WE MUST BE TRAVELERS, TOO.

Clarion

Quality

Comfort

Comfort Suites

Sleep

MainStay Suites

Econo Lodge

RODEWAY

FINANCIAL HIGHLIGHTS

	Years Ended December 31,			Seven Months Ended December 31,	Fiscal Year Ended May 31,
	2000	1999	1998	1997	1997
Company Results (In millions, except per share data)					
Royalty Fees	**$137.7**	$128.7	$115.2	$ 70.3	$ 97.2
Total Recurring Revenues	**167.5**	157.7	143.6	83.8	126.7
Recurring Income from Operations (a)	**95.1**	94.5	80.0	46.4	59.6
Recurring Net Income (a)	**58.4**	57.2	46.7	27.3	34.7
Net Income	**42.4**	57.2	55.3	27.3	34.7
Cash Flow from Operations	**67.6**	72.1	39.0	33.6	45.5
Basic Earnings per Share (b)	**$ 0.80**	$ 1.04	$ 0.94	$ 0.46	$ 0.55
Diluted Earnings per Share (b)	**$ 0.80**	$ 1.03	$ 0.93	$ 0.45	$ 0.55
System Results – Domestic Hotels – Unaudited					
Revenues (estimated in millions)	**$3,423**	$3,256	$3,063	$1,862	$2,678
Franchise Hotels Open	**3,244**	3,123	3,039	2,880	2,781
Franchise Hotels Under Development	**493**	596	866	725	710
Revenue Per Available Room	**$36.72**	$35.33	$34.35	$36.39	$32.52

(a) Recurring income from operations and recurring net income exclude the impact of the equity loss on Friendly Hotels, loss on Sunburst Hospitality note, loss (gain) on sale of investments and restructuring charges.

(b) Note: December 31, 1998 earnings per share includes $0.12 related to the early extinguishment of certain long-term debt obligations.

TO OUR SHAREHOLDERS

WE MUST BE TRAVELERS, TOO.

Charles A. Ledsinger, Jr.
President and Chief Executive Officer

"Choice is organized better for success now, with a new centralized franchise sales effort and enhanced localized services to our franchised hotels through a realignment in our regional operations from five to three Market Areas. Our field people now will focus solely on providing service to franchisees.
These strategic moves enable us to create a new operating plan that will strengthen our core hotel franchising business and give us new avenues for growth in hotel management and development."

As we take our first steps into the new millennium, it is clear what Choice Hotels must do to maintain its role as a global hospitality leader.

We must make every effort to know what travelers need when they enter our franchisees' hotels. We must create marketing and reservations programs that capture their attention and make it easy to use our services.

We must thoroughly understand an increasingly competitive environment.

And, since our customers are both the hotel guests and the franchisees who choose to develop and operate hotels under one of our brands, we must provide the support needed in order to deliver a level of hospitality worthy of our brands.

We must master the road they all travel, so that we become their destination of choice.

We must be travelers, too.

The year 2000 proved pivotal for Choice. We faced – and resolved with significant success – a range of changes and challenges affecting our organization and our industry. We entered the year with great optimism, even while dealing with key issues regarding our capital base. And we exited the year on a much firmer footing, with a greatly enhanced balance sheet, strong cash flow and the benefit of long-term franchise contracts delivering higher royalty rates.

We began 2000 with an outstanding receivable from Sunburst Hospitality and continued negative results from our investment in Friendly Hotels PLC in Europe, which limited our ability to grow our core hotel business more aggressively.

The good news is that we reached agreement with Sunburst on restructuring the outstanding note last fall, which resulted in a cash payment of $102 million in January 2001.

We also realized improvement in the Friendly situation, as that company undertook a comprehensive restructuring to revalue its real estate portfolio, dispose of non-core assets, restructure its banking arrangements and business relationship with Choice, and strengthen its management team.

Overall, we performed reasonably well. In 2000, domestic RevPAR grew 4.4%, royalty revenues increased 7% and our (EBITDA) grew almost 8%. We continued to make substantial progress in improving our brands and delivering more services and technology to our franchisees to help grow the business.

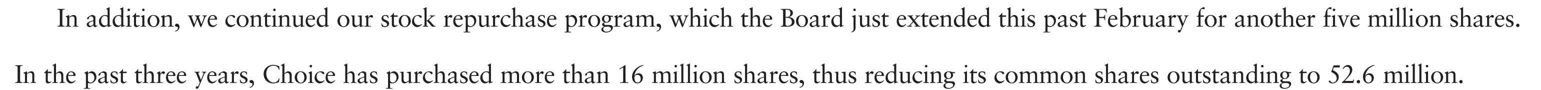
In addition, we continued our stock repurchase program, which the Board just extended this past February for another five million shares. In the past three years, Choice has purchased more than 16 million shares, thus reducing its common shares outstanding to 52.6 million.

Last December, management began a restructuring in our corporate organization that has helped streamline our business and enhance our focus on service to franchisees.

Choice is organized better for success now, with a new centralized franchise sales effort and enhanced localized services to our franchised hotels through a realignment in our regional operations from five to three Market Areas. Our field people now will focus solely on providing service to franchisees.

These strategic moves enable us to create a new operating plan that will strengthen our core hotel franchising business and give us new avenues for growth in hotel management and development.

At the same time, we realigned our North American call center network from five to three locations to reflect the ongoing shift in consumer



practices from toll-free telephone numbers to alternative distribution channels such as the Internet, and the Global Distribution Systems (GDS) run by major airlines and travel agencies. Even so, we continue to deliver an exceedingly strong reservations performance, which assures franchisees and consumers that we can reduce costs in the system without disrupting service.

All this is especially good news for existing and prospective franchisees. It demonstrates a franchise system that continues to deliver solid business to hotels and value-added services at the property level in a cost-efficient manner.

As the worldwide Choice system grows, we have to be mindful to preserve the value of the investment already made by franchisees. Even as we tighten standards, and under-performing hotels leave our brands through termination or attrition, we continue to grow. At year-end 2000, the number of hotels worldwide had grown 3.4% to 4,392 and the number of rooms had reached 350,351.

That's the good news on unit growth, which is fundamental to the success of our business. However, new hotel development has slowed in the past two years. We expect that trend will continue, given a tighter financing environment and uncertainty regarding the future growth in the economy.

As a result, we have embarked on a program to use our strong financial position, in combination with our well-known brands, wide distribution and established infrastructure, to more aggressively drive our core franchising business:

- With our enhanced capital base, we will use selective equity investments to penetrate profitable markets with new partners;
- We will continue to build our brands and increase consumer visibility for them; and,
- We will create new franchisee bases through selective use of capital and aggressive recruitment of partners who value our brands and development expertise.

Last year I told you about our new strategic vision: Unlocking the Power of Choice through Reaching More Consumers, Delivering Exceptional Services and Building Strong Brands.

In each of these three key areas, we made significant progress in 2000. And these three keys will continue to serve as the underlying focus of our operating plan. Looking ahead, we plan to carry out the following:

Reaching More Consumers. Said another way, we have to get more people staying in rooms we already have available. Even as we continue to aggressively grow our system, we must do a much better job of serving the system we already have.

To that end, we are embarking on a brand new marketing campaign, created by our new advertising agency, Arnold Worldwide/Washington. Set to launch in the spring, this exciting new creative voice will help us break through the clutter in the marketplace and provide our brands with a fresh energy that will drive more business to the hotels.

In 2001, we aim to capture a bigger share of business travelers through targeted marketing programs. A key element in this objective is our Guest Privileges frequent traveler program, which recently topped one million members. We will announce enhancements to the program shortly, which will include linkage with major airlines for mileage rewards.

Delivering Exceptional Services – to our franchisees, guests, vendors and associates. At the forefront is our world-class reservations system, which provides a multitude of voice and electronic channels to book reservations. Reservations through our Internet site, choicehotels.com, continue to grow rapidly as do bookings through GDS and alternate distribution systems.

Technology gives us the opportunity to do more in other areas as well. Among the tools that can help us raise the bar on service are:

- ChoiceBuys.com, our proprietary on-line procurement system;
- Profit Manager, our state-of-the-art property management system; and,
- The Learning Center, our central training center at our Silver Spring headquarters for franchisee and associate education.

These tools enhance both the desirability and value of a Choice franchise. Stop and consider the progress made in the past two years in providing more value-added services that in turn provide a richer investment for our franchisees – not only our technology-based initiatives but also new hotel sales support and enhanced training in the field. The effective and timely delivery of these needed services will play a key role in the company's future growth.

Building Strong Brands. Choice has made substantial progress to date to bring better standards and quality to the properties under our brands. But we are not satisfied. We need to do much more to differentiate these brands, which in turn will build more value in franchisees' investments and attract new franchisees.

During the past two years, we conducted extensive consumer and competitive research on how we can improve our brands. This research showed that some brands may benefit from re-imaging – specifically Comfort Suites, Quality and Sleep. After many months of developing new images, testing them with franchisees and consumers, and regional meetings with franchisees across the country, we hope to launch this program this year.

A FEW FINAL THOUGHTS.

2001 is an exciting time for Choice. We seek new opportunities to grow and to provide our 2,100 associates with greater opportunities for reward, guided by a clear strategic vision.

The progress made in 2000 in getting our organization better positioned for success reflects the dedication of our associates to keep improving performance and delivering exceptional services to our franchisees and guests. They deserve our heartfelt thanks, each and every one of them.

I also want to thank our Board of Directors, which continues to be highly supportive of our strategy. This spring, Gerald W. Petitt will be retiring from our Board, after 30 years of service to Choice. Included in that service is his valuable contribution as our president at a time when the company enjoyed some of its greatest growth. Jerry will be missed and we wish him well in his future endeavors.

We are eager to build on our foundation of almost 4,400 franchised hotels open and under development in 43 countries. We look to 2001 as a year of great opportunity.

Our mission is simple: We must be travelers, too.

In a highly competitive business, the company that understands and appreciates what today's traveler desires will succeed. We commit our considerable talent and resources to creating an increasingly value-added experience that will make ***The Power of Choice*** a compelling reality for our franchisees and guests. In the narrative that follows, you will see examples of what we are doing to carry out our vision and our mission.

Charles A. Ledsinger, Jr.
President and Chief Executive Officer
April 15, 2001

Comfort

WE MUST BE TRAVELERS, TOO.

Today's competitive business world makes it imperative that companies in the hospitality arena do more than ever to make travelers welcome and comfortable.

Even with the explosion in electronic communications tools, travel remains an important element in everyone's business and personal lives. Nothing can quite replace face-to-face contact, the renewal of old acquaintances and the forging of new relationships.

That's why Choice's vision, ***The Power of Choice***, holds renewed meaning in 2001. More than ever, we have to Reach More Consumers, Deliver Exceptional Services and Build Strong Brands.

