HOST HOTELS & RESORTS, INC.
Form 10-Q
October 15, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 5, 2008

OR

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

Commission file number 001-14625

HOST HOTELS & RESORTS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**53-0085950**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**
6903 Rockledge Drive, Suite 1500, Bethesda, Maryland	**20817**
(Address of Principal Executive Offices)	**(Zip Code)**

(240) 744-1000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x 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.

Large Accelerated filer x 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 x No

The registrant had 522,548,757 shares of its $0.01 par value common stock outstanding as of October 10, 2008.

Table of Contents

INDEX

		Page No.
	PART I. FINANCIAL INFORMATION	
Item 1.	Financial Statements:	
	Condensed Consolidated Balance Sheets- September 5, 2008 (unaudited) and December 31, 2007	3
	Condensed Consolidated Statements of Operations (unaudited)- Quarter and Year-to-Date Ended September 5, 2008 and September 7, 2007	4
	Condensed Consolidated Statements of Cash Flows (unaudited)- Year-to-Date Ended September 5, 2008 and September 7, 2007	5
	Notes to Condensed Consolidated Financial Statements (unaudited)	7
Item 2.	Management s Discussion and Analysis of Results of Operations and Financial Condition	13
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	34
Item 4.	Controls and Procedures	34
	PART II. OTHER INFORMATION	
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	35
Item 6.	Exhibits	35

Table of Contents

CONDENSED CONSOLIDATED BALANCE SHEETS

September 5, 2008 and December 31, 2007

(in millions, except shares and per share amounts)

	September 5, 2008 (unaudited)	December 31, 2007
ASSETS		
Property and equipment, net	$ 10,731	$ 10,588
Due from managers	99	106
Investments in affiliates	210	194
Deferred financing costs, net	51	51
Furniture, fixtures and equipment replacement fund	121	122
Other	228	198
Restricted cash	55	65
Cash and cash equivalents	494	488
Total assets	$ 11,989	$ 11,812
LIABILITIES AND STOCKHOLDERS EQUITY		
Debt		
Senior notes, including $1,091 million and $1,088 million, respectively, net of discount, of Exchangeable Senior Debentures	$ 4,117	$ 4,114
Mortgage debt	1,492	1,423
Credit facility, including $210 million of term loan borrowings	210	
Other	87	88
Total debt	5,906	5,625
Accounts payable and accrued expenses	132	315
Other	206	215
Total liabilities	6,244	6,155
Interest of minority partners of Host Hotels & Resorts, L.P. (redemption value of $306 million at September 5, 2008)	223	188
Interest of minority partners of other consolidated partnerships (redemption value of $82 million at September 5, 2008)	26	28
Stockholders equity		
Cumulative redeemable preferred stock (liquidation preference $100 million) 50 million shares authorized; 4.0 million shares issued and outstanding	97	97
Common stock, par value $.01, 750 million shares authorized; 518.9 million shares and 522.6 million shares issued and outstanding, respectively	5	5
Additional paid-in capital	5,638	5,673
Accumulated other comprehensive income	44	45
Deficit	(288)	(379)
Total stockholders equity	5,496	5,441
Total liabilities and stockholders equity	$ 11,989	$ 11,812

See notes to condensed consolidated statements.

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

Quarter and Year-to-Date Ended September 5, 2008 and September 7, 2007

(unaudited, in millions, except per share amounts)

	Quarter ended		Year-to-Date ended	
	September 5, 2008	September 7, 2007	September 5, 2008	September 7, 2007
REVENUES				
Rooms	$ 757	$ 769	$ 2,236	$ 2,216
Food and beverage	311	323	1,085	1,071
Other	78	83	241	242
Total hotel sales	1,146	1,175	3,562	3,529
Rental income	22	22	79	78
Total revenues	1,168	1,197	3,641	3,607
EXPENSES				
Rooms	191	190	547	533
Food and beverage	254	260	798	791
Hotel departmental expenses	313	307	897	870
Management fees	49	55	173	171
Other property-level expenses	91	93	268	268
Depreciation and amortization	133	119	388	352
Corporate and other expenses	14	14	45	51
Gain on insurance settlement		(5)	(7)	(5)
Total operating costs and expenses	1,045	1,033	3,109	3,031
OPERATING PROFIT	123	164	532	576
Interest income	4	9	13	27
Interest expense	(83)	(82)	(240)	(312)
Net gains on property transactions and other		3	2	5
Minority interest expense		(5)	(19)	(21)
Equity in earnings of affiliates	1		3	5
INCOME BEFORE INCOME TAXES	45	89	291	280
Benefit (provision) for income taxes	(4)	4	(11)	(1)
INCOME FROM CONTINUING OPERATIONS	41	93	280	279
Income from discontinued operations	13	4	25	154
NET INCOME	54	97	305	433
Less: Dividends on preferred stock	(2)	(2)	(6)	(6)
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	$ 52	$ 95	$ 299	$ 427
Basic earnings per common share:				
Continuing operations	$ .07	$ .17	$ .52	$ .52
Discontinued operations	.03	.01	.05	.30

Basic earnings per common share	$ .10	$ .18	$ .57	$ .82
Diluted earnings per common share:				
Continuing operations	$ .07	$ .17	$ .52	$ .51
Discontinued operations	.03	.01	.04	.28
Diluted earnings per common share	$ .10	$ .18	$ .56	$ .79

See notes to condensed consolidated statements.

