricted common stock	536,207	—	499,997	—
Weighted-average number of common shares outstanding—diluted	69,919,391	28,990,963	60,849,936	25,005,531
Diluted earnings (loss) per share	\$ 0.20	\$ (0.20)	\$ 0.30	\$ (0.44)

## 7. Debt

The Company has incurred limited recourse, property specific mortgage debt in conjunction with the acquisition of certain of the Company's hotels. In the event of default, the lender may only foreclose on the pledged assets; however, in the event of fraud, misapplication of funds and other customary recourse provisions, the lender may seek payment from the Company. As of June 16, 2006, ten of our seventeen hotel properties were secured by mortgage debt. The Company's mortgage debt contains certain property specific covenants and restrictions, including minimum debt service coverage ratios that trigger cash management provisions as well as restrictions on incurring additional debt without lender consent. As of June 16, 2006, the Company was in compliance with the financial covenants of our debt.

The following table sets forth information regarding the Company's debt as of June 16, 2006 (unaudited):

Property	Principal Balance	Interest Rate
Courtyard Manhattan / Midtown East	\$ 43,675,755	5.195%
Marriott Salt Lake City Downtown	37,457,150	5.50%
Courtyard Manhattan / Fifth Avenue	51,000,000	6.48%
Marriott Griffin Gate Resort	30,126,012	5.11%
Bethesda Marriott Suites	19,028,914	7.69%
Renaissance Worthington	57,400,000	5.40%
Frenchman's Reef & Morning Star Marriott Beach Resort	62,500,000	5.44%
Marriott Los Angeles Airport	82,600,000	5.30%
Orlando Airport Marriott	59,000,000	5.68%
Chicago Marriott Downtown Magnificent Mile	220,000,000	5.98%
<b>Total</b>	<b>\$ 662,787,831</b>	
Weighted Average Interest Rate		5.7%

On March 24, 2006, in connection with our acquisition of the Chicago Marriott Downtown Magnificent Mile, the Company assumed \$220 million of floating-rate debt. The Company refinanced the \$220 million floating-rate loan on April 7, 2006 with a 10-year fixed-rate loan bearing interest at 5.98%. The loan is interest-only for 3.5 years, after which the principal will amortize using a 30-year amortization schedule. The new loan is a limited recourse loan secured by a mortgage on the property. The remainder of the purchase price, after the application of the Company's \$10 million deposit, was financed by a \$79.5 million short-term floating-rate loan made by Wachovia Investment Holdings, LLC, which was repaid on April 5, 2006 with a portion of the net proceeds of our secondary offering.

On April 5, 2006, we repaid the \$33 million outstanding balance under our credit facility with proceeds from our secondary offering. As of June 16, 2006, we did not have an outstanding balance under the credit facility.

On May 9, 2006, we refinanced the \$23 million variable-rate mortgage debt on the Courtyard Manhattan/Fifth Avenue with a \$51 million fixed-rate loan bearing interest at 6.48% and a term of 10 years. In conjunction with this refinancing, the Company wrote off \$162,000 of unamortized deferred financing costs which is classified as interest expense in the accompanying condensed consolidated statements of operations. The loan is interest-only for five years, after which, the principal will amortize using a 30-year amortization schedule. The new loan is a limited recourse loan secured by a mortgage on the property.

## 8. Acquisitions

On March 24, 2006, we acquired the 1,192 room Chicago Marriott Downtown Magnificent Mile for a purchase price of \$295 million plus approximately \$11 million of net consideration in the form of an assumed property tax liability and other adjustments. A subsidiary of Marriott manages the hotel under a management agreement. The agreement provides for a base management fee of 3% of the hotel's gross revenues, and an incentive management fee of 20% of hotel operating profits. The calculation of incentive management fee is based on 20% of net house profit without an owner's priority. In addition, base management fees are not deducted from net house profit in the incentive management fee calculation. The Company reviewed the terms of the management agreement in conjunction with the hotel purchase accounting and concluded that the terms of the management agreement are more favorable to the manager than a typical current market management agreement and recorded an \$83.8 million unfavorable contract liability at the acquisition date. The terms of the management agreement were built into the Company's underwriting economics of the acquisition.

On May 2, 2006 we acquired the 369-room Westin Atlanta North at Perimeter Center in Atlanta, Georgia, for total contractual consideration of \$61.5 million. The hotel will remain a Westin-branded property under a franchise agreement and will be managed by Noble Management Group, LLC under a ten-year management agreement. We own 100% of the fee interest in the hotel. The management agreement provides for a base management fee of 3% of the hotel's gross revenues and an incentive management fee of 10% of hotel operating profits above an owner's priority defined in the management agreement.

The preliminary purchase price allocation, including transaction costs, of the two recently acquired hotels to the acquired assets and liabilities, which may be adjusted if any of the assumptions underlying the purchase accounting change, are as follows (in thousands):

	Chicago	Westin Atlanta
Land	\$ 36,900	\$ 7,490
Building	347,960	51,124
Furniture, fixtures and equipment	7,152	3,400
	<hr/>	<hr/>
Total fixed assets	392,012	62,014
Unfavorable contract liability	(83,812)	—
FF&E escrow and restricted cash	2,217	—
Accrued liabilities and other assets, net	(4,500)	(170)
	<hr/>	<hr/>
Purchase Price	\$ 305,917	\$ 61,844
	<hr/>	<hr/>

The acquired properties are included in our results of operations from the date of acquisition. The following unaudited pro forma results of operations reflect the transactions as if they had occurred on the first day of the fiscal year presented. In our opinion, all significant adjustments necessary to reflect the effects of the acquisitions have been made; however, a preliminary allocation of the purchase price to land, buildings and unfavorable contract liability was made, and we will finalize the allocation after all information is obtained.

	Fiscal Quarter Ended June 16, 2006	Fiscal Quarter Ended June 17, 2005	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005
Revenues	\$ 126,730,537	\$ 111,637,009	\$ 230,898,031	\$ 213,032,341
Net income (loss)	14,312,988	(27,168)	16,704,710	2,571,995
Earnings per share - Basic	\$ 0.20	\$ —	\$ 0.23	\$ 0.04
Earnings per share - Diluted	\$ 0.20	\$ —	\$ 0.23	\$ 0.04

## 9. Dividends

During the first fiscal quarter of 2006, the Company's board of directors declared a cash dividend of \$0.18 per share of our common stock. The dividend was paid on April 11, 2006, to all stockholders of record as of March 24, 2006. During the second fiscal quarter of 2006, the Company's board of directors declared a cash dividend of \$0.18 per share of our common stock. The dividend was paid on June 22, 2006 to all stockholders of record as of June 16, 2006.

## 10. Commitments and Contingencies

### Litigation

The Company is not involved in any material litigation nor, to its knowledge, is any material litigation threatened against the Company. The Company is involved in routine litigation arising out of the ordinary course of business, all of which is expected to be covered by insurance and none of which is expected to have a material impact on our financial condition or results of operations.

## 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 risk factors discussed herein and other factors discussed from time to time in our periodic filings with the Securities and Exchange Commission. 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

We are a self-advised lodging real estate company. We are committed to maximizing shareholder value through investing in premium full-service hotels and, to a lesser extent, premium urban select-service hotels. As of June 16, 2006, we owned seventeen hotels comprising 7,678 rooms. These hotels are geographically diversified across major markets in the United States.

We differentiate ourselves through our:

- Conservative capital structure;
- Aggressive asset management and
- Proven acquisition capability.

### ***Conservative Capital Structure***

We are committed to maintaining a conservative capital structure with prudent aggregate leverage primarily comprised of long-term fixed-rate debt. However, we maintain the flexibility to modify these strategies if we believe fundamental changes have occurred in the capital markets.