And in order to be successful, we must work with development partners who share our vision of the business and our passion for success. Whatever road our travelers take to reach us, we must be ready to greet and serve them.

Let's look at three examples of what we mean.

REACHING MORE CONSUMERS.

Jeffrey Saunders
President and CEO of Saunders Hotel Group

"With the latest in-room technology, a wealth of guest services and a perfect location, we worked with Choice to create a model for progressive, innovative upper mid-market hospitality."

Choice enters 2001 with a new marketing campaign, aimed at improving the mix of business travelers while preserving our share of the leisure travel market.

"We are taking a new approach, with the help of a new advertising agency, to create breakthrough advertising and marketing to drive more business to our hotels," said Wayne W. Wielgus, senior vice president, marketing. "When we introduce the new advertising, it will make a strong impact in connecting more with the customer and his or her needs. We will make it clear that Choice offers the right hotel choice for the right occasion."

At the same time, the company is opening new properties with greater appeal to both business and leisure travelers in highly desired locations. For travelers to Boston and New England, the Comfort Inn & Suites Boston Airport hotel in Revere, Massachusetts, represents an oasis in what has been a travel desert.

"We recognized an opportunity to build a new kind of airport hotel," said Jeffrey Saunders, president and chief executive officer of the Saunders Hotel Group. "With the latest in-room technology, a wealth of guest services and a perfect location, we worked with Choice to create a model for progressive, innovative upper mid-market hospitality near one of the nation's busiest airports."

Just three miles from Logan Airport, the 208-room hotel features a spacious lobby and breakfast area, an indoor pool and a full-service restaurant on site. Among the property's innovations is an environmental program that encourages guests to reuse linens and towels and incorporates energy-efficient windows throughout the building. An ozone laundry system cuts detergent and chemical costs and guests ride natural gas-powered vans to and from the airport.

A long-time fixture on the Boston hotel scene, Saunders opted for its first franchised brand with Comfort, seeking the name recognition that would attract travelers. For Choice, having the location near a major international airport was a coup.

"We had been looking at that market for years, and finally found the right partner in the Saunders Hotel Group," said Brendan Ebbs, senior vice president, franchise operations. "Their reputation and the excellence represented in their Boston properties, the Copley Square and Lenox Hotels, represent exactly the type of developer/management group we want."

Well-sited hotels with contemporary programs that guests embrace – a key element in Reaching More Consumers.

DELIVERING EXCEPTIONAL SERVICES.

Choice associates focus on delivering exceptional services to two key constituencies: our franchisees and the guests who stay in their hotels.

A critical component in providing top service is making use of the best technology to bring greater efficiency to hotel operations, thus freeing staff to attend more personally to individual guest needs.

One of the system's newer hotels embodies this approach both in its concept and design. Hersha Development Corporation, a leading development firm with more than 30 hotels, opened a unique twin-branded property in the fall of 2000 – a hotel that combines 89 MainStay Suites units and 79 Sleep Inn units under one roof in two distinct wings.

Located in King of Prussia, Pennsylvania, outside of Philadelphia, the new hotel features the distinctive kiosk used by MainStay Suites hotels to check guests in and out electronically. Front desk operations are powered by Profit Manager, Choice's proprietary property management system that helps owners improve yield management and create guest profiles to facilitate individualized service.

"By providing two distinct room styles under one roof, we can serve multiple markets for travelers, including extended-stay," said Jay Shah, Hersha's managing director. "This hotel marks the first one for Choice to house two brands in one building, a concept that offers guests the best in service. That's in keeping with Hersha's approach to our hotels."

For an Asian-American family like the Shahs , the concept of service is deeply ingrained in their company's operations. Hasu, the family patriarch and company founder, has instilled the importance of service and spirituality in his two sons, Jay and Neil, who play critical roles in Hersha. In a recent magazine interview, Jay noted, "There's a bit of God in every person, and to serve anyone is a form of serving God."

Service-oriented properties that target and meet guests' needs through optimum design and technology – a key to Delivering Exceptional Services.

Quality
Inn & Suites

BUILDING STRONG BRANDS.

At the core of Choice's business are its brands. Ranging from the oldest, Quality, to the newest, MainStay Suites, these brands are familiar icons for travelers throughout the world in more than 40 countries.

In recognition of changing travel needs and the desire to outpace the competition, Choice conducted a thorough brand review to determine what actions might be taken for brand improvement.

"We determined that some of our brands could benefit from a fresh image, others from specific amenity initiatives, still others from the introduction of new prototypes for new construction," said Steven T. Schultz, executive vice president, domestic hotels. "We're taking whatever steps are needed to keep our brands fresh, competitive and in tune with travelers' needs."

Against a backdrop of extensive consumer research, Choice is moving ahead with a major re-imaging program for three brands: Quality, Comfort Suites and Sleep Inn. Each will feature a distinctive new look that will help the brand attract new guests while keeping its loyal customers intact.

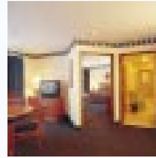
For Quality, the re-imaging comes on the heels of the brand's 60th anniversary and in conjunction with new brand initiatives that include a new prototype Quality Inn & Suites hotel and a new free hot breakfast program, Quality Beginnings, developed in collaboration with Kraft Foods.

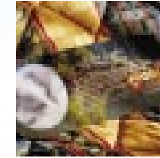
The Quality Inn & Suites in Fitchburg, Wisconsin, just south of Madison, is the first of the new prototype to open. Owned by KNK Hatchery Hill Hotel L.L.C. of Cambridge, Wisconsin, the 75-room property is also one of the first Quality properties to introduce the new breakfast.

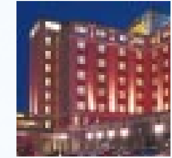
"We believe there is a real competitive advantage to entering the mid-priced market with a free hot breakfast," said Pete Jordan, vice president, core brands. "By partnering with Kraft Foods, we can provide our franchisees with a cost-effective, efficient way to serve a hot breakfast that guests will appreciate and value."

He added, "We've found a great deal of interest in our brand from developers, given the steps we've taken to reinvigorate its image, enhance the brand concept with a new prototype and attract guests with programs like Quality Beginnings."

Innovative design and amenity initiatives – a principal foundation block for Building Strong Brands.





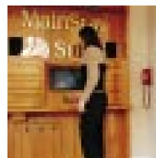


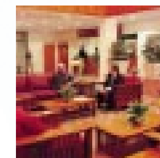
WE MUST BE TRAVELERS, TOO.

These brief examples are indicative of how Choice is moving forward with its vision, creating more value for franchisees and guests through innovation and technology.

But in the end, we recognize that the lodging business will always remain a people business. Guest satisfaction will ultimately determine success. That is why we must be travelers, too.

We must always remember the inherent value of the lodging experience, what makes guests happy, what occasions bring them together, be it business or pleasure. Working with our franchisee partners, we will strive to create more value-added services that will make ***The Power of Choice*** a compelling reason for travelers to stay with us.





Quality
Inn & Suites
Sleep Inn
MainStay Suites

CHOICE'S INTERNATIONAL DIVISION

Choice's International division accounts for approximately 25% of the hotels in the company's worldwide system. Choice added 98 hotels to its international portfolio in 2000, with the largest increase coming in Europe. Choice Hotels Europe increased its system by 44 properties while Choice Hotels Scandinavia added 19 hotels, including 10 in Denmark.

In Asia, Choice completed an agreement with K.K. Nippon Choice in Japan to open more than 40 hotels under the Clarion, Quality and Comfort brands within four years. The first Sleep Inn hotel in Japan opened in Fukuyama in a separate venture.

2000 INN OF THE YEAR

Comfort Hotel St. Albans, St. Albans, Great Britain

2000 HIGHLIGHTS

Choice opened its first hotel in mainland China, a 352-room Clarion Hotel in Guanghou.

In other country debuts, Choice opened two Comfort hotels and one Quality hotel in Egypt, as well as a Comfort hotel in San Salvador, El Salvador.

Choice Hotels Canada was named the Hotel Chain of the Year for the fifth consecutive year by the North West Commercial Travelers Association.

Open:	1,136 hotels,	84,239 rooms
Under Development:	209 hotels,	21,239 rooms
Total:	1,345 hotels,	105,478 rooms

2000 INN OF THE YEAR

Quality Inn Merry Acres, Albany, Georgia

QUALITY

The Quality brand offers an established mid-priced lodging product with rooms designed for both business and leisure travelers. The Quality Sleeper by Serta mattress, a signature item, gives travelers added value and comfort.

2000 HIGHLIGHTS

Introduced Quality Beginnings, a buffet-style breakfast that includes hot foods including eggs, breakfast meats, pancakes and waffles.

Celebrated its 60th anniversary with a productive $60 rate promotion.

Exceeded development expectations, and 50 percent of new executed contracts were for new construction.

Open:	436 hotels,	49,191 rooms
Under Development:	73 hotels,	6,994 rooms
Total:	509 hotels,	56,185 rooms

ECONO LODGE

The Econo Lodge brand is one of the best-known names in its category, offering clean, affordable lodging for travelers. Econo Lodge, which offers a clean room guarantee, is the first brand to have housekeepers pass a certification process through Proctor & Gamble's Mr. Clean.

2000 HIGHLIGHTS

In partnership with Coca-Cola, sponsored the Econo Lodge 200, a NASCAR Busch Series race broadcast live to a national audience on ESPN.

Launched the Discover Card Rambling Rewards offering a room upgrade and double, triple or quadruple Discover Card Cashback Bonus award points.

Rolled-out a new Econo Lodge prototype hotel.

Open:	684 hotels,	42,611 rooms
Under Development:	43 hotels,	3,108 rooms
Total:	727 hotels,	45,719 rooms

2000 INN OF THE YEAR

Econolodge, O'Fallon, Illinois

2000 INN OF THE YEAR

▲ *Sleep Inn Merry Acres, Albany, Georgia*

SLEEP

The Sleep brand offers consistent quality with an all-new construction, mid-priced hotel featuring a clean, fresh, contemporary design. Recently rated among the best hotels for satisfaction, service and value by D.K. Shifflet & Associates, the brand offers a complimentary continental breakfast and affordable rates backed by a 100 percent satisfaction guarantee.

2000 HIGHLIGHTS

Set record for executed contracts in the fourth quarter with an increase of 375 percent versus the same period in 1999.

Opened the 250th Sleep Inn in Henderson, N.C.

Open:	261 hotels,	20,158 rooms
Under Development:	114 hotels,	8,393 rooms
Total:	375 hotels,	28,551 rooms

MAINSTAY SUITES

The MainStay Suites brand is Choice's newest lodging concept: the industry's first franchised, mid-market extended-stay hotel with advanced technological design and residential amenities designed to serve professionals on extended assignments or relocation. All 100 percent satisfaction guaranteed.