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Year-to-Date Ended September 5, 2008 and September 7, 2007

(unaudited, in millions)

	Year-to-Date ended	
	September 5, 2008	September 7, 2007
OPERATING ACTIVITIES		
Net income	$ 305	$ 433
Adjustments to reconcile to cash provided by operations:		
Discontinued operations:		
Gain on dispositions	(24)	(139)
Depreciation		3
Depreciation and amortization	388	352
Amortization of deferred financing costs	8	10
Deferred income taxes	5	3
Net gains on property transactions	(2)	(5)
Equity in earnings of affiliates	(3)	(5)
Distributions from investments in affiliates	3	3
Minority interest expense	19	21
Change in due from managers	7	(8)
Changes in other assets	(9)	1
Changes in other liabilities	18	(3)
Cash provided by operations	715	666
INVESTING ACTIVITIES		
Proceeds from sales of assets, net	38	335
Acquisitions		(15)
Deposits for acquisitions		(22)
Investments in affiliates	(18)	(12)
Capital expenditures:		
Renewals and replacements	(245)	(161)
Repositionings and other investments	(218)	(206)
Change in furniture, fixtures and equipment (FF&E) reserves	1	(33)
Change in restricted cash designated for FF&E reserves	1	40
Other	(9)	30
Cash used in investing activities	(450)	(44)
FINANCING ACTIVITIES		
Financing costs	(8)	(9)
Debt issuances	510	1,025
Net draws (repayments) on credit facility revolver		(250)
Debt prepayments	(211)	(825)
Scheduled principal repayments	(12)	(29)
Common stock repurchase	(100)	
Dividends on common stock	(417)	(340)
Dividends on preferred stock	(7)	(7)
Distributions to minority interests	(23)	(17)
Change in restricted cash	9	25

Cash used in financing activities	(259)	(427)
INCREASE IN CASH AND CASH EQUIVALENTS	6	195
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	488	364
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 494	$ 559

See notes to condensed consolidated statements.

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Year-to-Date Ended September 5, 2008 and September 7, 2007

(unaudited, in millions)

Supplemental disclosure of cash flow information:

	Year-to-date ended	
	September 5, 2008	September 7, 2007
Interest paid	$ 213	$ 273
Income taxes paid	6	6

Supplemental disclosure of noncash investing and financing activities:

In 2008 and 2007, we issued approximately 2.5 million and 0.4 million shares, respectively, upon the conversion of operating partnership units (OP Units) of Host Hotels & Resorts, L.P. (Host LP) held by minority partners valued at approximately $39 million and $11 million, respectively.

On March 12, 2008, we acquired the remaining limited partnership interests in Pacific Gateway Ltd., a subsidiary partnership of Host LP, which owns the San Diego Marriott Hotel and Marina, and other economic rights formerly held by our partners, including the right to receive 1.7% of the hotel s sales, in exchange for 5,575,540 OP Units. The OP Units were valued at $93 million based on the closing stock price of $16.68 on such date for Host Hotels & Resorts, Inc.

See notes to condensed consolidated statements.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization

Host Hotels & Resorts, Inc., or Host, a Maryland corporation operating through an umbrella partnership structure, is the owner of hotel properties. We operate as a self-managed and self-administered real estate investment trust, or REIT, with our operations conducted solely through an operating partnership, Host Hotels & Resorts, L.P., or the operating partnership, or Host LP, and its subsidiaries. We are the sole general partner of the operating partnership and, as of September 5, 2008, own approximately 96% of the partnership interests of Host LP, which are referred to as OP units.

2. Summary of Significant Accounting Policies

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 included in our Annual Report on Form 10 K for the year ended December 31, 2007.

In our opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly our financial position as of September 5, 2008 and the results of our operations for the quarterly and year-to-date periods ended September 5, 2008 and September 7, 2007 and cash flows for the year-to-date periods ended September 5, 2008 and September 7, 2007. Interim results are not necessarily indicative of full year performance because of the impact of seasonal and short-term variations.

Certain prior year financial statement amounts have been reclassified to conform to the current presentation.