As of June 16, 2006, 100% of our debt carries fixed interest rates, with a weighted-average interest rate of 5.7% and a weighted-average maturity date of 9 years. As of June 16, 2006, we had \$662.8 million of debt outstanding.

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

### ***Aggressive Asset Management***

We believe that we are able to create significant value in our portfolio by utilizing our management's extensive experience and our innovative asset management strategies.

Our senior management team has established a broad network of hotel industry contacts and relationships, including relationships with hotel owners, financiers, operators, project managers and contractors and other key industry participants. In particular, we believe that we are unique in having a senior management team, most of whom worked for many years at Marriott, with very deep knowledge of Marriott's organization and processes, which gives us insight in how best to work with Marriott to deliver superior returns at our hotels.

Our philosophy is to negotiate management agreements that give us the right to exert significant influence (but not day-to-day control) over the management of our properties, annual budgets and all capital expenditures, and then to use those rights to continually monitor and improve the performance of our properties. We cooperatively partner with the managers of our hotels in an attempt to increase operating results and long-term asset values at our hotels. In addition to working directly with the personnel at our hotels, our senior management team also has long-standing professional relationships with our hotel managers' senior executives and we work directly with these senior executives to improve the performance of our portfolio.

We believe we can create significant value in our portfolio through innovative asset management strategies such as rebranding, renovating or repositioning. We are committed to regularly evaluating our portfolio to determine if we can employ these value-added strategies at our hotels. We have rebranded two of our properties. We also have budgeted to spend approximately \$89 million in 2006 on identified value-added capital investment opportunities at our existing hotels. The opportunities range from room renovation (Courtyard Manhattan/Midtown East, Los Angeles Airport Marriott, Bethesda Marriott Suites) to a total renovation and repositioning of the hotel (Torrance Marriott and Oak Brook Hills Marriott Resort). In connection with our planned renovations and repositionings, our senior management team and our asset managers are individually committed to completing these renovations on time, on budget and with a minimal disruption at our hotels. We are optimistic that, when completed, these renovations will enable us to achieve higher rates and greater demand for our hotels.

## ***Proven Acquisition Capability***

Since we completed our first acquisition in October 2004, through June 16, 2006, we have acquired seventeen premium hotels. We have acquired eleven of these hotels in off-market transactions, meaning that they were not made generally available to other companies around the time of the acquisition. We intend to make additional acquisitions that meet our stringent underwriting criteria. Consistent with this strategy, on May 2, 2006, we acquired the 369-room Westin Atlanta North at Perimeter at a contractual purchase price of \$61.5 million. We believe that the current environment presents an excellent opportunity to acquire hotels based on our view that lodging industry fundamentals are currently strong and will remain strong for some time to come.

Generally, we invest in hotels that we believe are priced below replacement cost and are located in markets with attractive growth prospects and high barriers to entry. We are focused on acquiring premium full-service hotels located throughout North America and, to a lesser extent, premium select-service hotels in urban locations.

We believe we have a competitive advantage in acquiring hotels through our unique investment sourcing relationship with Marriott, a leading worldwide hotel brand, franchise and management company. Our investment sourcing relationship with Marriott provides us, subject to certain limitations, with a “first look” at hotel acquisition and investment opportunities known to Marriott. As a result of Marriott’s extensive network, relationships and knowledge, we have preferred access to a unique source of hotel investment opportunities, many of which may not be available to other hospitality companies. Since our formation in May 2004, Marriott has provided us with access to several billion dollars of off-market acquisition opportunities. Our relationship with Marriott has facilitated the acquisition of eight of our hotels, including the Marriott Griffin Gate Resort and The Lodge at Sonoma, a Renaissance Resort & Spa, both of which we acquired directly from Marriott. Neither we nor Marriott have entered into a binding agreement or commitment setting forth the terms of this investment sourcing relationship. Our investment sourcing relationship may be modified or terminated at any time by either party.

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

- Occupancy percentage;
- ADR;
- RevPAR;
- EBITDA and
- FFO.

Occupancy, ADR and RevPAR are commonly used measures within the hotel industry to evaluate operating performance. RevPAR, which is calculated as the product of ADR and occupancy percentage, is an important statistic for monitoring operating performance at the individual hotel level and across our business as a whole. We evaluate individual hotel RevPAR performance on an absolute basis with comparisons to budget and prior periods, as well as on a company-wide and regional basis. ADR and RevPAR include only room revenue. Room revenue comprised approximately 65% of our total revenues for the fiscal quarter ended June 16, 2006, and is dictated by demand, as measured by occupancy percentage, pricing, as measured by ADR, and our available supply of hotel rooms.

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

We also use EBITDA and FFO as measures of the financial performance of our business. See “Non-GAAP Financial Matters.”

## Our Hotels

The following table sets forth certain operating information for each of our hotels for the period from January 1, 2006 to June 16, 2006. This information includes periods prior to our acquisition of these hotels unless otherwise indicated:

Property	Location	Number of Rooms	Average Occupancy(%)	ADR(\$)	RevPAR(\$)	% Change from 2005 RevPAR(3)
Chicago Marriott	Chicago, Illinois	1,192	81.2	209.66	170.21	11.1
Los Angeles Airport Marriott	Los Angeles, California	1,004	79.8	115.55	92.24	15.1
Salt Lake City Marriott Downtown	Salt Lake City, Utah	510	71.5	127.98	91.56	9.0
Frenchman's Reef & Morning Star Marriott Beach Resort (1)	St. Thomas, U.S. Virgin Islands	504	86.8	256.72	222.72	11.6
Renaissance Worthington	Fort Worth, Texas	504	79.8	167.76	133.90	9.6
Torrance Marriott	Los Angeles County, California	487	81.3	108.15	87.90	6.0
Orlando Airport Marriott	Orlando, Florida	486	80.5	117.94	94.98	6.8
Marriott Griffin Gate Resort	Lexington, Kentucky	408	59.3	128.58	76.26	0.9
Oak Brook Hills Marriott Resort	Oak Brook, Illinois	384	50.7	128.09	65.01	10.0
Westin Atlanta North at Perimeter (2)	Atlanta, Georgia	369	62.0	139.96	86.82	12.4
Vail Marriott Mountain Resort & Spa (1)	Vail, Colorado	346	70.8	262.95	186.30	20.4
Marriott Atlanta Alpharetta	Atlanta, Georgia	318	64.3	143.03	92.02	12.0
Courtyard Manhattan/Midtown East	New York, New York	307	78.3	233.19	182.51	2.1
Bethesda Marriott Suites	Bethesda, Maryland	272	71.3	178.08	127.05	3.3
SpringHill Suites Atlanta Buckhead	Atlanta, Georgia	220	69.3	117.11	81.15	N/A
Courtyard Manhattan/Fifth Avenue	New York, New York	185	88.7	223.68	198.35	25.4
The Lodge at Sonoma, a Renaissance Resort & Spa	Sonoma, California	182	67.6	195.03	131.90	9.9
<b>TOTAL/WEIGHTED AVERAGE (3)</b>		<b>7,678</b>	<b>75.0</b>	<b>164.13</b>	<b>123.09</b>	<b>10.9</b>

- (1) The Frenchman's Reef & Morning Star Marriott Beach Resort and Vail Marriott Mountain Resort & Spa report operations on a calendar month and year basis. The second fiscal quarter includes the operations for the period from March 1, 2006 to May 31, 2006 for these two hotels.
- (2) The Westin Atlanta North at Perimeter reports operations on a calendar month and year basis. The second fiscal quarter includes the operations for the period from May 2, 2006 (date of acquisition) to May 31, 2006.
- (3) The percentage change from 2005 RevPAR and totals exclude the SpringHill Suites Atlanta Buckhead. The hotel was newly built in 2005 and there are no comparable statistics for the fiscal quarter ended June 17, 2005 because the hotel was not yet opened.