2000 HIGHLIGHTS

Opened the Industry's first "dual-branded" hotel concept with Sleep Inn with Mainstay Suites as the anchor brand in King of Prussia, Pa.

Launched the New Generation II Mainstay Suites prototype designed to be easier and more economical to construct. The first Generation II Mainstay Suites Hotel opened in Lancaster, Pa.

Open:	34 hotels,	3,099 rooms
Under Development:	26 hotels,	2,044 rooms
Total:	60 hotels,	5,143 rooms

2000 INN OF THE YEAR

▲ *MainStay Suites, Cincinnati, Ohio*

COMFORT SUITES

Comfort Suites hotels offer affordable rates, exceptional suites and amenities such as compact refrigerators, microwaves and oversized baths and a free deluxe breakfast, all 100 percent guaranteed.

2000 HIGHLIGHTS

Added 53 new hotels in 2000, growing the system by 24%.

Announced the reimaging of the Comfort Suites brand to create a more distinctive idenitity for the growing brand.

Open:	277 hotels,	21,773 rooms
Under Development:	101 hotels,	8,002 rooms
Total:	378 hotels,	29,775 rooms

2000 INN OF THE YEAR

Comfort Suites River Front Park, New Bern, North Carolina

COMFORT INN

The Comfort Inn brand is a leading limited service hotel chain offering highly competitive rates, free deluxe continental breakfast and exceptional rooms and amenities, all backed by a 100 percent satisfaction guarantee.

2000 HIGHLIGHTS

Successful summer promotion, in conjunction with the release of Pokemon The Movie 2000, offered a Pokemon activity book to summer vacation travelers.

Launched the “Frank and Bride” television commercial, which was seen nationally on network and cable television stations.

Open:	1,291 hotels,	100,998 rooms
Under Development:	110 hotels,	8,260 rooms
Total:	1,401 hotels,	109,258 rooms

2000 INN OF THE YEAR

Comfort Inn, Laurinburg, North Carolina

2000 INN OF THE YEAR

▲ *Clarion Inn Willow River, Sevierville, Tennessee*

CLARION

The Clarion brand features upscale full-service hotels that provide outstanding value to both business and leisure travelers, as well as superior service and a 100 percent satisfaction guarantee.

2000 HIGHLIGHTS

The Clarion brand's overall revenue per available room, or RevPAR, outpaced its competitive set in 2000.

The 352-room Clarion Hotel Guangzhou became the first Choice brand hotel to open in China.

Open:	114 hotels,	18,537 rooms
Under Development:	10 hotels,	1,694 rooms
Total:	124 hotels,	20,231 rooms

RODEWAY INN

The Rodeway Inn brand offers economy hotels with national consumer exposure specializing in meeting the needs of the senior travel markets across the country.

2000 HIGHLIGHTS

Outpaced its competitive set in revenue per available room, or RevPAR, which increased by 1.6 percent.

Became a partner in the American Automobile Association's "Show Your Card and Save" program.

Open:	147 hotels,	9,605 rooms
Under Development:	16 hotels,	1,044 rooms
Total:	163 hotels,	10,649 rooms

2000 INN OF THE YEAR

▲ *Rodeway Inn & Suites, Leavenworth, Washington*

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The Company is one of the largest hotel franchisors in the world with 4,392 hotels open and 703 hotels under development as of December 31, 2000, representing 350,351 rooms open and 60,927 rooms under development in 43 countries. The Company franchises hotels under the Comfort, Quality, Econo Lodge, Sleep Inn, Clarion, Rodeway Inn and MainStay Suites brand names. The Company operates in all 50 states and the District of Columbia and 37 additional countries with 97% of its franchising revenue derived from hotels franchised in the United States.

The principal factors that affect the Company's results are: growth in the number of hotels under franchise; occupancies and room rates achieved by the hotels under franchise; the effective royalty rate achieved; the number and relative mix of franchised hotels; and the Company's ability to manage costs. The number of rooms at franchised properties and occupancies and room rates at those properties significantly affect the Company's results because franchise royalty fees are based upon room revenues at franchised hotels. The key industry standard for measuring hotel operating performance is revenue per available room (RevPAR), which is calculated by multiplying the percentage of occupied rooms by the average daily room rate realized. The variable overhead costs associated with franchise system growth are substantially less than incremental royalty fees generated from new franchisees; therefore, the Company is able to capture a significant portion of those royalty fees as operating income.

Comparison of Calendar Year 2000 Operating Results and Calendar Year 1999 Operating Results

The Company recorded net income of $42.4 million for the year ended December 31, 2000, a decrease of $14.8 million, compared to net income of $57.2 million for the year ended December 31, 1999. Operating income of $92.4 million in 2000 was $1.8 million under 1999 operating income of $94.2 million due to a restructuring charge of $5.6 million in 2000. A corporate-wide reorganization was implemented in 2000 to provide a more consistent service to franchisees, establish a centralized sales focus and create a more competitive overhead structure. Net income was further adversely affected in 2000 by a $7.4 million (net of taxes) equity loss in Friendly Hotels plc ("Friendly") and a $4.6 million (net of taxes) loss on the subordinated term note (the "Note") from Sunburst Hospitality Corporation ("Sunburst"). The Friendly equity loss was due to a comprehensive restructuring program at Friendly to strengthen its balance sheet and improve its operations. The Sunburst loss was attributed to two early payment transactions as the Company moved to monetize the note receivable.

Summarized financial results for the years ended December 31, 2000 and 1999 are as follows:

(In thousands)	2000	1999
REVENUES:		
Royalty fees	**$137,721**	$128,653
Initial franchise and relicensing fees	**12,154**	13,910
Partner services revenue	**10,300**	9,055
Other revenue	**7,299**	6,111
Product sales	**—**	3,871
Total revenues	**167,474**	**161,600**
OPERATING EXPENSES:		
Selling, general and administrative	**57,787**	55,860
Restructuring charges	**5,637**	—
Depreciation and amortization	**11,623**	7,687
Product cost of sales	**—**	3,883
Total operating expenses	**75,047**	**67,430**
Operating income	**92,427**	94,170
Interest expense	**18,490**	16,398
Interest and dividend income	**(15,534)**	(17,147)
Equity loss on Friendly Hotels	**12,071**	380
Loss on Sunburst Hospitality note	**7,565**	—
Other	**253**	68
Income before income taxes	**69,582**	94,471
Income taxes	**27,137**	37,316
Net income	**$ 42,445**	**$ 57,155**

Franchise Revenues: Management analyzes its business based on net franchise revenue, which is total revenue excluding product sales, and franchise operating expenses which are reflected as selling, general and administrative expenses.

Net franchise revenues were $167.5 million for 2000 and $157.7 million for 1999. Royalties increased $9.0 million to $137.7 million from $128.7 million in 1999, an increase of 7.0%. The increase in royalties is attributable to a 3.2% increase in the number of domestic franchised hotel rooms, an increase in the effective royalty rate of the domestic hotel system to 3.85% from 3.7%, and an improvement in domestic RevPAR of 4.4%. Domestic initial fee revenue generated from franchise contracts signed was $6.4 million down from $9.6 million in 1999. In 2000, ninety-eight franchise agreements were entered into which included future potential rebates and/or incentive payments. Initial franchise fees of $3.3 millon were deferred and will be recognized when the incentive criteria are met or the deal is terminated, whichever occurs first. Total franchise agreements signed in 2000 were 298, a decline from 318 total agreements executed in 1999. Despite the continued competitive hotel franchising environment, the Company believes that its refocused, centralized sales group will complete approximately 300 new franchise agreements in 2001. Revenues generated from partner service relationships increased to $10.3 million from $9.1 million in 1999. Under the partner services program, the Company generates revenue from hotel industry vendors (who have been designated as preferred providers) based on the level of goods or services purchased from the vendors by hotel owners and hotel guests who stay in the Company's franchised hotels.

The number of domestic rooms on-line increased to 265,962 from 258,120, an increase of 3.0% for the year ended December 31, 2000. For 2000, the total number of domestic hotels on-line grew 3.9% to 3,244 from 3,123 for 1999. The total number of international hotels on-line increased to 1,148 from 1,125, an increase of 2.0% for the year ended December 31, 2000. International rooms on-line increased to 84,389 as of December 31, 2000 from 80,134, an increase of 5.3%. As of December 31, 2000, the Company had 493 franchised hotels with 39,539 rooms either in design or under construction in its domestic system. The Company had an additional 210 franchised hotels with 21,388 rooms under development in its international system as of December 31, 2000.

Franchise Expenses: The cost to operate the franchising business is reflected in selling, general and administrative expenses. Selling, general and administrative expenses were $57.8 million for 2000, an increase of $1.9 million from the 1999 total of $55.9 million. As a percentage of net franchise revenues, selling, general and administrative expenses

declined to 34.5% in 2000 from 35.4% in 1999. The improvement in the franchising margins relates to the economies of scale generated from operating a larger franchisee base and improvements in franchised hotel performance.

Marketing and Reservations: The Company's franchise agreements require the payment of franchise fees which include marketing and reservation fees. These fees, which are based on a percentage of the franchisees' gross room revenues, are used exclusively by the Company's marketing and reservation funds for expenses associated with providing such franchise services as central reservation and yield management systems, national marketing and media advertising. The Company is contractually obligated to expend the marketing and reservation fees it collects from franchisees in accordance with the franchise agreements; as such, no income or loss to the Company is generated.

The total marketing and reservation fees received by the Company were $162.4 million and $146.0 million for the years ended December 31, 2000 and 1999, respectively. Depreciation and amortization incurred by the marketing and reservation funds was $10.5 million and $9.6 million for the years ended December 31, 2000 and 1999, respectively. Interest expense incurred by the reservation fund was $4.8 million and $3.3 million for the years ended December 31, 2000 and 1999, respectively. Reservation fees and marketing fees not expended in the current year are carried over to the next fiscal year and expended in accordance with the franchise agreements. Shortfall amounts are similarly recovered in subsequent years. Excess or shortfall amounts from the operation of these programs are recorded as a payable or receivable from the particular fund. Under the terms of the franchise agreements, the Company may advance capital as necessary to the marketing and reservation funds and recover such advances through future fees. As of December 31, 2000, the Company's balance sheet includes a receivable of $57.8 million related to advances made to the marketing ($24.9 million) and reservation ($32.9 million) funds. As of December 31, 1999, the Company's balance sheet includes a receivable of $32.8 million related to advances made to the marketing ($12.5 million) and reservation ($20.3 million) funds. The Company has the ability under existing franchise agreements and expects to recover these advances through future marketing and reservation fees.