Reporting Periods

The results we report are based on results of our hotels reported to us by our hotel managers. Our hotel managers use different reporting periods. Marriott, the manager of the majority 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 of the year and sixteen or seventeen weeks for the fourth quarter of the year. In contrast, other managers of our hotels, such as Starwood and Hyatt, report results on a monthly basis. For results reported by hotel managers using a monthly reporting period (approximately 41% of our hotels), the month of operation that ends after our fiscal quarter-end is included in our results of operations in the following fiscal quarter. Accordingly, our results of operations include results from hotel managers reporting results on a monthly basis as follows: first quarter (January, February), second quarter (March to May), third quarter (June to August), and fourth quarter (September to December). We elected to adopt the reporting period used by Marriott modified so that our fiscal year always ends on December 31 because we are a REIT. Accordingly, our first three quarters of operations end on the same day as Marriott but our fourth quarter ends on December 31.

Interest of minority partners of Host Hotels & Resorts, L.P.

The percentage of Host LP owned by third parties, presented as interest of minority partners of Host LP in the condensed consolidated balance sheets, was $223 million and $188 million as of September 5, 2008 and December 31, 2007, respectively. We adjust the interest of the minority partners of Host LP each period to maintain a proportional relationship between the book value of equity associated with our common stockholders relative to that of the unitholders of Host LP since OP Units may be exchanged into common stock on a one-for-one basis. Net income is allocated to the minority partners of Host LP based on their weighted average ownership percentage during the period. As of September 5, 2008, approximately $306 million of cash or Host stock, at our option, would be paid to the outside partners of the operating partnership if the partnership were terminated. The $306 million approximate redemption value is equivalent to the 21.4 million OP Units outstanding valued at the September 5, 2008 Host common stock price of $14.32, which we have assumed would be equal to the value provided to outside partners upon liquidation of the operating partnership.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Distributions from investments in affiliates

We classify the distributions from our equity investments in the statement of cash flows based upon an evaluation of the specific facts and circumstances of each distribution to determine its nature. For example, distributions from cash generated by property operations are classified as cash flows from operating activities. However, distributions received as a result of property sales would be classified as cash flows from investing activities.

Application of New Accounting Standards

The FASB recently issued FASB staff position (FSP) APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement) (FSP 14-1). FSP 14-1 specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate on the instrument s issuance date when interest cost is recognized. Our $600 million $2^5/_8$% Exchangeable Senior Debentures (the 2007 Debentures) and our $500 million 3.25% Exchangeable Senior Debentures (the 2004 Debentures) are within the scope of FSP 14-1; therefore, we will be required to record the debt components of the debentures at fair value as of the date of issuance and amortize the discount as an increase to interest expense over the expected life of the debt. The implementation of this standard will result in a decrease to net income and earnings per share for all periods presented; however, there is no effect on our cash interest payments. FSP 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and shall be applied retrospectively to all periods presented. Early adoption of FSP 14-1 is not permitted. We anticipate that as a result of the application of this standard, our annual diluted earnings per common share will decrease by approximately $.03 to $.05 per share. Additionally, we anticipate that the application of this standard will decrease our debt balance as of December 31, 2008 by approximately $89 million, with a corresponding increase to stockholders equity.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. Earnings per Common Share

Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding. Diluted earnings per common share is computed by dividing net income available to common stockholders as adjusted for potentially dilutive securities, by the weighted average number of shares of common stock outstanding plus potentially dilutive securities. Dilutive securities may include shares granted under comprehensive stock plans, preferred OP units held by minority partners and exchangeable debt securities. No effect is shown for securities that are anti-dilutive.

	Quarter ended (in millions, except per share amounts)					
	September 5, 2008			September 7, 2007		
	Income	Shares	Per Share Amount	Income	Shares	Per Share Amount
Net income	$ 54	519.3	$ .10	$ 97	522.3	$ .19
Dividends on preferred stock	(2)			(2)		(.01)
Basic earnings available to common stockholders	52	519.3	.10	95	522.3	.18
Assuming distribution of common shares granted under the comprehensive stock plan, less shares assumed purchased at average market price		.3			.8	
Assuming conversion of minority OP units issuable					1.2	
Assuming conversion of 2004 Exchangeable Senior Debentures				4	29.5	
Diluted earnings available to common stockholders	$ 52	519.6	$ .10	$ 99	553.8	$ .18