### Significant highlights for the Fiscal Quarter ended June 16, 2006 and subsequent period are as follows:

*Secondary Offering.* We completed a secondary offering of our common stock on April 4, 2006. We sold 19,320,000 shares of common stock, including 2,520,000 shares of common stock exercised in the underwriters' over-allotments, at the offering price of \$13.00 per share. The net proceeds to us, after deduction of offering costs, were \$238.2 million.

*Westin Atlanta North.* On May 2, 2006, we acquired the 369-room Westin Atlanta North at Perimeter Center in Atlanta, Georgia for total consideration of \$61.8 million.

*Refinancing of Courtyard Manhattan/Fifth Avenue.* On May 9, 2006, we refinanced the \$23 million variable-rate mortgage debt on the Courtyard Manhattan/Fifth Avenue with \$51 million of fixed-rate mortgage loan bearing interest at 6.48% and a term of 10 years.

*Payment of Second Quarter Dividend.* During the second fiscal quarter of 2006, the Company's board of directors declared a cash dividend of \$0.18 per share of our common stock. The dividend was paid on June 22, 2006 to all recorded holders of our common stock as of June 16, 2006.



## Results of Operations

### Fiscal Quarter Ended June 16, 2006

As of June 16, 2006, we owned seventeen hotels. Our total assets were \$1.5 billion as of June 16, 2006. Total liabilities were \$835.5 million as of June 16, 2006, including \$665.5 million of debt. Shareholders' equity was approximately \$698.8 million as of June 16, 2006. Our total assets were \$966 million as of December 31, 2005. Total liabilities were \$502.6 million as of December 31, 2005, including \$431.2 million of debt. Shareholders' equity was approximately \$463.4 million as of December 31, 2005. Our net income for the fiscal quarter ended June 16, 2006 was \$13.9 million compared to a net loss of \$5.8 million for the fiscal quarter ended June 17, 2005. We acquired ten of our seventeen hotels after the second fiscal quarter of 2005. Accordingly, the current period results are not comparable to the results for the corresponding period in 2005.

*Revenue.* Our revenues totaled \$125.0 million and \$33.5 million for the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively. Revenue consists primarily of the room, food and beverage and other revenues from our hotels. Revenues for the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively, consist of the following:

	Fiscal Quarter Ended June 16, 2006	Fiscal Quarter Ended June 17, 2005
Rooms	\$ 81,273,462	\$ 23,833,517
Food and beverage	36,675,546	7,791,155
Other	7,018,328	1,891,044
<b>Total revenues</b>	<b>\$ 124,967,336</b>	<b>\$ 33,515,716</b>

Individual hotel revenues for the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively, consist of the following (in millions):

	Fiscal Quarter Ended June 16, 2006	Fiscal Quarter Ended June 17, 2005
Chicago Marriott	\$ 24.3	\$ —
Frenchman's Reef & Morning Star Marriott Beach Resort (1)	16.5	—
Los Angeles Airport Marriott	12.7	—
Renaissance Worthington	9.7	—
Marriott Griffin Gate Resort	7.0	6.7
Vail Marriott Mountain Resort & Spa (1)	6.3	—
Oak Brook Hills Marriott Resort	6.3	—
Courtyard Manhattan/Midtown East	6.2	5.4
Orlando Airport Marriott	5.7	—
Salt Lake City Marriott Downtown	5.3	5.3
Torrance Marriott	5.3	4.9
The Lodge at Sonoma, a Renaissance Resort & Spa	4.6	4.0
Bethesda Marriott Suites	4.5	4.2
Marriott Atlanta Alpharetta	3.8	—
Courtyard Manhattan/Fifth Avenue	3.6	3.0
SpringHill Suites Atlanta Buckhead	1.7	—
Westin Atlanta North at Perimeter (2)	1.5	—
<b>Total</b>	<b>\$ 125.0</b>	<b>\$ 33.5</b>

- (1) The Frenchman's Reef & Morning Star Marriott Beach Resort and Vail Marriott Mountain Resort & Spa report operations on a calendar month and year basis. The second fiscal quarter includes the operations for the period from March 1, 2006 to May 31, 2006 for these two hotels.
- (2) The Westin Atlanta North at Perimeter reports operations on a calendar month and year basis and was acquired on May 2, 2006. The second fiscal quarter includes the operations for the period from May 2, 2006 to May 31, 2006 for this hotel.

The following pro forma key hotel operating statistics for our hotels for each of the fiscal quarters ended June 16, 2006 and June 17, 2005 exclude the SpringHill Suites Atlanta Buckhead due to the fact that this hotel was newly built and opened on July 1, 2005, after the end of the second fiscal quarter. The pro forma hotel operating statistics presented below include the results of operations of the hotels under previous ownership for the comparable prior year period to our ownership period.

	Fiscal Quarter Ended June 16, 2006	Fiscal Quarter Ended June 17, 2005	% Change
Occupancy %	76.8%	75.8%	1.0 percentage point
ADR	\$ 169.91	\$ 154.19	10.2%
RevPAR	\$ 130.44	\$ 116.86	11.6%

The hotel operating statistics presented below are pro forma as they include the results of operations of the hotels under previous ownership for the comparable prior year period to our ownership period. Individual hotel RevPAR for the fiscal quarters ended June 16, 2006 and June 17, 2005 is as follows:

Property	Fiscal Quarter Ended June 16, 2006	Fiscal Quarter Ended June 17, 2005	% Change from 2005 (2)
Bethesda Marriott Suites	\$ 147.32	\$ 141.03	4.5%
Chicago Marriott	170.21	153.22	11.1
Courtyard Manhattan/Midtown East	230.51	200.69	14.9
Courtyard Manhattan/Fifth Avenue	226.89	186.80	21.5
Frenchman's Reef & Morning Star Marriott Beach Resort	216.40	185.75	16.5
Los Angeles Airport Marriott	89.06	76.55	16.3
Marriott Atlanta Alpharetta	94.32	82.37	14.5
Marriott Griffin Gate Resort	98.58	98.35	0.2
Oak Brook Hills Marriott Resort	79.75	77.31	3.2
Orlando Airport Marriott	87.71	74.05	18.4
Renaissance Worthington	137.10	129.41	5.9
Salt Lake City Marriott Downtown	81.75	83.53	(2.1)
The Lodge at Sonoma, a Renaissance Resort & Spa	165.55	151.55	9.2
SpringHill Suites Atlanta Buckhead (1)	82.28	N/A	N/A
Torrance Marriott	89.82	79.08	13.6
Vail Marriott Mountain Resort & Spa	133.49	119.81	11.4
Westin Atlanta North at Perimeter	86.82	77.21	12.4
<b>Total</b>	<b>\$ 130.44</b>	<b>\$ 116.86</b>	<b>11.6%</b>

(1) SpringHill Suites Atlanta Buckhead was newly built and commenced operations on July 1, 2005. There are no comparable statistics for 2005.

(2) The percentage change from the fiscal quarter ended June 17, 2005 excludes the SpringHill Suites Atlanta Buckhead. The hotel was newly built in 2005 and there are no comparable statistics for 2005.