Product Sales: In the fourth quarter of 1998, the Company discontinued its group purchasing program as previously operated. The group purchasing program utilized bulk purchases to obtain favorable pricing from third party vendors for franchisees ordering similar products. The Company acted as a clearinghouse between the franchisee and the vendor, and orders were shipped directly to the franchisee. Sales made to franchisees through the Company's group purchasing program were $3.9 million in 1999, with product cost of sales of $3.9 million.

Depreciation and Amortization: Depreciation and amortization increased to $11.6 million in 2000 from $7.7 million in 1999. This increase was primarily attributable to new computer systems installations and corporate office renovations.

Other: Interest expense of $18.5 million in 2000 is up $2.1 million from $16.4 million in 1999 due to higher interest rates. Included in 2000 and 1999 results is approximately $15.2 million and $14.2 million, respectively, of interest income earned on the note receivable from Sunburst. During 1999, the Company recorded $2.1 million in dividend income from Friendly. The Company's investment in Friendly resulted in a $12.1 million equity loss in 2000 associated with Friendly's comprehensive restructuring program. The Company recognized a $7.6 million loss in 2000 associated with the monetization of $137.5 million of the Sunburst note.

Comparison of Calendar Year 1999 Operating Results and Calendar Year 1998 Operating Results

The Company recorded net income of $57.2 million for the year ended December 31, 1999, an increase of $1.9 million, compared to net income of $55.3 million for the year ended December 31, 1998. Net income in 1998 included a $7.2 million extraordinary gain from the early extinguishment of debt. The increase in net income for 1999 was primarily attributable to an increase in the effective royalty rates achieved, an increase in franchise revenue as a direct result of improvements in the operating performance of hotels, and the addition of new franchisees to the system. Lower net interest costs versus 1998 also contributed favorably to the 1999 results.

Summarized financial results for the years ended December 31, 1999 and 1998 are as follows:

(In thousands)	1999	1998
REVENUES:		
Royalty fees	$128,653	$115,171
Initial franchise and relicensing fees	13,910	16,571
Partner services revenue	9,055	6,370
Other revenue	6,111	5,516
Product sales	3,871	20,748
European hotel operations	—	1,098
Total revenues	161,600	165,474
OPERATING EXPENSES:		
Selling, general and administrative	55,860	52,948
Depreciation and amortization	7,687	6,710
Product cost of sales	3,883	19,532
European hotel operations	—	1,133
Total operating expenses	67,430	80,323
Operating income	94,170	85,151
Interest expense	16,398	17,757
Interest and dividend income	(17,147)	(12,636)
Equity loss on Friendly Hotels	380	—
Loss (gain) on sale of investments	68	(2,370)
Income before income taxes and extraordinary item	94,471	82,400
Income taxes	37,316	34,327
Net income before extraordinary item	57,155	48,073
Gain on early extinguishment of debt, net of $4,732 of income taxes	—	7,232
Net income	$ 57,155	$ 55,305

Franchise Revenues: Net franchise revenues were $157.7 million for 1999 and $143.6 million for 1998. Royalties increased $13.5 million to $128.7 million from $115.2 million in 1998, an increase of 11.7 %. The increase in royalties is attributable to a 2.3% increase in the number of domestic franchised hotel rooms, an increase in the effective royalty rate of the domestic hotel system to 3.7% from 3.6%, and an improvement in domestic RevPAR of 3.0%. Domestic initial fee revenue generated from franchise contracts signed was $10.1 million down from $13.1 million in 1998. Total franchise agreements signed in 1999 were 318, a decline from the 440 total agreements executed in 1998. An increasingly competitive hotel franchising environment, coupled with stricter hotel brand standards being enforced by the Company, contributed to the decline in the total franchise agreements signed in the period. Revenues generated from partner service relationships increased to $9.1 million from $6.4 million in 1998.

The number of domestic rooms on-line increased to 258,120 from 252,357, an increase of 2.3% for the year ended December 31, 1999. For 1999, the total number of domestic hotels on-line grew 2.8% to 3,123 from 3,039 for 1998. The total number of international hotels on-line increased to 1,125 from 632, an increase of 78.0% for the year ended December 31, 1999. International rooms on-line increased to 80,134 as of December 31, 1999 from 53,095, an increase of 50.9%. As of December 31, 1999, the Company had 596 franchised hotels with 46,664 rooms either in design or under construction in its domestic system. The Company had an additional 165 franchised hotels with 17,431 rooms under development in its international system as of December 31, 1999.

Franchise Expenses: Selling, general and administrative expenses were $55.9 million for 1999, an increase of $3.0 million from the 1998 total of $52.9 million. As a percentage of net franchise revenues, selling, general and administrative expenses declined to

35.4% in 1999 from 36.8% in 1998. The improvement in the franchising margins relates to the economies of scale generated from operating a larger franchisee base and improvements in franchised hotel performance.

Marketing and Reservations: The total marketing and reservation fees received by the Company were $146.0 million and $127.4 million for the years ended December 31, 1999 and 1998, respectively. Depreciation and amortization incurred by the marketing and reservation funds was $9.6 million and $6.2 million for the years ended December 31, 1999 and 1998, respectively. Interest expense incurred by the reservation fund was $3.3 million and $1.8 million for the years ended December 31, 1999 and 1998, respectively. As of December 31, 1999, the Company's balance sheet includes a receivable of $32.8 million related to advances made to the marketing ($12.5 million) and reservation ($20.3 million) funds. As of December 31, 1998, the Company's balance sheet includes a receivable of $18.7 million related to advances made to the marketing ($7.8 million) and reservation ($10.9 million) funds.

Product Sales: Sales made to franchisees through the Company's group purchasing program declined $16.8 million to $3.9 million in 1999 from $20.7 million in 1998. Similarly, product cost of sales decreased $15.6 million to $3.9 million from 1998. In the fourth quarter of 1998, the Company discontinued this group purchasing program as previously operated.

European Hotel Operations: In January 1998, Friendly acquired from the Company ten hotels in France, two in Germany and one in the United Kingdom, in exchange for $22.2 million in 5.75% convertible preferred shares in Friendly.

Depreciation and Amortization: Depreciation and amortization increased to $7.7 million in 1999 from $6.7 million in 1998. This increase was primarily attributable to new computer systems installations and corporate office renovations.

Interest Expense and Interest Income: Interest expense of $16.4 million in 1999 is down slightly from $17.8 million in 1998. Included in 1999 and 1998 results is approximately $14.2 million and $10.4 million, respectively, of interest income earned on the note receivable from Sunburst. The Company's investment in Friendly resulted in $2.2 million and $2.1 million in dividend income in 1999 and 1998, respectively.

Extraordinary Item: During 1998, the Company recorded an extraordinary gain from the early extinguishment of debt. The Company retired $13.7 million in debt and removed related assets of $1.8 million from the consolidated balance sheets. The extraordinary gain was $7.2 million, after income tax expense of $4.7 million, or $0.12 per diluted share.

Liquidity and Capital Resources

Net cash provided by operating activities was $67.6 million for the year ended December 31, 2000, a decrease of $2.4 million from $70.0 million for the year ended December 31, 1999. The reduction in cash provided was primarily due to changes in working capital.

Cash used in investing activities for the years ended December 31, 2000, 1999 and 1998, was $30.4 million, $40.9 million and $9.1 million, respectively. Investment in property and equipment includes installation of system-wide property and yield management systems and upgrades to financial and reservations systems. During the years ended December 31, 2000, 1999 and 1998, capital expenditures totaled $16.6 million, $30.6 million and $17.5 million, respectively. Capital expenditures in prior years included amounts for renovations to the Company's corporate headquarters (including a franchisee learning and training center); computer hardware; and financial,

reservation, and property and yield management systems.

The Company made net cash advances to the marketing and reservation funds totaling $14.5 million in 2000. The advances are associated with a system-wide property and yield management systems implementation, the timing of expenditures associated with specific brand initiatives of the marketing fund and the recognition of costs and the timing of payments received from franchisees in conjunction with the Company's frequency stay program. The Company has the ability under existing franchise agreements and expects to recover these advances through future marketing and reservation fees. The Company expects the marketing and reservation funds to generate positive cash flows of approximately $10 million in 2001 due to cost reductions associated with restructured operations, programmed brand initiatives, growth in fees from normal operations and increases in property and yield management fees.

On September 1, 2000, Sunburst transferred title to three MainStay properties under a put/call agreement entered into between the Company and Sunburst in March 2000. These properties were received by the Company as consideration for $16.3 million of the then $149 million amount due under the Note. The initial Note carried a simple interest rate of 11% per annum. In connection with an amendment of the strategic alliance agreement (as defined in Note 7 to Consolidated Financial Statements), effective October 15, 2000, interest payable accrued at a rate of 11% per annum compounded daily. The Company implemented this amendment prospectively beginning on January 1, 1999, and has recognized interest on the outstanding principal and accrued interest amounts at an effective rate of 10.58%. Total interest accrued at December 31, 2000 and 1999 was $42.2 million and $27.0 million, respectively. On January 5, 2001, the Company received from Sunburst $101.9 million, a parcel of land valued at approximately $1.5 million and a new 11 3/8% seven-year senior subordinated note in the amount of $35 million as consideration for the five-year subordinated term note.

Financing cash flows relate primarily to the Company's borrowings under its credit lines and treasury stock purchases. In 1997, the Company entered into a five-year, $300 million competitive advance and multi-currency revolving credit facility (as defined in Note 10 to Consolidated Financial Statements). The Credit Facility provides for a term loan of $150 million and a revolving credit facility of $150 million, $50 million of which is available in foreign currency borrowings. As of December 31, 2000, the Company had $80 million of term loans outstanding and $109 million of revolving loans. The term loan is payable over five years, $42.5 million of which is due in 2001. The Credit Facility includes customary financial and other covenants that require the maintenance of certain ratios including maximum leverage and interest coverage and restrict the Company's ability to make certain investments, incur debt and dispose of assets. At the Company's option, the interest rate may be based on LIBOR, a certificate of deposit rate or an alternate base rate (as defined), plus a facility fee percentage. The rate is determined based on the Company's consolidated leverage ratio at the time of borrowing.

In 1998, the Company completed a $100 million senior unsecured note offering ("the Senior Notes"), bearing a coupon rate of 7.13% with an effective rate of 7.22%. The Senior Notes will mature on May 1, 2008, with interest on the Senior Notes to be paid semi-annually. The Company used the net proceeds from the offering of approximately $99 million to repay amounts outstanding under the Company's Credit Facility.

In January 2001, the Company provided Friendly, in association with Friendly's restructuring (see Note 5 to Consolidated Financial Statements), with a letter of credit in an amount up to £7.8 million (approximately US $11.4 million) to guarantee additional credit facilities from Friendly's banks. As of March 20, 2001, Friendly had drawn £5.5 million on this letter of credit.