	Year-to-Date ended (in millions, except per share amounts)					
	September 5, 2008			September 7, 2007		
	Income	Shares	Per Share Amount	Income	Shares	Per Share Amount
Net income	$ 305	520.8	$ .58	$ 433	522.0	$ .83
Dividends on preferred stock	(6)		(.01)	(6)		(.01)
Basic earnings available to common stockholders	299	520.8	.57	427	522.0	.82
Assuming distribution of common shares granted under the comprehensive stock plan, less shares assumed purchased at average market price		.4			.9	
Assuming conversion of minority OP units issuable					1.2	
Assuming conversion of 2004 Exchangeable Senior Debentures	13	31.2	(.01)	13	29.5	(.03)
Diluted earnings available to common stockholders	$ 312	552.4	$ .56	$ 440	553.6	$ .79

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. Property and Equipment

Property and equipment consists of the following as of:

	September 5, 2008	December 31, 2007
	(in millions)	
Land and land improvements	$ 1,618	$ 1,621
Buildings and leasehold improvements	11,343	10,907
Furniture and equipment	1,653	1,530
Construction in progress	206	230
	14,820	14,288
Less accumulated depreciation and amortization	(4,089)	(3,700)
	$ 10,731	$ 10,588

5. Debt

Credit Facility. On September 19, 2008, we borrowed $200 million under the revolver portion of our credit facility at a rate of LIBOR plus 65 basis points. Currently, we have $400 million of available capacity under the revolver portion of the credit facility.

6. Stockholder s Equity

Dividends. On September 18, 2008, our Board of Directors declared a cash dividend of $0.20 per share on our common stock. The dividend will be paid on October 15, 2008 to stockholders of record as of September 30, 2008.

On September 18, 2008, our Board of Directors declared a cash dividend of $0.5546875 per share on our Class E cumulative redeemable preferred stock. The dividend will be paid on October 15, 2008 to preferred stockholders of record as of September 30, 2008.

Stock Repurchase. The Company s Board of Directors authorized a program to repurchase up to $500 million of common stock and equity related securities. These securities may be purchased in the open market or through private transactions, depending on market conditions. The plan does not obligate the Company to repurchase any specific number or amount of securities and may be suspended at any time at management s discretion. As of September 5, 2008, the Company repurchased 6.5 million shares valued at approximately $100 million, of which 2.1 million shares valued at approximately $27.7 million were purchased in the third quarter. The shares repurchased constitute authorized but unissued shares.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

7. Geographic Information

We consider each one of our hotels to be an operating segment, none of which meets the threshold for a reportable segment. We also allocate resources and assess operating performance based on individual hotels. Our hotels meet the aggregation criteria for financial reporting and, accordingly, we report one business segment, hotel ownership. Our foreign operations consist of four properties located in Canada, two properties located in Chile and one property located in Mexico. There were no intercompany sales between our domestic properties and our foreign properties. The following table presents revenues for each of the geographical areas in which we operate:

	Quarter ended		Year-to-Date ended	
	September 5, 2008	September 7, 2007	September 5, 2008	September 7, 2007
	(in millions)			
United States	$ 1,130	$ 1,161	$ 3,519	$ 3,502
Canada	23	24	81	72
Chile	8	6	22	16
Mexico	7	6	19	17
Total revenue	$ 1,168	$ 1,197	$ 3,641	$ 3,607

8. Comprehensive Income

Other comprehensive income consists of unrealized gains and losses on foreign currency translation adjustments and hedging instruments. During 2008, we have entered into three foreign currency forward purchase contracts totaling 60 million (approximately $88 million) to hedge a portion of the foreign currency exposure resulting from the eventual repatriation of our net investment in the joint venture in Europe. The following table summarizes our three foreign currency forward purchase contracts (in millions):

Transaction Date	Transaction Amount in Euros	Transaction Amount in Dollars	Forward Purchase Date
February 2008	30	$ 43	August 2011
February 2008	15	22	February 2013
May 2008	15	23	May 2014

These derivatives are considered a hedge of the foreign currency exposure of a net investment in a foreign operation, and, in accordance with SFAS 133, are marked-to-market with changes in fair value recorded to accumulated other comprehensive income within the stockholders equity portion of our condensed consolidated balance sheet. We also evaluate counterparty credit risk in the calculation of the fair value of the swaps. Year-to-date, we have recorded an increase in the fair value of the derivative instruments totaling approximately $4 million, which is equal to the fair value as of September 5, 2008 included in accumulated other comprehensive income.