*Hotel operating expenses.* Our hotel operating expenses totaled \$86.4 million for the fiscal quarter ended June 16, 2006 compared to \$25.2 million for the fiscal quarter ended June 17, 2005. Hotel operating expenses consist primarily of operating expenses of our hotels, including non-cash ground rent expense. The operating expenses for the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively, consist of the following (in millions):

	Fiscal Quarter Ended June 16, 2006	Fiscal Quarter Ended June 17, 2005
Rooms departmental expenses	\$ 18.1	\$ 5.6
Food and beverage departmental expenses	23.4	5.7
Other hotel expenses	33.3	9.8
Base management fees	3.5	1.1
Yield support	(1.4)	—
Incentive management fees	2.7	0.1
Property taxes	4.7	1.0
Ground rent—Contractual	0.4	0.3
Ground rent—Non-cash	1.7	1.6
<b>Total operating expenses</b>	<b>\$ 86.4</b>	<b>\$ 25.2</b>

In connection with entering into certain management agreements with Marriott, Marriott provided the Company with limited operating cash flow guarantees (“yield support”) for those hotels. The yield support is designed to protect us from the disruption often associated with changing the hotel’s brand or manager or undergoing significant renovations. Across our portfolio, we are entitled to up to \$2.5 million of yield support through December 31, 2007 for the Oak Brook Hills Marriott, \$1.0 million of yield support through December 31, 2006 at the Orlando Airport Marriott and \$100,000 in each of 2006 and 2007 for the Buckhead SpringHill Suites. We currently anticipate that we will recognize all \$3.6 million of yield support available for the three hotels in 2006. We recorded yield support of \$1.4 million for the fiscal quarter ended June 16, 2006. We recorded no yield support during the fiscal quarter ended June 17, 2005.

*Depreciation and amortization.* Our depreciation and amortization expense totaled \$12.1 million and \$4.3 million for the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively. Depreciation and amortization is recorded over 40 years on our hotel buildings 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. We have assigned shorter depreciable lives of 1 to 2 years for the furniture, fixtures and equipment of the Marriott Atlanta Alpharetta, the Frenchman’s Reef & Morning Star Marriott Beach Resort, the Los Angeles Airport Marriott, the Oak Brook Hills Marriott Resort and the Orlando Airport Marriott since these hotels will undergo, (and/or have undergone), significant renovations within two years of acquisition.

*Corporate expenses.* Our corporate expenses totaled \$2.6 million and \$5.9 million for the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively. Corporate expenses principally consist of employee-related costs, including base payroll, bonus and restricted stock. Corporate expenses also include organizational costs, professional fees and directors’ fees. The Company recorded an expense of \$3,736,250 during the fiscal quarter ended June 17, 2005 relating to the commitment to issue 382,500 of deferred stock units to the Company’s senior executive officers.

*Interest expense.* Our interest expense totaled \$9.3 million and \$3.6 million for the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively. The 2006 interest expense is related to mortgage debt incurred (or assumed) in connection with our acquisitions of our hotels (\$8.8 million), amortization and write off of deferred financing costs (\$0.3 million) and interest and unused facility fees on our credit facility (\$0.2 million). The 2005 interest expense is related to mortgage debt incurred (or assumed) in connection with our acquisitions of our hotels (\$2.8 million) and amortization of deferred financing costs (\$0.8 million). As of June 16, 2006, we had property-specific mortgage debt outstanding on ten of our hotels. On all ten of the hotels, we have fixed-rate secured debt, which bears interest at rates ranging from 5.11% to 7.69% per year. As of June 16, 2006, our weighted-average interest rate as of June 16, 2006 was 5.7%. Amounts drawn under the credit facility bear interest at a variable rate that fluctuates based on the level of outstanding indebtedness in relation to the value of our assets from time to time. The Company did not have an outstanding balance under the credit facility as of June 16, 2006.

*Interest income.* We recorded interest income of \$1,207,161 and \$284,049 for the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively. Interest income increased from the comparable period in 2005 as a result of interest earned on cash received from the secondary offering completed in the second quarter of 2006.

*Income taxes.* We recorded income tax expense of \$1,828,790 and \$478,990 for the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively, primarily based on TRS income of \$4,024,050 and \$1,185,619 for the fiscal quarters ended June 16, 2006 and June 17, 2005, respectively.

#### *Period from January 1, 2006 to June 16, 2006*

As of June 16, 2006, we owned seventeen hotels. Our total assets were \$1.5 billion as of June 16, 2006. Total liabilities were \$835.5 million as of June 16, 2006, including \$665.5 million of debt. Shareholders’ equity was approximately \$698.8 million as of June 16, 2006. Our total assets were \$966 million as of December 31, 2005. Total liabilities were \$502.6 million as of December 31, 2005, including \$431.2 million of debt. Shareholders’ equity was approximately \$463.4 million as of December 31, 2005. Our net income for the period from January 1, 2006 to June 16, 2006 was \$18.3 million compared to a net loss of \$11.1 million for the period from January 1, 2005 to June 17, 2005. We acquired ten of our seventeen hotels after the second fiscal quarter of 2005. Accordingly, the current period results are not comparable to the results for the corresponding period in 2005.

*Revenue.* Our revenues totaled \$208.1 million and \$59.9 million for the periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005, respectively. Revenue consists primarily of the room, food and beverage and other revenues from our hotels. Revenues for the periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005, respectively, consist of the following:

	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005
Rooms	\$ 135,788,214	\$ 42,501,868
Food and beverage	60,745,508	14,205,252
Other	11,555,764	3,157,377
<b>Total revenues</b>	<b>\$ 208,089,486</b>	<b>\$ 59,864,497</b>

Individual hotel revenues for the periods from January 1, 2006 to June 16, 2006, and January 1, 2005 to June 17, 2005, respectively, consist of the following (in millions):

	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005
Los Angeles Airport Marriott	\$ 26.6	\$ —
Frenchman's Reef & Morning Star Marriott Beach Resort (1)	26.3	—
Chicago Marriott	24.3	—
Renaissance Worthington	18.9	—
Vail Marriott Mountain Resort & Spa (1)	13.5	—
Orlando Airport Marriott	12.1	—
Salt Lake City Marriott Downtown	11.8	10.8
Marriott Griffin Gate Resort	10.7	10.3
Torrance Marriott	10.3	10.2
Oak Brook Hills Marriott Resort	10.1	—
Courtyard Manhattan/Midtown East	9.8	9.7
Bethesda Marriott Suites	7.7	7.4
Marriott Atlanta Alpharetta	7.4	—
The Lodge at Sonoma, a Renaissance Resort & Spa	7.4	6.5
Courtyard Manhattan/Fifth Avenue	6.3	5.0
SpringHill Suites Atlanta Buckhead	3.4	—
Westin Atlanta North at Perimeter (2)	1.5	—
<b>Total</b>	<b>\$ 208.1</b>	<b>\$ 59.9</b>

- (1) The Frenchman's Reef & Morning Star Marriott Beach Resort and Vail Marriott Mountain Resort & Spa report operations on a calendar month and year basis. The second fiscal quarter includes the operations for the period from March 1, 2006 to May 31, 2006 for these two hotels.
- (2) The Westin Atlanta North at Perimeter reports operations on a calendar month and year basis and was acquired on May 2, 2006. The second fiscal quarter includes the operations for the period from May 2, 2006 to May 31, 2006 for this hotel.

The following pro forma key hotel operating statistics for our hotels for the periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005 exclude the SpringHill Suites Atlanta Buckhead due to the fact that this hotel was newly built and opened on July 1, 2005. The pro forma hotel operating statistics presented below include the results of operations of the hotels under previous ownership for the comparable period to our ownership period.