As of December 31, 2000, the total debt outstanding for the Company was $297.2 million.

The Company had repurchased 9.1 million shares of its common stock at a total cost of $129.2 million as of December 31, 2000. On February 8, 2001, the Company received authorization from its Board of Directors to repurchase up to an additional 5 million shares. Subsequent to December 31, 2000 and using the proceeds of the Sunburst note, the Company repurchased 7.3 million shares of outstanding common stock at a total cost of $105.4 million.

The Company believes that cash flows from operations and available financing capacity are adequate to meet the expected operating, investing, financing and debt service requirements of the business for the immediate future.

Impact of Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board (Board) issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which established accounting and reporting standards for derivative instruments, including derivative instruments embedded in other contracts, and for hedging activities. SFAS No. 133 requires the recognition of the fair value of derivatives in the statement of financial position, with changes in the fair value recognized either in earnings or as a component of other comprehensive income dependent upon the hedging nature of the derivative. In June 1999, the Board issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133," which deferred the effective date of SFAS No. 133 until fiscal years beginning after June 15, 2000. SFAS No. 133 does not have a material impact on the Company's earnings or other comprehensive income.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition," which requires revenues to be recognized when realized and earned. Revenue is generally realized and earned when all the following criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the selling price must be fixed or determinable; and, (iv) collectibility is reasonably assured. The Company implemented SAB No. 101 in 2000.

Forward-Looking Statements

Certain statements contained in this annual report, including those in the section entitled Management's Discussion and Analysis, that are not historical facts constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act. Words such as "believes," "anticipates," "expects," "intends," "estimates," "projects," and other similar expressions, which are predictions of or indicate future events and trends, typically identify forward-looking statements. Such statements are subject to a number of risks and uncertainties which could cause actual results to differ materially from those projected, including: competition within each of our business segments; business strategies and their intended results; the balance between supply of and demand for hotel rooms; our ability to obtain new franchise agreements; our ability to develop and maintain positive relations with current and potential hotel owners; the effect of international, national and regional economic conditions; the availability of capital to allow us and potential hotel owners to fund investments and construction of hotels; the cost and other effects of legal proceedings; and other risks described from time to time in our filings with the Securities and Exchange Commission, including those set forth under the heading "Risk Factors" in our Report on Form 10-Q for the period ended June 30, 1999. Given these uncertainties, you are cautioned not to place undue reliance on such statements. The Company also undertakes no obligation to publicly update or revise any forward-looking statement to reflect current or future events or circumstances.

Choice Hotels International, Inc. and Subsidiaries

To Choice Hotels International, Inc.

We have audited the accompanying consolidated balance sheets of Choice Hotels International, Inc. and subsidiaries, as defined under "Company Information and Significant Accounting Policies" in the Notes to Consolidated Financial Statements, as of December 31, 2000 and 1999, and the related consolidated statements of income, cash flows, and shareholders' equity and comprehensive income for the years ended December 31, 2000, 1999 and 1998. These consolidated financial statements are the responsibility of Choice Hotels International, Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Choice Hotels International, Inc. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for the years ended December 31, 2000, 1999 and 1998, in conformity with accounting principles generally accepted in the United States.

Vienna, Virginia
February 2, 2001

Choice Hotels International, Inc. and Subsidiaries

(In thousands, except per share amounts)	Years ended December 31, 2000	1999	1998
REVENUES:			
Royalty fees	**$137,721**	$128,653	$115,171
Initial franchise and relicensing fees	**12,154**	13,910	16,571
Partner services revenue	**10,300**	9,055	6,370
Other revenue	**7,299**	6,111	5,516
Product sales	**—**	3,871	20,748
European hotel operations	**—**	—	1,098
Total revenues	**167,474**	161,600	165,474
OPERATING EXPENSES:			
Selling, general and administrative	**57,787**	55,860	52,948
Restructuring charges (Note 8)	**5,637**	—	—
Depreciation and amortization	**11,623**	7,687	6,710
Product cost of sales	**—**	3,883	19,532
European hotel operations	**—**	—	1,133
Total operating expenses	**75,047**	67,430	80,323
Operating income	**92,427**	94,170	85,151
OTHER:			
Interest expense (Note 10)	**18,490**	16,398	17,757
Interest and dividend income (Notes 5 and 7)	**(15,534)**	(17,147)	(12,636)
Equity loss on Friendly Hotels (Note 5)	**12,071**	380	—
Loss on Sunburst Hospitality note (Note 7)	**7,565**	—	—
Loss (gain) on sale of investments	**253**	68	(2,370)
Total other	**22,845**	(301)	2,751
Income before income taxes and extraordinary item	**69,582**	94,471	82,400
Income taxes (Note 14)	**27,137**	37,316	34,327
Income before extraordinary item	**42,445**	57,155	48,073
Gain on early extinguishment of debt (net of taxes of $4,732)	**—**	—	7,232
Net income	**$ 42,445**	$ 57,155	$ 55,305
Weighted-average shares outstanding	**52,895**	54,859	58,717
Diluted shares outstanding	**53,253**	55,667	59,548
Basic EPS: (Note 17)			
Income before extraordinary item	**$ 0.80**	$ 1.04	$ 0.82
Extraordinary item	**—**	—	0.12
Net income	**$ 0.80**	$ 1.04	$ 0.94
Diluted EPS: (Note 17)			
Income before extraordinary item	**$ 0.80**	$ 1.03	$ 0.81
Extraordinary item	**—**	—	0.12
Net income	**$ 0.80**	$ 1.03	$ 0.93

See notes to consolidated financial statements.

Choice Hotels International, Inc. and Subsidiaries

(In thousands)	**December 31, 2000**	December 31, 1999
ASSETS		
Current assets		
Cash and cash equivalents	**$ 19,701**	$ 11,850
Receivables (net of allowance for doubtful accounts of $5,754 and $6,691, respectively)	**31,865**	30,035
Income taxes receivable and other current assets (Note 14)	**520**	37
Total current assets	**52,086**	41,922
Property and equipment, at cost, net (Note 2)	**72,946**	58,255
Goodwill, net (Note 3)	**62,663**	64,706
Franchise rights, net (Note 4)	**39,163**	43,101
Investment in Friendly Hotels (Note 5)	**34,616**	41,195
Advances to marketing and reservation funds (Note 6)	**57,824**	32,807
Other assets	**27,330**	40,819
Note receivable from Sunburst Hospitality (Note 7)	**137,492**	141,853
Total assets	**$484,120**	$464,658
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt (Note 10)	**$ 50,046**	$ 44,646
Accounts payable	**15,964**	21,362
Accrued expenses (Notes 8 and 9)	**27,818**	21,368
Income taxes payable (Note 14)	**—**	1,367
Total current liabilities	**93,828**	88,743
Long-term debt (Note 10)	**247,179**	262,710
Deferred income taxes ($39,573 and $30,648, respectively) and other liabilities (Note 14)	**53,020**	47,589
Total liabilities	**394,027**	399,042
SHAREHOLDERS' EQUITY		
Common stock, $ .01 par value, 160,000,000 shares authorized; 52,561,568 and 53,833,911 shares issued and outstanding at December 31, 2000 and 1999, respectively (Note 15)	**526**	538
Additional paid-in-capital	**55,245**	52,386
Accumulated other comprehensive (loss) income	**(54)**	1,205
Deferred compensation	**(1,300)**	(1,937)
Treasury stock (9,102,056 and 7,527,027 shares at December 31, 2000 and 1999, respectively)	**(129,172)**	(108,294)
Retained earnings	**164,848**	121,718
Total shareholders' equity	**90,093**	65,616
Total liabilities and shareholders' equity	**$484,120**	$464,658

See notes to consolidated financial statements.

Choice Hotels International, Inc. and Subsidiaries

(In thousands)	2000	1999	1998
	Years ended December 31,		
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	**$42,445**	$57,155	$55,305
Reconciliation of net income to net cash provided by operating activities:			
Depreciation and amortization	**12,104**	8,023	7,401
Provision for bad debts	**(585)**	588	1,473
Deferred income taxes and other	**11,018**	10,216	14,852
Non-cash interest and dividend income	**(15,170)**	(16,639)	(12,364)
Equity loss on Friendly Hotels	**12,071**	380	—
Loss on early prepayment of Sunburst Hospitality note	**6,520**	—	—
Gain on early extinguishment of debt	**—**	—	(11,964)
Change in assets and liabilities:			
Receivables	**(2,245)**	(4,006)	(4,311)
Prepaid expenses and other current assets	**30**	1,355	(1,849)
Current liabilities	**1,714**	6,086	(6,180)
Income taxes payable/receivable	**(278)**	6,794	(3,411)
Net cash provided by operating activities	**67,624**	69,952	38,952
CASH FLOWS FROM INVESTING ACTIVITIES			
Investment in property and equipment	**(16,590)**	(30,633)	(17,488)
Advances to/from marketing and reservation funds, net	**(14,532)**	(5,545)	1,512
Repayments of advances to Sunburst Hospitality	**—**	—	8,145
Other items, net	**760**	(4,765)	(1,225)
Net cash utilized in investing activities	**(30,362)**	(40,943)	(9,056)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from mortgages and other long-term debt	**85,500**	88,630	194,901
Proceeds from exercise of stock options	**1,736**	5,136	4,919
Principal payments of debt	**(95,757)**	(59,458)	(184,300)
Purchase of treasury stock	**(20,893)**	(53,166)	(54,015)
Proceeds from issuance of common stock	**3**	7	9
Net cash utilized in financing activities	**(29,411)**	(18,851)	(38,486)
Net change in cash and cash equivalents	**7,851**	10,158	(8,590)
Cash and cash equivalents at beginning of period	**11,850**	1,692	10,282
Cash and cash equivalents at end of period	**$19,701**	$11,850	$ 1,692
Supplemental disclosure of cash flow information			
Cash payments during the year for:			
Interest	**$22,145**	$19,387	$19,200
Income taxes	**15,674**	17,834	22,278
Non-cash investing activities:			
Properties assumed through put/call transaction	**$12,233**	—	—
Reduction in Sunburst Hospitality note from put/call transaction	**16,333**	—	—

See notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

Choice Hotels International, Inc. and Subsidiaries

(In thousands, except share amounts)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Deferred Compensation	Treasury Stock	Comprehensive Income	Retained Earnings	Total
Balance as of December 31, 1997	59,828,878	$598	$47,907	$(8,316)	$ —	$ (189)		$ 9,258	$49,258
Comprehensive income									
Net income	—	—	—	—	—	—	$55,305	55,305	55,305
Other comprehensive income									
Foreign translation adjustments	—	—	—	—	—	—	10,048	—	10,048
Unrealized gain on securities, net of reclassification adjustment (Note 16)	—	—	—	—	—	—	380	—	380
Other comprehensive income	—	—	—	10,428	—	—	10,428	—	—
Comprehensive income							$65,733		
Exercise of stock options/grants, net	667,227	7	5,058	—	—	—			5,065
Issuance of restricted stock	160,212	2	2,272	—	(2,274)	—		—	—
Amortization of deferred compensation	—	—	—	—	609	—		—	609
Treasury purchases	(3,929,400)	(39)	—	—	—	(53,976)			(54,015)
Purchase of MainStay brand option from Sunburst	—	—	(10,140)	—	—	—		—	(10,140)
Balance as of December 31, 1998	56,726,917	$568	$45,097	$2,112	$(1,665)	$(54,165)		$ 64,563	$56,510
Comprehensive income									
Net income	—	—	—	—	—	—	$57,155	57,155	57,155
Other comprehensive income									
Foreign translation adjustments	—	—	—	—	—	—	(108)	—	(108)
Unrealized loss on securities, net of taxes, net of reclassification adjustment (Note 16)	—	—	—	—	—	—	(799)	—	(799)
Other comprehensive income	—	—	—	(907)	—	—	(907)	—	—
Comprehensive income							$56,248		
Exercise of stock options/grants, net	623,647	6	6,275	—	—	—		—	6,281
Issuance of restricted stock	70,260	1	1,014	—	(1,015)	—		—	—
Amortization of deferred compensation	—	—	—	—	743	—		—	743
Treasury purchases	(3,586,913)	(37)	—	—	—	(54,129)		—	(54,166)
Balance as of December 31, 1999	53,833,911	$538	$52,386	$1,205	$(1,937)	$(108,294)		$121,718	$65,616
Comprehensive income									
Net income	—	—	—	—	—	—	$42,445	42,445	42,445
Other comprehensive income									
Foreign translation adjustments	—	—	—	—	—	—	(1,786)	—	(1,786)
Unrealized gain on securities, net of taxes, net of reclassification adjustment (Note 16)	—	—	—	—	—	—	527	—	527
Other comprehensive income	—	—	—	(1,259)	—	—	(1,259)	—	—
Comprehensive income							$41,186		
Exercise of stock options/grants, net	288,634	3	3,362	—	—	—			3,365
Issuance of restricted stock	14,052	—	182	—	(182)	—		—	—
Amortization of deferred compensation	—	—	—	—	819	—		—	819
Treasury purchases	(1,575,029)	(15)	—	—	—	(20,878)		—	(20,893)
Liquidation of foreign subsidiaries	—	—	(685)	—	—	—		685	—
Balance as of December 31, 2000	52,561,568	$526	$55,245	$ (54)	$(1,300)	$(129,172)		$164,848	$90,093

See notes to consolidated financial statements.

1. Company Information and Significant Accounting Policies

Company Information. Choice Hotels International, Inc. ("the Company") is in the business of hotel franchising. As of December 31, 2000, the Company had franchise agreements with 4,392 hotels open and 703 hotels under development in 43 countries under the following brand names: Comfort, Quality, Econo Lodge, Sleep Inn, Clarion, Rodeway Inn, and MainStay Suites.

Principles of Consolidation and Use of Estimates. The consolidated financial statements include the accounts of Choice Hotels International, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States and require management to make certain 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 these estimates.

Cash and Cash Equivalents. The Company considers all highly liquid investments purchased with a maturity of three months or less at the date of purchase to be cash equivalents.

Capitalization Policies. Major renovations, replacements and interest during construction are capitalized to appropriate property and equipment accounts. Upon sale or retirement of property, the cost and related accumulated depreciation are eliminated from the accounts and the related gain or loss is taken into income. Maintenance, repairs and minor replacements are charged to expense.

Impairment Policy. The Company evaluates the recoverability of long-lived assets, including franchise rights and goodwill, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured based on net, undiscounted expected cash flows. Assets are considered to be impaired if the net, undiscounted expected cash flows are less than the carrying amount of the assets. Impairment charges are recorded based upon the difference between the carrying value of the asset and the expected net cash flows, discounted at an appropriate interest rate.

Deferred Financing Costs. Debt financing costs are deferred and amortized, using the effective interest method, over the term of the related debt.

Investments. The Company accounts for its investments in common stock in accordance with Statements of Financial Accounting Standards ("SFAS") No. 115 "Accounting for Certain Investments in Debt and Equity Securities" and SFAS No. 130 "Reporting Comprehensive Income." The Company accounts for its investment in unincorporated joint ventures in accordance with Accounting Principles Board Opinion ("APB") No. 18 "The Equity Method of Accounting for Investments in Common Stock."

Revenue Recognition. The Company enters into numerous franchise agreements committing to provide franchisees with various marketing services, a centralized reservation system and limited rights to utilize the Company's registered tradenames. These agreements are typically for a period of twenty years, with certain rights to the franchisee to terminate after five, ten, or fifteen years. In most instances, initial franchise fees are recognized upon sale because the initial franchise fee is non-refundable and the Company has no continuing obligations related to the franchisee. However, when

franchise agreements are entered into which include future potential rebates and/or incentive payments, the initial franchise fees are deferred and recognized when the incentive criteria are met or the deal is terminated, whichever occurs first. In 2000, ninety-eight franchise agreements were entered into with incentive clauses which resulted in deferred initial franchise fee revenue of $3.3 million. Royalty fees, primarily based on gross room revenues of each franchisee, are recorded when earned. Reserves for uncollectible accounts are charged to bad debt expense and are included in selling, general and administrative expenses in the accompanying consolidated statements of income.

The Company's franchise agreements require the payment of franchise fees which include marketing and reservation fees. These fees, which are based on a percentage of the franchisees' gross room revenues, are used exclusively by the Company's marketing and reservation funds for expenses associated with providing such franchise services as central reservation systems, national marketing and media advertising. The Company is contractually obligated to expend the marketing and reservation fees it collects from franchisees in accordance with the franchise agreements; as such, no income or loss to the Company is generated. Accordingly, marketing and reservation fees collected and associated expenses are reported net by the Company.

The Company generates partner services revenue from hotel industry vendors based on the level of goods or services purchased from the vendors by hotel owners and hotel guests who stay in the Company's franchised hotels. In accordance with Staff Accounting Bulletin No. 101, "Revenue Recognition," the Company recognizes partner services revenues (i) upon the completion of service or delivery of product, assuming reasonable assurance of collectibility; (ii) upon completion of a specific event; or, failing the previous two conditions, (iii) over the life of the contract, regardless of whether monies are received in advance or in arrears, and regardless of whether the monies are non-refundable.

Self-Insurance Program. The Company maintains its own health insurance program, which includes certain levels of retained risk. Estimated costs are accrued at present values based on actuarial projections for known and anticipated claims.

Reclassifications. Certain reclassifications have been made to the prior year consolidated financial statements to conform to the current year presentation.

2. Property and Equipment

The components of property and equipment in the consolidated balance sheets are:

(In thousands)	December 31, 2000	December 31, 1999
Land	**$ 2,593**	$ 1,227
Facilities in progress	**4,075**	1,838
Building and improvements	**29,474**	18,458
Furniture, fixtures and equipment	**74,812**	60,629
	110,954	82,152
Less: Accumulated depreciation	**(38,008)**	(23,897)
	$72,946	$58,255

Depreciation has been computed for financial reporting purposes using the straight-line method. A summary of the ranges of estimated useful lives upon which depreciation rates have been based follows:

Building and improvements	10-40 years
Furniture, fixtures and equipment	3-20 years

3. Goodwill

Goodwill primarily represents an allocation of the excess purchase price of the stock of the Company over the recorded minority interest that was previously held by members of the Company's former management team. Goodwill is amortized on a straight-line basis over 40 years. Such amortization amounted to $2.0 million in each of the years

ended December 31, 2000, 1999 and 1998, respectively. Goodwill is net of accumulated amortization of $12.1 million and $10.1 million at December 31, 2000 and 1999, respectively.

4. Franchise Rights

Franchise rights are intangible assets and represent an allocation in purchase accounting for the value of long-term franchise contracts. As of December 31, 2000, the net balance is associated with the Econo Lodge acquisition made in fiscal year 1991. Franchise rights acquired are amortized over an average life of 15 years. Amortization expense for the years ended December 31, 2000, 1999 and 1998 amounted to $3.9 million, $4.3 million and $3.8 million, respectively. Franchise rights are net of accumulated amortization of $26.9 million and $23.0 million at December 31, 2000 and 1999, respectively.

The Company periodically assesses the amortization lives of its franchise rights. Effective January 1, 1998, the Company changed its estimate of the useful life of Econo Lodge franchise rights to a 17 year period and Rodeway franchise rights to a 3 year period to more closely match the remaining estimated contract lives of franchise contracts acquired in 1991.

5. Investment in Friendly

As of December 31, 2000, the Company had 1,083,333 shares of common stock and 23,624,742 shares of 5.75% convertible preferred stock in Friendly Hotels plc ("Friendly"), the Company's master franchisor for the United Kingdom, Ireland and continental Europe. The preferred shares were convertible for one new Friendly common share for every 150p nominal of the preferred convertible shares.

The Company has the right to appoint three directors to the board of Friendly. Given the Company's ability to exercise significant influence over the operations of Friendly, the equity method of accounting is applied.

Friendly holds the master franchise rights for the Company's Comfort, Quality and Clarion brand hotels in the United Kingdom, Ireland and throughout Europe (with the exception of Scandinavia) for a 10-year period. In exchange, the Company received Friendly common stock and was to receive from Friendly, $8.0 million payable in eight equal annual installments.