The following table presents comprehensive income for all periods presented:

	Quarter ended		Year-to-Date ended	
	September 5, 2008	September 7, 2007	September 5, 2008	September 7, 2007
	(in millions)			

Net income	$ 54	$ 97	$ 305	$ 433
Other comprehensive income (loss)	(5)	9	(1)	13
Comprehensive income	$ 49	$ 106	$ 304	$ 446

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

9. Dispositions

Dispositions. In 2008, we have disposed of the Sheraton Tampa Suites and Host Airport Hotel Sacramento for a total of approximately $39 million and recorded gains on dispositions of approximately $23 million, net of tax. The following table summarizes the revenues, income before taxes, and the gain on dispositions, net of tax, of the hotels which have been reclassified to discontinued operations in the condensed consolidated statements of operations for the periods presented:

	Quarter ended		Year-to-Date ended	
	September 5, 2008	September 7, 2007	September 5, 2008	September 7, 2007
	(in millions)			
Revenues	$	$ 8	$ 6	$ 40
Income before income taxes		5	2	17
Gain on dispositions, net of tax	13		23	139

Item 2. Management s Discussion and Analysis of Results of Operations and Financial Condition

The following discussion and analysis should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this report. Host Hotels & Resorts, Inc. is a Maryland corporation and operates as a self-managed and self-administered real estate investment trust, or REIT. Host Hotels & Resorts, Inc. owns properties and conducts operations through Host Hotels & Resorts, L.P., a Delaware limited partnership of which Host Hotels & Resorts, Inc. is the sole general partner and in which it holds approximately 96% of the partnership interests as of September 5, 2008. In this report, we use the terms we or our to refer to Host Hotels & Resorts, Inc. and Host Hotels & Resorts, L.P. together, unless the context indicates otherwise. We also use the term Host to specifically refer to Host Hotels & Resorts, Inc. and the terms operating partnership or Host LP to refer to Host Hotels & Resorts, L.P. in cases where it is important to distinguish between Host and Host LP.

Forward-Looking Statements

In this report on Form 10-Q, we make some forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are identified by their use of terms and phrases such as anticipate, believe, could, expect, may, int predict, project, plan, will, estimate and other similar terms and phrases. Forward-looking statements are based on management s current expectations and assumptions and are not guarantees of future performance that involve known and unknown risks, uncertainties and other factors which may cause our actual results to differ materially from those anticipated at the time the forward-looking statements are made. These risks and uncertainties include those risk factors discussed in our Annual Report on Form 10 K for the year ended December 31, 2007 and in other filings with the Securities and Exchange Commission (SEC). Although we believe the expectations reflected in such forward-looking statements are based upon reasonable assumptions, we can give no assurance that we will attain these expectations or that any deviations will not be material. Except as otherwise required by the federal securities laws, we disclaim any obligations or undertaking to publicly release updates to any forward-looking statement contained in this report to conform the statement to actual results or changes in our expectations.

Outlook

As of September 5, 2008, we own 117 hotel properties, which operate primarily in the luxury and upper upscale hotel sectors. For a general overview of our business and a discussion of our reporting periods, see our most recent Annual Report on Form 10-K.

During the quarter, the overall weakness in the U.S. economy, particularly the turmoil in the credit markets, weakness in the housing market, and volatile energy and commodity costs, have resulted in considerable negative pressure on both consumer and business spending. As a result, lodging demand, which is primarily driven by GDP growth, business investment and employment growth, continued to weaken during the third quarter and led to a decline in RevPAR of 2.1% at our comparable hotel properties. We expect the year-over-year declines in RevPAR to continue for the remainder of 2008 and into 2009. We anticipate that lodging demand will not improve, and will likely weaken further, until the current economic trends reverse course, particularly the expected weakness in the overall economy and the lack of liquidity in the credit markets.

Total room nights for our properties decreased in the third quarter for both transient and group business. The decrease in demand in our transient business has been most prominent in the higher-rated corporate, premium and special corporate segments due to the slowdown in business travel as companies have sought to cut costs because of the current economic environment. We expect corporate travel will continue to decline due to the current economic trends. In addition, leisure demand has continued to be soft during the quarter and we expect that leisure travel will further weaken, as this segment continues to be affected by increases in airline ticket prices and declines in airline capacity. For the quarter, group business at our hotels declined as short-term bookings decreased compared to the third quarter of 2007 and attrition rates increased. We anticipate that the declines in our group booking pace and the increase in attrition will likely accelerate in the fourth quarter.

To help mitigate the effect of these trends, our operators are adjusting the business mix of our properties in order to attempt to maximize the average room rate and manage demand during off-peak time periods. Additionally, our

Table of Contents

operators are seeking to manage costs and each of our properties have implemented certain contingency plans, such as matching the level of staffing to the reduced level of occupancy, eliminating discretionary spending, modifying restaurant outlet operation hours and delaying the implementation of brand standards. These efforts to control certain costs were modestly effective in the third quarter in limiting the decline in operating profit.

New supply forecasts for the markets in which we own hotels suggest that supply growth will increase approximately 2% in 2009. However, we believe that the growth in supply will be lower in 2010 and 2011 as new hotel construction will be delayed or cancelled due to the high level of construction materials and financing limitations in the current credit markets.