	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005	% Change
Occupancy %	75.0%	74.5%	0.5 percentage point
ADR	\$ 164.13	\$ 149.05	10.1%
RevPAR	\$ 123.09	\$ 110.98	10.9%

The hotel operating statistics presented below are pro forma as they include the results of operations of the hotels under previous ownership for the comparable period to our ownership period. Individual hotel RevPAR for the periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005 are as follows:

Property	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005	% Change from 2005 (2)
Bethesda Marriott Suites	\$ 127.05	\$ 122.99	3.3%
Chicago Marriott	170.21	153.22	11.1
Courtyard Manhattan/Midtown East	182.51	178.84	2.1
Courtyard Manhattan/Fifth Avenue	198.35	158.19	25.4
Frenchman's Reef & Morning Star Marriott Beach Resort	222.72	199.58	11.6
Los Angeles Airport Marriott	92.24	80.13	15.1
Marriott Atlanta Alpharetta	92.02	82.18	12.0
Marriott Griffin Gate Resort	76.26	75.60	0.9
Oak Brook Hills Marriott Resort	65.01	59.08	10.0
Orlando Airport Marriott	94.98	88.97	6.8
Renaissance Worthington	133.90	122.15	9.6
Salt Lake City Marriott Downtown	91.56	83.98	9.0
The Lodge at Sonoma, a Renaissance Resort & Spa	131.90	120.03	9.9
SpringHill Suites Atlanta Buckhead (1)	81.15	N/A	N/A
Torrance Marriott	87.90	82.95	6.0
Westin Atlanta North at Perimeter	86.82	77.21	12.4
Vail Marriott Mountain Resort & Spa	186.30	154.71	20.4
<b>Total</b>	<b>\$ 123.09</b>	<b>\$ 110.98</b>	<b>10.9%</b>

(1) SpringHill Suites Atlanta Buckhead was newly built and commenced operations on July 1, 2005. There are no comparable statistics for 2005.

(2) The percentage change from the period from January 1, 2005 to June 17, 2005 excludes the SpringHill Suites Atlanta Buckhead. The hotel was newly built in 2005 and there are no comparable statistics for 2005.

*Hotel operating expenses.* Our hotel operating expenses totaled \$147.9 million for the period from January 1, 2006 to June 16, 2006 compared to \$47.8 million for the period from January 1, 2005 to June 17, 2005. Hotel operating expenses consist primarily of operating expenses of our hotels, including non-cash ground rent expense. The operating expenses for the periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005, respectively, consist of the following (in millions):

	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005
Rooms departmental expenses	\$ 31.0	\$ 10.6
Food and beverage departmental expenses	40.3	10.8
Other hotel expenses	57.9	18.4
Base management fees	6.1	2.0
Yield support	(1.6)	—
Incentive management fees	3.2	0.1
Property taxes	6.8	2.0
Ground rent—Contractual	0.8	0.7
Ground rent—Non-cash	3.4	3.2
<b>Total operating expenses</b>	<b>\$ 147.9</b>	<b>\$ 47.8</b>

In connection with entering into certain management agreements with Marriott, Marriott provided the Company with yield support for those hotels. The yield support is designed to protect us from the disruption often associated with changing the hotel's brand or manager or undergoing significant renovations. Across our portfolio, we are entitled to up to \$2.5 million of yield support through December 31, 2007 for the Oak Brook Hills Marriott, \$1.0 million of yield support through December 31, 2006 at the Orlando Airport Marriott and \$100,000 in each of 2006 and 2007 for the Buckhead SpringHill Suites. We currently anticipate that we will recognize all \$3.6 million of yield support available for the three hotels in 2006. We recorded yield support of \$1.6 million for the period from January 1, 2006 to June 16, 2006. We recorded no yield support during the period from January 1, 2005 to June 17, 2005.

*Depreciation and amortization.* Our depreciation and amortization expense totaled \$21.1 million and \$8.7 million for the periods from January 1, 2006 to June 16, 2006, and January 1, 2005 to June 17, 2005, respectively. 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. We have assigned shorter depreciable lives of 1 - 2 years for the furniture, fixtures and equipment of the Marriott Atlanta Alpharetta, the Frenchman's Reef & Morning Star Marriott Beach Resort, the Los Angeles Airport Marriott, the Oak Brook Hills Marriott Resort and the Orlando Airport Marriott since these hotels will undergo, and/or have undergone, significant renovations within two years of acquisition.

*Corporate expenses.* Our corporate expenses totaled \$5.2 million and \$7.9 million for the periods from January 1, 2006 to June 16, 2006, and January 1, 2005 to June 17, 2005, respectively. Corporate expenses principally consist of employee-related costs, including base payroll, bonus and restricted stock. Corporate expenses also include organizational costs, professional fees and directors' fees. The Company recorded an expense of \$3,736,250 during the fiscal quarter ended June 17, 2005 relating to the commitment to issue 382,500 deferred stock units to the Company's senior executive officers.

*Interest expense.* Our interest expense totaled \$15.1 million and \$6.5 million for the periods from January 1, 2006 to June 16, 2006, and January 1, 2005 to June 17, 2005, respectively. The 2006 interest expense is related to mortgage debt incurred (or assumed) in connection with our acquisitions of our hotels (\$14 million), amortization and write off of deferred financing costs (\$0.5 million) and interest and unused facility fees on our credit facility (\$0.6 million). The 2005 interest expense is related to mortgage debt incurred (or assumed) in connection with our acquisitions of our hotels (\$5.6 million) and amortization and write off of deferred financing costs (\$0.9 million). As of June 16, 2006, we had property-specific mortgage debt outstanding on ten of our hotels. On all ten of the hotels, we have fixed-rate secured debt, which bears interest at rates ranging from 5.11% to 7.69% per year. Our weighted-average interest rate as of June 16, 2006 was 5.7%. Amounts drawn under the credit facility bear interest at a variable rate that fluctuates based on the level of outstanding indebtedness in relation to the value of our assets from time to time. The Company did not have an outstanding balance under the credit facility as of June 16, 2006.

*Interest income.* We recorded interest income of \$1,390,530 and \$560,827 for the periods from January 1, 2006 to June 16, 2006 and January 1, 2005 to June 17, 2005, respectively. Interest income increased from the comparable period in 2005 as a result of interest earned on cash received from the secondary offering completed in the second quarter of 2006.

*Income taxes.* We recorded income tax expense of \$1,798,876 and \$558,847 for the periods from January 1, 2006 to June 16, 2006, and January 1, 2005 to June 17, 2005, respectively. The 2006 income tax expense was incurred on the \$3,737,000 pre-tax income of our TRS for the period from January 1, 2006 to June 16, 2006. The Company recorded an income statement charge of \$1.4 million in the 2005 first quarter to reverse a portion of the deferred tax assets recorded in 2004 in connection with our REIT election. This charge was offset by an income tax benefit of \$0.8 million recorded on the pre-tax loss of our TRS for the period from January 1, 2005 to June 17, 2005.

## **Liquidity and Capital Resources**

Our short-term liquidity requirements consist primarily of funds necessary to fund future distributions to our shareholders to maintain our REIT status as well as to pay for operating expenses and other expenditures directly associated with our hotels, including maintenance and recurring capital expenditures as well as payments of interest and principal. We expect to meet our short-term liquidity requirements generally through net cash provided by operations, existing cash balances and, if necessary, short-term borrowings under our credit facility.

Our long-term liquidity requirements consist primarily of funds necessary to pay for the costs of acquiring additional hotels, renovations, expansions and other capital expenditures that need to be made periodically to our hotels, scheduled debt payments and making distributions to our stockholders. We expect to meet our long-term liquidity requirements through various sources of capital, cash provided by operations, existing cash balances, and borrowings as well as through the issuances of additional equity or debt securities. Our ability to incur additional debt is dependent upon a number of factors, including our degree of leverage, the value of our unencumbered assets and borrowing restrictions imposed by existing lenders. Our ability to raise funds through the issuance of debt and equity securities is dependent upon, among other things, general market conditions for REITs and market perceptions about us.

### *Our Financing Strategy*

We are committed to maintaining a conservative capital structure with aggregate leverage weighted towards long-term fixed-rate debt. However, we maintain the flexibility to modify these strategies if we believe fundamental changes have occurred in the capital or lodging markets.