On December 21, 2000, Friendly announced a comprehensive restructuring program to strengthen its balance sheet and improve its operations. Elements of the restructuring program include a revaluation of its real estate portfolio, disposal of non-core assets, renegotiations of certain commercial arrangements with the Company, and a future strategy focused on growth of its franchising business. To improve Friendly's competitive position in Europe, the Company has agreed to forgive and waive certain royalty fees due over the next five years, waive the five remaining annual installments of the master franchise agreement and to provide Friendly with a letter of credit in an amount up to £7.8 million (approximately US $11.4 million) to guarantee additional credit facilities from Friendly's banks. The Company's letter of credit will be secured by substantially all of Friendly's assets in France and Germany, valued in excess of £8.2 million (approximately US $12.0 million). In consideration for this support, Friendly will reduce the conversion rate from 150p for each of Choice's convertible preferred shares to 60p for each convertible preferred share. Other modifications to the Company's convertible preferred shares will include a change in the dividend rate from 5.75% (payable in cash) to 2% per annum, if payable in additional convertible preferred shares. Friendly may alternatively elect to pay cash dividends at the rate of 3.5% per annum up until January 30, 2013 and thereafter at the rate of 5.75%. In addition, accrued dividends due to the Company as of February 7, 2001 will be converted to additional convertible preferred shares of Friendly. The effect of this change in conversion price together with the conversion of dividend arrearage to additional convertible preferred shares of Friendly is

to increase the Company's fully diluted ownership in Friendly from the current level of 44% to approximately 69%. Friendly will be granted an option to settle the deferred consideration of $4.0 million pursuant to a January, 1998 transaction, in additional convertible preferred shares. In the event that Friendly settles this obligation before maturity, the amount payable shall be discounted at a rate of 10% per annum. Due to the restructuring program, the Company has recorded an equity loss on Friendly of $12.1 million in accordance with Emerging Issues Task Force ("EITF") No. 99-10, "Percentage Used to Determine the Amount of Equity Method Losses." Going forward, the EITF No. 99-10 requires the Company to recognize changes in Friendly's hypothetical liquidated book value as an equity adjustment to the Company's recorded investment.

Since the closing of the restructuring transaction in January 2001, the Company continues to closely monitor its strategic options with respect to its investment in Friendly. In the event that Friendly's financial condition deteriorates, there may not be sufficient cash from operations and available credit lines to fund the business. In the event that Friendly cannot secure additional borrowings or equity, the Company will consider its strategic and financial options, including, but not limited to i) stand-aside to additional funding requirements which would likely result in the insolvency of Friendly, a further or complete write-down of the Company's investment in Friendly and the Company taking back its franchising rights for the United Kingdom, Ireland and continental Europe, or ii) conversion of its convertible preferred shares into ordinary common stock resulting in control of and full consolidation of Friendly.

The Company recognized $2.2 million and $2.1 million in preferred dividend income from the Friendly investment for the years ended December 31, 1999 and 1998, respectively. As of December 31, 1999 and 1998, accrued but unpaid preferred dividends were $5.8 million and $3.7 million, respectively. The Company also recognized $1.1 million, $2.2 million and $1.4 million in royalty revenue from Friendly for the years ended December 31, 2000, 1999 and 1998, respectively.

The Company owned approximately 5.4%, 5.3% and 5.2% of Friendly's outstanding ordinary shares at December 31, 2000, 1999, and 1998, respectively. The fair market value of the ordinary shares at December 31, 2000, 1999 and 1998 was $0.7 million, $2.0 million and $1.9 million, respectively.

Summarized unaudited balance sheet data for Friendly is as follows:

	Unaudited December 31,	
(In thousands)	**2000**	1999
Current assets	**$ 27,298**	$ 33,557
Non-current assets	**138,679**	193,299
Current liabilities	**70,541**	55,441
Non-current liabilities	**60,820**	89,776
Redeemable preferred stock	**23,115**	37,800
Shareholders' equity	**34,616**	81,639

Summarized unaudited income statement data for Friendly is as follows:

		Unaudited December 31,	
(In thousands)	**2000**	1999	1998
Net revenues	**$138,135**	$150,332	$130,028
Gross profit	**76,032**	84,852	73,447
Income from continuing operations	**(40,193)**	(8,584)	12,778
Net (loss) income after preferred dividends	**(50,640)**	(31,424)	18,984

6. Advances to Marketing and Reservation Funds

The total marketing and reservation fees received by the Company for the years ended December 31, 2000, 1999 and 1998 amounted to $162.4 million, $146.0 million and $127.4 million, respectively. Depreciation and amortization incurred by the marketing and reservation funds for the years ended December 31, 2000, 1999 and 1998 amounted to $10.5 million, $9.6 million and $6.2 million, respectively. Interest expense incurred by the reservation fund was $4.8 million, $3.3 million and $1.8 million for the years ended December 31, 2000, 1999 and 1998, respectively. Under the terms of the franchise agreements, reservation fees and marketing fees not expended in the current year are carried over to the next fiscal year and expended in accordance with the

franchise agreements. Shortfall amounts are similarly recovered in subsequent years. Excess or shortfall amounts from the operation of these programs are recorded as a payable or receivable, respectively, from the particular fund. As of December 31, 2000 and 1999, the Company's consolidated balance sheet includes advances to marketing and reservation funds of $57.8 million (marketing $24.9 million and reservation $32.9 million) and $32.8 million (marketing $12.5 million and reservation $20.3 million), respectively. The Company has the ability under the existing franchise agreements and expects to recover the remaining receivables through future marketing and reservation fees.

7. Transactions with Sunburst

Effective October 15, 1997, Choice Hotels International, Inc. ("CHI"), which at that point included both the franchising business and owned hotel business, separated the businesses via spin-off of the Company (the "Sunburst Distribution"). CHI changed its name to Sunburst Hospitality Corporation (referred to hereafter as "Sunburst"). As part of the spin-off, Sunburst and the Company entered into a strategic alliance agreement, which was amended in December 1998 and September 2000. Among other things, the strategic alliance agreement provides for (i) certain commitments by Sunburst for the development of MainStay Suites hotels; (ii) special procedures associated with liquidated damages; and (iii) predetermined franchise fee credits based on operating performance. The amended strategic alliance agreement extends through October 15, 2002 as it relates to development commitments. Liquidated damage and franchise fee credit provisions extend through the life of existing franchise agreements.

In connection with the spin-off, the Company borrowed $115 million under its Credit Facility (as defined in Note 10) in order to fund a subordinated term note to Sunburst (the "Note"). The Note of $115 million accrues interest monthly at an initial simple rate of 11% per annum through October 14, 2000. In connection with an amendment of the strategic agreement discussed above, effective October 15, 2000, interest shall accrue at a rate of 11% per annum compounded daily. On January 1, 1999, the Company began recognizing interest on the outstanding principal and accrued interest amounts at an effective rate of 10.58%. The Note is payable in full, along with accrued interest, on October 15, 2002. Total interest accrued as of December 31, 2000 and 1999 was $42.2 million and $27.0 million, respectively.

On September 1, 2000, Sunburst transferred title to three MainStay properties under a put/call agreement entered into between the Company and Sunburst in March 2000. The properties were received by the Company as consideration for $16.3 million of the then $149 million amount due under the Note. The fair market value of the MainStay properties was approximately $12.2 million. Accordingly, the Company recognized a $4.1 million pre-tax loss on the Note.

On September 20, 2000, the Company and Sunburst reached agreement on the terms of a proposed restructuring of the then existing $136 million Note. Under the terms of the agreement, the Company would receive cash and a newly issued 11 3/8% seven-year subordinated note. On January 5, 2001, the Company received $101.9 million, a parcel of land valued at approximately $1.5 million and a $35 million seven-year senior subordinated note bearing interest at 11 3/8% in settlement of the balance of the Note. In 2000, the Company recognized a pre-tax loss of $3.5 million resulting from this transaction.

During the periods presented, Sunburst operated substantially all of its hotels pursuant to franchise agreements with the Company. Total fees paid to the Company included in the accompanying consolidated financial statements for franchising royalty, marketing and reservation fees were $10.3 million, $9.1 million and $11.2 million for the years ended December 31, 2000, 1999 and 1998, respectively.

In accordance with the spin-off, the Company agreed to assume and pay certain

liabilities of Sunburst, subject to the Company maintaining a minimum net worth of $40 million, at the date of the Sunburst Distribution. As of December 31, 1997, the Company reflected a $25 million receivable due from Sunburst on the consolidated balance sheet. In 1998, net payments of approximately $8 million were collected from Sunburst in cash. In December 1998, the Company and Sunburst amended the strategic alliance agreement entered into in connection with the Sunburst Distribution. As part of that amendment, the Company exchanged the remaining $17 million balance in return for, among other things, the exclusive rights to the MainStay Suites brand from Sunburst. The $17 million, net of income taxes of approximately $7 million, was recorded as an adjustment to additional paid-in-capital as it represents an adjustment to the accounting for the Sunburst Distribution.

8. Restructuring Program

During 2000, the Company recognized $5.6 million in restructuring charges. The restructuring charges include $4.7 million that relates to reorganizing the Company's operations in order to improve service and support to the Company's franchisees. Of this $4.7 million, $4.1 million relates to severance and termination benefits for 176 employees (consisting of property and yield management system installers, reservation agents and field service administrative support) and $0.6 million relates to the cancellation of pre-existing contracts for termination of international leases. The remaining $0.9 million of the $5.6 million is due to the termination of an in-room internet initiative launched in 1999.

As of December 31, 2000, $0.5 million has been paid related to severance and termination benefits. The Company expects the remaining $5.1 million restructuring liability to be paid in 2001.

9. Accrued Expenses

Accrued expenses consisted of the following as of December 31:

(In thousands)	2000	1999
Accrued salaries and benefits	**$13,027**	$12,813
Accrued interest	**2,606**	1,996
Accrued restructuring	**5,100**	—
Other	**7,085**	6,559
Total	**$27,818**	$21,368

10. Long-Term Debt

As of December 31, debt consisted of the following:

(In thousands)	2000	1999
$300 million competitive advance and multi-currency revolving credit facility with an average rate of 7.31% and 6.81% at December 31, 2000 and 1999, respectively	**$189,000**	$194,500
$100 million senior note offering with an average rate of 7.22% at December 31, 2000 and 1999, respectively	**99,382**	99,382
$15 million line of credit with an average rate of 7.53% and 6.90% at December 31, 2000 and 1999, respectively	**7,400**	12,000
Other notes with an average rate of 6.42% and 5.90% at December 31, 2000 and 1999, respectively	**1,443**	1,474
Total debt	**$297,225**	$307,356

Maturities of debt as of December 31, 2000 were as follows:

Year	(In thousands)
2001	$ 50,046
2002	146,646
2003	146
2004	146
2005	146
Thereafter	100,095
Total	$297,225

On October 15, 1997, the Company entered into a $300 million competitive advance and multi-currency revolving credit facility (the "Credit Facility") provided by a group of 13 banks. The Credit Facility provides for a term loan of $150 million and a revolving credit facility of $150 million, $50 million of which is available for borrowings in foreign currencies. The Credit Facility includes customary financial and other covenants that require the maintenance of certain ratios including maximum leverage and interest coverage and restricts the Company's ability to make certain investments, incur debt and dispose of assets. The term loan ($80 million of which is outstanding at December 31, 2000) is payable over five years, $42.5 million of which is due in 2001. Borrowings under the Credit Facility are, at the option of the borrower, at one of several rates including LIBOR plus 20.0 to 87.5 basis points, based upon a defined financial ratio and the loan type. In addition, the Company has the option to request participating banks to bid on loan participation at lower rates than those contractually provided by the Credit Facility. The Credit Facility requires the Company to pay annual fees of 1/10 of 1% to 1/3 of 1%, based upon a defined financial ratio of the total loan commitment. The Credit Facility will terminate on October 15, 2002.