Due to the combination of economic and lodging industry trends discussed above, we believe that comparable hotel RevPAR will decrease 3% to 5% for the fourth quarter and will range from flat to down 1% for the full year 2008 compared to 2007. For 2009, we believe that the economic forecasts for weak growth in GDP, increasing unemployment and declines in business investment and profits, when combined with the turmoil in the credit markets, will continue to negatively affect both leisure and business travel and, accordingly, decrease lodging demand. Further, as properties adjust to reduced demand by shifting the occupancy mix to lower-rated business, we would expect that average room rates will decline slightly in many markets. We are in the very early stages of our budget process and the complexity and uncertainty of the current economic environment makes it difficult to accurately forecast our operating results. However, based on preliminary discussions with our operators and hotel general managers, as well as a review of booking pace and other hotel-specific and broad economic metrics, we believe comparable hotel RevPAR for 2009 will decline in relation to 2008. Additionally, we believe that our results will be adversely effected by certain operating costs and other expenses, including wages, benefits, real estate taxes and utilities, which are expected to increase at a rate greater than inflation. This, in turn, will likely result in reduced operating profit margins.

Management believes that, despite the negative forecast for operating results for the remainder of 2008 and 2009, we are in a strong financial position. Since 2003, we have taken advantage of historically low interest rates and high access to capital to extend our weighted average maturity, reduce interest costs and improve our financial covenant ratios under our senior notes indenture and credit facility (which include, among others, the allowable amounts of leverage, coverage and fixed charges). As of the end of the third quarter, we had approximately $494 million in cash, and, subsequent to the end of the quarter, we drew $200 million on the revolver portion of our credit facility. We currently have access to an additional $400 million of available capacity under the credit facility. Management believes we have the financial resources necessary to succeed during this period of economic uncertainty, as well as the ability to take advantage of any opportunities should they materialize.

The general economic trends discussed above make it a difficult environment to predict operating results for our hotels for the remainder of 2008 and 2009. Therefore, there can be no assurances that we will not experience further declines in hotel revenues or earnings at our properties for any number of reasons, including, but not limited to, greater than anticipated weakness in the economy and changes in travel patterns.

Application of New Accounting Standards

The FASB recently issued FASB staff position (FSP) APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement) (FSP 14-1). FSP 14-1 specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate on the instrument s issuance date when interest cost is recognized. Our $600 million $2^5/_8$% Exchangeable Senior Debentures (the 2007 Debentures) and our $500 million 3.25% Exchangeable Senior Debentures (the 2004 Debentures) are within the scope of FSP 14-1 and therefore, we will be required to record the debt components of the debentures at fair value as of the date of issuance and amortize the discount as an increase to interest expense over the expected life of the debt. The implementation of this standard will result in a decrease to net income, earnings per share and FFO per diluted share for all periods presented; however, there is no effect on our cash interest payments. FSP 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and shall be applied retrospectively to all periods presented. Early adoption of FSP 14-1 is not permitted. We anticipate that as a result of the application of this standard, our annual diluted earnings per common share and FFO per diluted share will decrease by approximately $.03 to $.05 per share. Additionally, we anticipate that the application of this standard will decrease our debt balance as of December 31, 2008 by approximately $89 million, with a corresponding increase to stockholders equity.

Table of Contents

Recent Events

On September 11, 2008, we announced that our European joint venture entered into an agreement to purchase six hotels, comprising 1,954 rooms, in France, Germany and The Netherlands for approximately 565 million. The purchase price includes the assumption of approximately 434 million of debt at an interest rate under 6%. The acquisition provides the venture with further geographic diversification in prime urban markets with significant barriers to entry. Additionally, these properties will benefit from recent significant capital investment of over 80 million. Upon closing, the European joint venture will be fully funded and invested, owning 17 hotels with nearly 5,500 rooms in eight countries. The purchase is subject to regulatory approvals and other closing conditions and is expected to close late this year.

Table of Contents

Results of Operations

The following table reflects certain line items from our statements of operations and other significant operating statistics (in millions, except operating statistics and percentages):

	Quarter ended		
	September 5, 2008	September 7, 2007	% Increase (Decrease)
Revenues:			
Total hotel sales	$ 1,146	$ 1,175	(2.5)%
Operating costs and expenses:			
Property-level costs (1)	1,031	1,024	0.7
Corporate and other expenses	14	14	
Gain on insurance settlement		5	(100.0)
Operating profit	123	164	(25.0)
Interest expense	83	82	1.2
Minority interest expense		5	(100.0)
Income from discontinued operations	13	4	N/M(4)
Net income	54	97	(44.3)
All hotel operating statistics (2):			
RevPAR	$ 137.75	$ 138.97	(0.9)%
Average room rate	$ 184.53	$ 181.71	1.6%
Average occupancy	74.7%	76.5%	(1.8) pts.
Comparable hotel operating statistics (3):			
RevPAR	$ 140.13	$ 143.15	(2.1)%
Average room rate	$ 187.00	$ 184.54	1.3%
Average occupancy	74.9%	77.5%	(2.6) pts.