As of June 16, 2006, 100% of our debt carries fixed interest rates, with a weighted-average interest rate of 5.7%, and a weighted-average maturity of 9 years. As of June 16, 2006, we had \$662.8 million of debt outstanding.

In the current market, we have a preference towards fixed-rate, long-term, limited recourse, single property specific debt. When possible and desirable, we will seek to replace short-term sources of capital with long-term financing. In addition to property-specific debt and our credit facility, we intend to use other financing methods as necessary, including obtaining funds from banks, institutional investors or other lenders, bridge loans, letters of credit and other arrangements, any of which may be unsecured or may be secured by mortgages or other interests in our investments. In addition, we may issue publicly or privately placed debt instruments.

#### *Our Senior Secured Revolving Credit Facility*

We are party to a \$75 million senior secured revolving credit facility with Wachovia Bank, National Association, as administrative agent under the credit facility. Citicorp North America, Inc. and Bank of America, N.A. are co-syndication agents under the credit facility. We have the right to extend the maturity date and increase the amount of the credit facility to \$250 million subject to the lenders' approval.

Interest is paid on the periodic advances under the credit facility at varying rates, based upon either LIBOR or the applicable prime rate, plus an agreed upon additional margin amount. The interest rate depends upon our level of outstanding portfolio indebtedness in relation to the value of our assets from time-to-time, as follows:

	Leverage Ratio		
	70% or greater	65% to 70%	less than 65%
Prime rate margin	1.25%	1.00%	0.75%
LIBOR margin	2.00%	1.75%	1.45%

In addition to the interest payable on amounts outstanding under the credit facility, we are required to pay an amount equal to 0.35% of the unused portion of the credit facility.

On April 5, 2006, we repaid the remaining outstanding balance of \$33 million under the credit facility. As of June 16, 2006, we did not have an outstanding balance under the credit facility.

Our senior secured revolving credit facility contains various financial covenants. We complied with all of these covenants as of June 16, 2006. A summary of the most restrictive covenants, along with our corresponding value for each covenant, as of June 16, 2006, is as follows:

Covenant Test	Covenant	Value at June 16, 2006
Maximum leverage ratio	75%	47.3%
Minimum fixed charge coverage ratio	1.5x	3.4x
Unhedged floating rate debt as a percentage of total indebtedness	50%	0%
Minimum implied debt service ratio for the borrowing base assets for the trailing twelve months	1.40x	N/A
Limitation on our distributions to stockholders	100%	50.5%

#### *2006 Mortgage Financings*

On March 24, 2006, in connection with our acquisition of the Chicago Marriott Downtown Magnificent Mile, the Company assumed \$220 million of floating-rate debt. The Company refinanced the \$220 million floating-rate loan with a fixed-rate loan bearing interest at 5.98% and a term of 10 years. The loan is interest only for 3.5 years, after which, the principal will amortize using a 30-year amortization schedule. The new loan is a limited recourse loan secured by a mortgage on the property. The remainder of the purchase price, after the application of the Company's \$10 million deposit, was financed by a \$79.5 million short-term floating-rate loan made by Wachovia Investment Holdings, LLC, which was repaid with a portion of the net proceeds of our secondary offering of common stock, which closed on April 4, 2006.

On May 9, 2006, we refinanced the \$23 million variable-rate mortgage debt on the Courtyard Manhattan/Fifth Avenue with a \$51 million fixed-rate loan bearing interest at 6.48% and a term of 10 years. The loan is interest only for five years, after which, the principal will amortize using a 30-year amortization schedule. The new loan is a limited recourse loan secured by a mortgage on the property.

## Sources and Uses of Cash

Our principal sources of cash are cash from operations, borrowing under mortgage financings, draws on our senior secured credit facility and the proceeds from our equity offerings. Our principal uses of cash are debt service, asset acquisitions, capital expenditures, operating costs, corporate expenses and dividends.

*Cash Provided by Operations.* Our cash provided by operations was \$37.5 million for the period from January 1, 2006 to June 16, 2006, which is the result of our net income, adjusted for the impact of several non-cash charges, including \$21.1 million of depreciation, \$3.4 million of non-cash straight line ground rent, \$0.5 million of amortization of deferred financing costs, and \$1.2 million of stock compensation, offset by \$0.5 million of amortization of unfavorable agreements and unfavorable working capital changes of \$6.3 million. Our cash provided by operations was \$4.3 million for the period from January 1, 2005 to June 17, 2005, which is the result of our \$11.1 million net loss, adjusted for the impact of several non-cash charges, including \$8.7 million of depreciation, \$3.2 million of non-cash straight line ground rent, \$1.0 million of amortization of deferred financing costs, \$5.0 million of stock compensation, and unfavorable working capital changes of \$2.8 million.

*Cash Used In Investing Activities.* Our cash used in investing activities was \$171.1 million and \$81.9 million for the periods from January 1, 2006 to June 16, 2006, and January 1, 2005 to June 17, 2005, respectively. During the period from January 1, 2006 to June 16, 2006, we utilized \$145.6 million of cash for the acquisitions of the Chicago Marriott Downtown Magnificent Mile and Westin Atlanta North at Perimeter. During the period from January 1, 2006 to June 16, 2006, we also incurred normal recurring capital expenditures at our other hotels of \$26.0 million. During the period from January 1, 2005 to June 17, 2005, we utilized \$72.2 million to acquire the Torrance Marriott. During the period from January 1, 2005 to June 17, 2005, we also received \$4 million of Key Money related to certain acquisitions, incurred normal recurring capital expenditures at our hotels of \$3.7 million and paid \$10.9 million for pre-acquisition costs related to the acquisition of the Blackacre Portfolio and Vail Marriott.

*Cash Provided by Financing Activities.* Approximately \$233.0 million and \$273.7 million of cash was provided by financing activities for the periods from January 1, 2006 to June 16, 2006, and January 1, 2005 to June 17, 2005, respectively. The cash provided by financing activities for the period from January 1, 2006 to June 16, 2006, primarily consists of \$79.5 million of proceeds from a short-term loan incurred in conjunction with the acquisition of the Chicago Marriott, \$271 million of proceeds from the mortgage debt of the Chicago Marriott (\$220 million) and the Courtyard Manhattan/Fifth Avenue (\$51 million), \$238.2 million of net proceeds from our secondary offering of our common stock, and \$24.0 million in draws under the Company's senior secured credit facility. The cash provided by financing activities for the period from January 1, 2006 to June 16, 2006 was offset by the \$325.5 repayment of debt, including the \$220 variable-rate mortgage assumed in the acquisition of the Chicago Marriott, the \$23 million variable-rate mortgage debt on the Courtyard Manhattan/Fifth Avenue, and the \$79.5 million short-term loan incurred in conjunction with the acquisition of the Chicago Marriott, a \$33.0 million repayment of the Company's senior secured credit facility, \$1.6 million of scheduled debt principal payments, \$1.3 million payment of financing costs, and \$18.3 million of dividend payments. The cash provided by financing activities for the period from January 1, 2005 to June 17, 2005, primarily consists of \$44 million of proceeds from mortgage debt of the Torrance Marriott, and \$290.2 million of net proceeds from the initial public offering of our common stock. The cash provided by financing activities for the period from January 1, 2005 to June 17, 2005 was offset by \$2.1 million of financing costs paid during the period, \$56.9 million repayment of the Torrance and Sonoma debt and \$1.4 million cash paid for scheduled mortgage debt principal payments.