	Year-to-Date ended		
	September 5, 2008	September 7, 2007	% Increase (Decrease)
Revenues:			
Total hotel sales	$ 3,562	$ 3,529	0.9%
Operating costs and expenses:			
Property-level costs (1)	3,071	2,985	2.9
Corporate and other expenses	45	51	(11.8)
Gain on insurance settlement	7	5	40.0
Operating profit	532	576	(7.6)
Interest expense	240	312	(23.1)
Minority interest expense	19	21	(9.5)
Income from discontinued operations	25	154	N/M(4)
Net income	305	433	(29.6)
All hotel operating statistics (2):			
RevPAR	$ 144.07	$ 141.81	1.6%
Average room rate	$ 195.80	$ 190.20	2.9%
Average occupancy	73.6%	74.6%	(1.0) pts.
Comparable hotel operating statistics (3):			
RevPAR	$ 146.27	$ 145.46	0.6%
Average room rate	$ 198.30	$ 193.26	2.6%
Average occupancy	73.8%	75.3%	(1.5) pts.

(1) Amount represents total operating costs and expenses per our condensed consolidated statements of operations less corporate expenses and gains on insurance settlement.

Table of Contents

(2) Operating statistics are for all properties as of September 5, 2008 and September 7, 2007 and include the results of operations for hotels we have sold prior to their disposition.
(3) Comparable hotel operating statistics for September 5, 2008 and September 7, 2007 are based on 115 comparable hotels as of September 5, 2008.
(4) N/M=Not Meaningful.

2008 Compared to 2007

Hotel Sales Overview

	Quarter ended September 5, 2008	September 7, 2007	% Increase (Decrease)
	(in millions)		
Revenues:			
Rooms	$ 757	$ 769	(1.6)%
Food and beverage	311	323	(3.7)
Other	78	83	(6.0)
Total hotel sales	$ 1,146	$ 1,175	(2.5)

	Year-to-Date ended September 5, 2008	September 7, 2007	% Increase (Decrease)
	(in millions)		
Revenues:			
Rooms	$ 2,236	$ 2,216	0.9%
Food and beverage	1,085	1,071	1.3
Other	241	242	(0.4)
Total hotel sales	$ 3,562	$ 3,529	0.9

Hotel sales declined 2.5% for the quarter and increased 0.9% for year-to-date 2008, reflecting continued weakness in the lodging industry. Sales for properties sold or classified as held for sale in 2008 or 2007 have been reclassified as discontinued operations. See Discontinued Operations below.

We discuss operating results for our hotels on a comparable basis. Comparable hotels are those properties that we have owned for the entirety of the reporting periods being compared. Comparable hotels do not include the results of properties acquired or sold, or that incurred significant property damage and business interruption or large scale capital improvements during these periods. As of September 5, 2008, 115 of our 117 hotels have been classified as comparable hotels. See Comparable Hotel Operating Statistics for a complete description of our comparable hotels. We discuss our operating results by property type (i.e. urban, suburban, resort/conference or airport), geographic region and mix of business (i.e. transient, group or contract).

For the quarter, comparable hotel sales decreased 3.1% to approximately $1.1 billion. The revenue decline reflects the decrease in comparable RevPAR of 2.1% as a result of a decrease in occupancy of 2.6 percentage points, partially offset by an increase in average room rates of 1.3%. Year-to-date, comparable hotel sales increased 0.6% to approximately $3.5 billion. The revenue growth reflects the increase in comparable RevPAR of 0.6%, as a result of an increase in average room rates of 2.6%, partially offset by a decrease in occupancy of 1.5 percentage points. The year-to-date increase also includes one extra day of results for approximately 41% of our comparable hotels that report results on a monthly basis as 2008 is a leap year.

Food and beverage revenues for our comparable hotels decreased 4.6% for the quarter and increased 0.7% year-to-date. The decrease in the quarter reflects a decline in both banquet and outlet revenues. Other revenues for our comparable hotels, which primarily represent spa, golf, parking, internet connectivity and attrition and cancellation fees, decreased 6.0% for the quarter and 0.8% year-to-date.

Table of Contents

Comparable Hotel Sales by Property Type

The following tables set forth performance information for our comparable hotels by property type as of September 5, 2008 and September 7, 2007:

Comparable Hotels by Property Type (a)

	As of September 5, 2008		Quarter ended September 5, 2008			Quarter ended September 7, 2007			
	No. of Properties	No. of Rooms	Average Room Rate	Average Occupancy Percentages	RevPAR	Average Room Rate	Average Occupancy Percentages	RevPAR	Percent Change in RevPAR
Urban	55	32,989	$ 204.22	78.2%	$ 159.70	$ 197.08	81.0%	$ 159.73	%
Suburban	32	12,311	154.84	70.3	108.84	153.75	71.2	109.48	(0.6)
Resort/ Conference	13	8,082	209.98	67.3	141.32	221.06	72.9	161.26	(12.4)
Airport	15	7,208	132.26	76.4	101.10	132.42	77.6	102.70	(1.6)
All Types	115	60,590	187.00	74.9	140.13	184.54	77.5	143.15	(2.1)

	As of September 5, 2008		Year-to-Date ended September 5, 2008			Year-to-Date ended September 7, 2007			
	No. of Properties	No. of Rooms	Average Room Rate	Average Occupancy Percentages	RevPAR	Average Room Rate	Average Occupancy Percentages	RevPAR	Percent Change in RevPAR
Urban	55	32,989	$ 210.29	75.8%	$ 159.44	$ 202.31	78.0%	$ 157.73	1.1%
Suburban	32	12,311	159.58	67.3	107.43	156.11	68.6	107.04	0.4
Resort/ Conference	13	8,082	256.76	73.8	189.58	258.75	74.1	191.67	(1.1)
Airport	15	7,208	138.69	75.3	104.42	137.20	75.7	103.91	0.5
All Types	115	60,590	198.30	73.8	146.27	193.26	75.3	145.46	0.6

(a) The reporting period for our comparable operating statistics for the year-to-date periods ended September 5, 2008 and September 7, 2007 is from December 29, 2007 to September 5, 2008 and December 30, 2006 to September 7, 2007, respectively. For further discussion, see Reporting Periods in our most recent Annual Report on Form 10-K.

For the third quarter of 2008, our urban hotels performed the best, with flat RevPAR, led by strong growth from our New York, San Francisco and Canadian hotels. RevPAR at our resort/conference properties significantly underperformed in comparison to the overall portfolio primarily due to the under-performance of our Hawaiian properties as a result of decreased airlift to the Hawaiian islands and overall weak demand in this market. RevPAR at our airport and suburban hotels also declined due to the overall decline in lodging demand.

Table of Contents

Comparable Hotel Sales by Geographic Region

The following tables set forth performance information for our comparable hotels by geographic region as of September 5, 2008 and September 7, 2007:

Comparable Hotels by Region (a)

	As of September 5, 2008		Quarter ended September 5, 2008			Quarter ended September 7, 2007			
	No. of Properties	**No. of Rooms**	**Average Room Rate**	**Average Occupancy Percentages**	**RevPAR**	**Average Room Rate**	**Average Occupancy Percentages**	**RevPAR**	**Percent Change in RevPAR**
Pacific	27	15,936	$ 193.33	80.9%	$ 156.43	$ 198.97	82.6%	$ 164.36	(4.8)%
Mid-Atlantic	11	8,684	258.56	81.6	210.89	240.98	85.8	206.70	2.0
North Central	14	6,175	153.73	72.8	111.91	157.40	75.6	119.06	(6.0)
Florida	9	5,676	165.06	67.8	111.95	161.15	68.5	110.46	1.3
DC Metro	13	5,666	175.31	80.0	140.29	175.09	77.5	135.63	3.4
New England	11	5,663	175.51	77.4	135.76	171.34	84.7	145.14	(6.5)
South Central	8	4,358	149.97	62.7	94.09	146.60	65.8	96.53	(2.5)
Mountain	8	3,372	136.63	65.6	89.70	130.13	71.0	92.45	(3.0)
Atlanta	7	2,589	179.13	62.1	111.24	184.37	66.1	121.91	(8.8)
International	7	2,471	171.67	64.7	111.05	155.41	66.6	103.50	7.3
All Regions	115	60,590	187.00	74.9	140.13	184.54	77.5	143.15	(2.1)

	As of September 5, 2008		Year-to-Date ended September 5, 2008			Year-to-Date ended September 7, 2007			
	No. of Properties	**No. of Rooms**	**Average Room Rate**	**Average Occupancy Percentages**	**RevPAR**	**Average Room Rate**	**Average Occupancy Percentages**	**RevPAR**	**Percent Change in RevPAR**
Pacific	27	15,936	$ 201.37	76.9%	$ 154.86	$ 201.57	77.6%	$ 156.33	(0.9)%
Mid-Atlantic	11	8,684	255.14	79.3	202.32	241.03	82.4	198.69	1.8
North Central	14	6,175	150.95	66.6					