The following table summarizes our significant financing activities since January 1, 2006:

Transaction Date	Description of Transaction	Amount
January 25, 2006	Draw under senior secured credit facility	11.0 million
January 27, 2006	Payment of fourth quarter dividends	(8.9 million)
February 28, 2006	Draw under senior secured credit facility	5.0 million
March 9, 2006	Draw under senior secured credit facility	5.0 million
March 13, 2006	Draw under senior secured credit facility	3.0 million
March 24, 2006	Repayment of senior secured credit facility	(3.0 million)
March 24, 2006	Proceeds from Wachovia short-term loan	79.5 million
April 4, 2006	Proceeds from our follow on offering	239.2 million
April 5, 2006	Repayment of senior secured credit facility	(33.0 million)
April 5, 2006	Repayment of Wachovia short-term loan	(79.5 million)
April 11, 2006	Payment of first quarter dividends	(9.3 million)
May 9, 2006	Net proceeds from Courtyard Manhattan/Fifth Avenue refinancing	27.3 million
June 22, 2006	Payment of second quarter dividends	(12.8 million)



## Dividend Policy

Generally, we intend to continue to distribute to our stockholders each year on a regular quarterly basis sufficient amounts of 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 and TRS lessees, which are all subject to tax at regular corporate rates) and to qualify for the tax benefits afforded to REITs under the Internal Revenue Code of 1986, as amended (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, 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.

During the first fiscal quarter of 2006, the Company's board of directors declared a cash dividend of \$0.18 per share of our common stock. The dividend was paid on April 11, 2006 to all stockholders of record as of March 24, 2006. During the second fiscal quarter of 2006, the Company's board of directors declared a cash dividend of \$0.18 per share of our common stock. The dividend was paid on June 22, 2006 to all stockholders of record as of June 16, 2006.

## Capital Expenditures

The management 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 and fixtures at the hotel. Contributions to the property improvement fund are calculated as a percentage of hotel sales. 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 agreement. As of June 16, 2006, we had set aside \$24.9 million for capital projects in property improvement funds (\$19.3 million) and lender held restricted cash (\$5.6 million). Funds held in property improvement funds for one hotel are not permitted to be applied to any other property.

We have a number of significant capital projects currently planned or underway and we expect to spend approximately \$89 million on such projects in 2006. A description of the current status of significant capital projects is as follows:

- Bethesda Marriott Suites: We completed all of the planned guest room renovations in the first quarter of 2006.
- Courtyard Manhattan Fifth Avenue: We completed the guestroom and corridor renovation during 2005. The renovation of the lobby and other public spaces was completed in the second quarter of 2006.
- Courtyard Manhattan Midtown East: During the first quarter, we substantially completed the renovation of guestrooms, lobby, restaurant and meeting space.
- Frenchman's Reef & Morning Star Marriott Beach Resort: In 2005, we completed the replacement of case goods in a portion of the guestrooms. We are currently planning several significant projects at the hotel during 2006, including additional replacement of case goods in select rooms and the renovation of guestrooms, restaurants, and certain meeting space. The work is expected to be done in the third and fourth quarter of this year.
- Los Angeles Airport Marriott: In 2005, we completed a renovation of the hotel ballroom, conversion of a food outlet to a junior ballroom and renovation of the hotel bar. Additionally, we are currently completing a complete room renovation, which we have accelerated from 2007 to 2006. The project consists of the renovation of the hotel guestrooms and bathrooms and is being funded, in part, by a \$1.5 million non-recoverable contribution from Marriott International. The renovation is scheduled to be completed by the end of 2006.
- Oak Brook Hills Marriott Resort: We will begin a significant renovation in the fourth quarter of 2006. The renovation will include the hotel guestrooms and bathrooms, the hotel main ballroom and meeting rooms and the hotel lobby.

- Orlando Airport Marriott: We will begin a significant renovation in 2006. The renovation will include the hotel guestrooms and bathrooms, the hotel meeting rooms and the hotel lobby. The renovation is scheduled for the third and fourth quarters of 2006.
- Torrance Marriott: We are currently completing the renovation of the Torrance Marriott. The initial phase of the project consisted of the renovation of the hotel guestroom soft goods and bathrooms and the renovation of the hotel's main ballroom and meeting rooms, which were completed in January 2006. During the third quarter of 2006, renovations will include the hotel lobby and the conversion of a food and beverage outlet to meeting space.
- Vail Marriott: We are currently designing a major renovation of the hotel ballrooms.

#### 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 two non-GAAP financial measures that we believe are useful to investors as key measures of our operating performance: (1) EBITDA and (2) FFO. These measures should not be considered in isolation or as a substitute for measures of performance in accordance with GAAP.

EBITDA represents net income (loss) 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 indebtedness use EBITDA as a measure of financial compliance. We also use EBITDA as one measure in determining the value of hotel acquisitions and dispositions.

	Fiscal Quarter Ended June 16, 2006	Fiscal Quarter Ended June 17, 2005	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005
Net income (loss)	\$ 13,896,680	\$ (5,824,555)	\$ 18,262,694	\$ (11,086,066)
Interest expense	9,324,262	3,630,470	15,131,967	6,484,739
Income tax expense	1,828,790	478,990	1,798,876	558,847
Depreciation and amortization	12,078,225	4,340,984	21,125,333	8,703,130
<b>EBITDA</b>	<b>\$ 37,127,957</b>	<b>\$ 2,625,889</b>	<b>\$ 56,318,870</b>	<b>\$ 4,660,650</b>

We compute FFO in accordance with standards established by the National Association of Real Estate Investment Trusts, which defines FFO as net income (loss) (determined in accordance with GAAP), excluding gains (losses) from sales of property, plus depreciation and amortization and after adjustments for unconsolidated partnerships and joint ventures (which are calculated to reflect FFO on the same basis). We believe that the presentation of FFO provides useful information to investors regarding our operating performance because it is a measure of our operations without regard to specified non-cash items, such as real estate depreciation and amortization and gain or loss on sale of assets. We also use FFO as one measure in determining our results after taking into account the impact of our capital structure.

	Fiscal Quarter Ended June 16, 2006	Fiscal Quarter Ended June 17, 2005	Period from January 1, 2006 to June 16, 2006	Period from January 1, 2005 to June 17, 2005
Net income (loss)	\$ 13,896,680	\$ (5,824,555)	\$ 18,262,694	\$ (11,086,066)
Real estate related depreciation and amortization	12,078,225	4,340,984	21,125,333	8,703,130
<b>FFO</b>	<b>\$ 25,974,905</b>	<b>\$ (1,483,571)</b>	<b>\$ 39,388,027</b>	<b>\$ (2,382,936)</b>

## Critical Accounting Policies

Our consolidated financial statements include the accounts of DiamondRock Hospitality Company and all consolidated subsidiaries. The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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 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 materially from these estimates. We evaluate our estimates and judgments, including those related to the impairment of long-lived assets, on an ongoing basis. We base our estimates on experience and on various other assumptions that are believed to be reasonable under the circumstances. All of our significant accounting policies are disclosed in the notes to our consolidated financial statements. The following represent certain critical accounting policies that require us to exercise our business judgment or make significant estimates:

*Investment in Hotels.* Investments in hotels, land improvements, building and furniture, fixtures and equipment and identifiable intangible assets are recorded at fair value in accordance with Statement of Financial Accounting Standards No. 141, *Business Combinations*. Property and equipment are recorded at fair value based on analyses, including current replacement cost for similar capacity and allocated to buildings, improvements, furniture, fixtures and equipment based on analysis performed by management and appraisals received from independent third parties. Property and equipment are depreciated using the straight-line method over an estimated useful life of 15 to 40 years for buildings and land improvements and one to ten years for furniture and equipment. Identifiable intangible assets are typically related to contracts, including ground lease agreements and hotel management agreements, which are recorded at fair value. Above-market and below-market contract values are based on the present value of the difference between contractual amounts to be paid pursuant to the contracts acquired and our estimate of the fair market contract rates for corresponding contracts. Contracts acquired that are at market do not have significant value. We typically enter into a new hotel management agreement based on market terms at the time of acquisition. Intangible assets are amortized using the straight-line method over the remaining non-cancelable term of the related agreements. In making estimates of fair values for purposes of allocating purchase price, we may utilize a number of sources that may be obtained in connection with the acquisition or financing of a property and other market data. Management also considers information obtained about each property as a result of its pre-acquisition due diligence in estimating the fair value of the tangible and intangible assets acquired.

We review our investments in hotels for impairment whenever events or changes in circumstances indicate that the carrying value of the investments in hotels may not be recoverable. Events or circumstances that may cause us to perform a review include, but are not limited to, adverse changes in the demand for lodging at our properties due to declining national or local economic conditions and/or new hotel construction in markets where our 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 an investment in a hotel exceed the hotel's carrying value. If the estimated undiscounted future cash flows are less than the carrying amount of the asset, an adjustment to reduce the carrying value to the estimated fair market value is recorded and an impairment loss recognized.

*Revenue Recognition.* Hotel revenues, including room, golf, food and beverage, and other hotel revenues, are recognized as the related services are provided.

*Stock-based Compensation.* The Company accounts for stock-based employee compensation using the fair value based method of accounting described in Statement of Financial Accounting Standards No. 123 (revised 2004) ("SFAS 123R"), *Share-Based Payment*. The Company records the cost of awards with service conditions based on the grant-date fair value of the award (with limited exceptions). 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. No awards with performance-based or market-based conditions have been issued.

*Accounting for Key Money.* Marriott has contributed to us certain amounts, which we refer to as key money, in exchange for the right to manage certain of our hotels. We defer key money received from a hotel manager in conjunction with entering into a long-term hotel management agreement and amortize the amount received against management fees over the term of the management agreement.

*Accounting for Yield Support.* Marriott has provided the Company with operating cash flow guarantees for certain hotels to fund shortfalls of actual hotel operating income compared to a negotiated target net operating income. We refer to these guarantees as "Yield Support". Yield Support received is recognized over the period earned if the Yield Support is not refundable and there is reasonable uncertainty of receipt at inception of the management agreement. Yield Support is recorded as an offset to base management fees.

## **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. Historically, we have experienced approximately two-thirds of our annual income in the second and fourth quarters.

## **New Accounting Pronouncements**

FASB Interpretation No.48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* (“FIN 48”). We will adopt the provisions of FIN 48 for fiscal years beginning after December 15, 2006. The Company does not expect FIN 48 to have a material impact on our results of operations, financial position, or cash flows.

## **Item 3. Qualitative Disclosure 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, which we expect to be exposed in the future, is interest rate risk. Our total outstanding debt at June 16, 2006 was approximately \$662.8 million, none of which was variable rate debt. If market rates of interest were to increase by 1.0%, or approximately 100 basis points, the decrease in the fair value of our fixed-rate debt would be \$40.4 million. On the other hand, if market rates of interest were to decrease by one percentage point, or approximately 100 basis points, the increase in the fair value of our fixed-rate debt would be \$40.4 million. As of June 16, 2006, the fair value of the \$662.8 million of fixed-rate debt was approximately \$652.3 million.

## **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 Commissions 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.

**PART II**

**Item 1. Legal Proceedings**

We are not involved in any material litigation nor, to our knowledge, is any material litigation threatened against us other than routine litigation arising out of the ordinary course of business or which is expected to be covered by insurance and none of which is expected to have a material impact on our business, financial condition or results of operations.

**Item 1A. Risk Factors**

There have been no material changes in the risk factors described in Item 1A (“Risk Factors”) of the Company’s Annual Report on Form 10-K for the year ended December 31, 2005.

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

None

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Submission of Matters to a Vote of Security Holders**

- (a) The Company held its Annual Meeting of Stockholders on April 27, 2006. The proposals in front of our stockholders and the results of voting on such proposals were as noted below.
- (b) Election of Directors: the following persons were elected as directors for a one-year term expiring at the Annual Meeting held in 2007.

	VOTES FOR	VOTES WITHHELD
William W. McCarten	38,875,750	1,334,059
John L. Williams	40,167,465	42,344
Daniel Altobello	39,222,394	987,415
W. Robert Grafton	39,509,544	700,265
Maureen L. McAvey	40,182,815	26,994
Gilbert T. Ray	40,137,757	72,052

- (c) Ratification of Independent Auditors: the selection of KPMG LLP as our independent auditors for fiscal year ending December 31, 2006 was ratified. The voting results were as follows:

VOTES FOR	VOTES AGAINST	VOTES ABSTAINED
40,188,348	17,062	4,400

**Item 5. Other Information**

None.

**Item 6. Exhibits**

(a) *Exhibits*

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

<u>Exhibit</u>	
10.1	Purchase and Sale Agreement, dated as of March 1, 2006, among Chicago 540 Hotel, L.L.C., Chicago 540 Lessee, Inc., and DiamondRock Chicago Owner, LLC ( <i>incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 7, 2006</i> )
12.1	Ratio of Earnings to Combined Fixed Charges and Preferred Dividends
31.1	Certification of Chief Executive Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Chief Executive Officer and Chief Financial Officer Required by Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended.

**SIGNATURE**

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.

July 28, 2006

DiamondRock Hospitality Company

/s/ Michael D. Schechter

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Michael D. Schechter  
Executive Vice President,  
General Counsel and Corporate Secretary

## RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS

	Period From January 1, 2006 to June 16, 2006	Period From January 1, 2005 to June 17, 2005
Income (Loss) Before Income Taxes	\$ 20,061,570	\$ (11,086,066)
Fixed Charges	16,746,318	7,392,441
Amortization of Capitalized Interest	19,865	—
Capitalized Interest	(220,772)	—
<b>Earnings</b>	<b>\$ 36,606,981</b>	<b>\$ (3,693,625)</b>
Interest Expense	\$ 15,131,967	\$ 6,484,739
Portion of Rent Related to Interest	1,393,579	907,702
Capitalized Interest	220,772	—
<b>Fixed Charges</b>	<b>16,746,318</b>	<b>7,392,441</b>
Preferred Stock Dividends	—	—
<b>Combined Fixed Charges and Preferred Stock Dividends</b>	<b>\$ 16,746,318</b>	<b>\$ 7,392,441</b>
<b>Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends</b>	<b>2.2x</b>	<b>—</b>
<b>Deficiency</b>	<b>\$ —</b>	<b>\$ 11,086,066</b>



**Certification of Chief Executive Officer**  
**Pursuant to Rule 13a-14(a)**

I, William W. McCarten, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of DiamondRock Hospitality Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July28, 2006

/s/ William W. McCarten

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William W. McCarten  
Chairman of the Board and  
Chief Executive Officer  
(Principal Executive Officer)

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**Certification of Chief Financial Officer**  
**Pursuant to Rule 13a-14(a)**

I, Mark W. Brugger, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of DiamondRock Hospitality Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 28, 2006

/s/ Mark W. Brugger

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Mark W. Brugger  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial Officer)

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**Certification**  
**Pursuant to Rule 13a-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002**  
**(18 U.S.C. Section 1350(a) and (b))**

The undersigned officers, who are the Chief Executive Officer and Chief Financial Officer of DiamondRock Hospitality Company (the "Company"), each hereby certifies to the best of his knowledge, that the Company's Quarterly Report on Form 10-Q (the "Report") to which this certification is attached, as filed with the Securities and Exchange Commission on the date hereof, fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended, and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ William W. McCarten

/s/ Mark W. Brugger

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William W. McCarten  
Chairman of the Board and  
Chief Executive Officer  
July 28, 2006

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Mark W. Brugger  
Executive Vice President,  
Chief Financial Officer and Treasurer  
July 28, 2006

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