On May 1, 1998, the Company issued $100 million of senior unsecured notes (the "Senior Notes") at a discount of $0.6 million, bearing a coupon rate of 7.13% with an effective rate of 7.22%. The Senior Notes will mature on May 1, 2008, with interest on the Senior Notes to be paid semi-annually. The Company used the net proceeds from the offering of approximately $99 million to repay amounts outstanding under the Company's Credit Facility.

During June 2000, the Company renewed its revolving line of credit for $15 million. Borrowings on the line of credit are used to finance short-term working capital requirements and other short-term general corporate goals. The line of credit is due to expire on May 31, 2001 and bears interest at LIBOR plus 75 basis points. Interest accrues monthly on the outstanding balance. The line of credit contains essentially the same covenants as the Credit Facility and is prepayable without penalty.

11. Interest Rate Hedges

On December 3, 1999, the Company entered into an interest rate swap agreement with a notional amount of $115 million to fix certain of its variable rate debt in order to reduce the Company's exposure to fluctuations in interest rates. The interest rate differential to be paid or received on the interest rate swap agreement is accrued as interest rates change and is recognized as an adjustment to interest expense. On average at December 31, 1999, the interest rate swap agreement had a life of two months with a fixed rate of 5.85% and variable rate of 6.12%, and a fair market valuation of approximately $0.1 million. On March 3, 2000, the interest rate swap agreement was settled for approximately $0.1 million.

12. Foreign Operations

The Company accounts for foreign currency translation in accordance with SFAS No. 52, "Foreign Currency Translation." Revenues generated by foreign operations for the years ended December 31, 2000, 1999 and 1998 were $5.3 million, $6.9 million (exclusive of $2.5 million of foreign dividends) and $5.8 million (exclusive of $2.1 million of foreign dividends), respectively. The Company's foreign operations had net income (loss) of $(12.3 million), $1.0 million and $0.0 million for the years ended December 31, 2000, 1999 and 1998, respectively.

13. Pension, Profit Sharing, and Incentive Plans

Bonuses accrued for key executives of the Company under incentive compensation plans were $1.1 million and $1.0 million at December 31, 2000 and 1999, respectively.

During 2000, 1999 and 1998, employees of the Company participated in 401(k) retirement plans sponsored by the Company. For the years ended December 31, 2000, 1999 and 1998, the Company recorded compensation expense of $1.6 million, $1.3 million and $1.2 million, respectively, related to the plans.

14. Income Taxes

Income before income taxes were derived from the following:

(In thousands)	Years ended December 31, 2000	1999	1998
Income before income taxes and extraordinary item:			
Domestic operations	**$80,982**	$92,058	$82,400
Foreign operations	**(11,400)**	2,413	—
Income before income taxes and extraordinary item	**$69,582**	$94,471	$82,400

The provisions for income taxes follow:

(In thousands)	Years ended December 31, 2000	1999	1998
Current tax expense			
Federal	**$20,707**	$22,038	$15,918
State	**2,434**	2,723	3,482
Foreign	**886**	1,422	2
Deferred tax (benefit) expense			
Federal	**3,598**	10,515	12,420
State	**(481)**	618	2,505
Foreign	**(7)**	—	—
	$27,137	$37,316	$34,327

Deferred tax assets (liabilities) are comprised of the following:

(In thousands)	December 31, 2000	1999
Depreciation and amortization	**$(21,663)**	$(16,582)
Prepaid expenses	**(21,247)**	(17,542)
Other	**(6,606)**	(6,175)
Gross deferred tax liabilities	**(49,516)**	(40,299)
Foreign operations	**4,352**	223
Accrued expenses	**6,496**	9,112
Net operating losses	**—**	99
Other	**1,976**	3,979
Gross deferred tax assets	**12,824**	13,413
Net deferred tax liability	**$(36,692)**	$(26,886)

No provision has been made for U.S. federal deferred income taxes on approximately $4 million of accumulated and undistributed earnings of foreign subsidiaries at December 31, 2000, since these earnings are considered to be permanently invested in foreign operations.

A reconciliation of income tax expense at the statutory rate to income tax expense included in the accompanying consolidated statements of income follows:

(In thousands, except Federal income tax rate)	Years ended December 31, 2000	1999	1998
Federal income tax rate	**35%**	35%	35%
Federal taxes at statutory rate	**$24,354**	$33,065	$28,856
State income taxes, net of federal tax benefit	**1,269**	2,172	3,892
Other	**1,514**	2,079	1,579
Income tax expense	**$27,137**	$37,316	$34,327

Cash paid for income taxes was $15.7 million, $17.8 million and $22.3 million for the years ended December 31, 2000, 1999 and 1998, respectively.

15. Capital Stock

In 2000, the Company granted key employees and non-employee directors 14,052 restricted shares of common stock with a value of $0.2 million on the grant date. The shares vest over a three year period. In 1999, the Company granted key employees and

non-employee directors 70,260 restricted shares of common stock with a value of $1.0 million on the grant date. The shares vest over a three to five year period with 11,016 shares of the restricted stock vesting over a three year period, 32,180 shares vesting over a four year period and 27,064 shares vesting over a five year period. A total of 18,000 shares of restricted stock were forfeited in 2000 and 1999.

On February 19, 1998, the Board of Directors adopted a shareholder rights plan under which a dividend of one preferred stock purchase right was distributed for each outstanding share of the Company's common stock to shareholders of record on April 3, 1998. Each right will entitle the holder to buy 1/100th of a share of a newly issued series of a junior participating preferred stock of the Company at an exercise price of $75 per share. The rights will be exercisable, subject to certain exceptions, 10 days after a person or a group acquires beneficial ownership of 10% or more of the Company's common stock. Shares owned by a person or group on February 19, 1998, and held continuously thereafter are exempt for purposes of determining beneficial ownership under the rights plan. The rights will be non-voting and will expire on January 31, 2008, unless exercised or previously redeemed by the Company for $.001 each. If the Company is involved in a merger or certain other business combinations not approved by the Board of Directors, each right will entitle its holder, other than the acquiring person or group, to purchase common stock of either the Company or the acquiror or having a value of twice the exercise price of the right.

The Company has stock option plans for which it is authorized to grant options to purchase up to 9.0 million shares of the Company's common stock, of which 2.0 million shares remain available for grant. Stock options may be granted to officers, key employees and non-employee directors with an exercise price not less than the fair market value of the common stock on the date of grant.

A summary of the option activity under the above plans is as follows as of December 31, 2000, 1999 and 1998:

	2000		1999		1998	
Fixed Options	**Shares**	**Weighted-Option Price**	Shares	Weighted-Option Price	Shares	Weighted-Option Price
Outstanding at beginning of year	**3,907,326**	**$11.19**	3,969,309	$10.13	4,167,045	$8.62
Granted	**1,187,845**	**15.71**	732,372	13.19	933,263	13.37
Exercised	**(288,634)**	**7.22**	(695,228)	7.06	(738,318)	4.75
Cancelled	**(499,953)**	**15.10**	(99,127)	12.85	(392,681)	11.88
Outstanding at end of year	**4,306,584**	**$12.39**	3,907,326	$11.19	3,969,309	$10.31
Options exercisable at year end	**2,035,332**		1,727,748		1,813,541	
Weighted-average fair value of options granted during the year		**$ 3.78**		$ 6.20		$ 7.81

The following table summarizes information about stock options outstanding at December 31, 2000:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number Outstanding at 12/31/00**	**Weighted-Average Remaining Contractual Life**	**Weighted-Average Exercise Price**	**Number Exercisable at 12/31/00**	**Weighted-Average Exercise Price**
$ 3.01 to 5.00	309,635	1.0 years	$ 4.52	309,637	$ 4.52
5.00 to 9.00	395,932	3.9 years	7.19	285,772	6.96
9.00 to 13.00	1,931,593	7.3 years	12.06	1,021,832	11.83
13.00 to 17.65	1,669,424	8.8 years	15.45	418,091	14.08
	4,306,584			2,035,332	

SFAS No. 123, "Accounting for Stock-Based Compensation," requires companies to provide additional note disclosures about employee stock-based compensation plans based on a fair value based method of accounting. As permitted by this accounting standard, the Company continues to account for these plans under APB Opinion 25.

For purposes of the pro forma disclosure, compensation cost for the Company's stock option plan was determined based on the fair value at the grant dates for awards under those plans consistent with the method of SFAS No. 123. The fair value of each option grant has been estimated on the date of grant using an option-pricing model with the following weighted-average assumptions used for grants in 2000, 1999 and 1998:

	2000	1999	1998
Risk-free interest rate	**5.10%**	6.45%	4.70%
Volatility	**56.6%**	38.0%	36.7%
Expected lives	**10 years**	10 years	10 years
Dividend yield	**0%**	0%	0%

If options had been reported as compensation expense based on their fair value, pro forma net income would have been $41.8 million, $56.4 million and $54.0 million for the years ended December 31, 2000, 1999 and 1998, respectively, and pro forma earnings per share would have been $0.79, $1.01 and $0.90, respectively.

16. Comprehensive Income

The components of total accumulated other comprehensive income are as follows:

(In thousands)	December 31, **2000**	1999	1998
Unrealized gains (losses) on available-for-sale securities	**$ 108**	$ (419)	$ 380
Foreign currency translation adjustments	**(162)**	1,624	1,732
Total accumulated other comprehensive income (loss)	**$ (54)**	$1,205	$2,112

The related income tax effect allocated to each component of other comprehensive income (loss) is as follows:

(In thousands)	Amount Before Taxes	Income Tax (Expense) /Benefit	Amount Net of Taxes
Calendar year 2000			
Net unrealized gains	**$ 844**	**$ (317)**	**$ 527**
Foreign currency translation adjustment, net	**(1,786)**	**—**	**(1,786)**
Total other comprehensive (loss)	**$ (942)**	**$ (317)**	**$(1,259)**
Calendar year 1999			
Net unrealized losses	$ (1,024)	$ 225	$ (799)
Foreign currency translation adjustment, net	(108)	—	(108)
Total other comprehensive (loss)	$ (1,132)	$ 225	$ (907)
Calendar year 1998			
Net unrealized gains	$ 585	$ (205)	$ 380
Foreign currency translation adjustment, net	10,048	—	10,048
Total other comprehensive income	$10,633	$ (205)	$10,428

Below represents the detail of other comprehensive income:

	2000	1999	1998
Foreign currency translation adjustments	**$ (291)**	$ (108)	$ 1,916
Plus: reclassification of loss on liquidation of foreign subsidiaries	**(1,495)**	—	8,132
Net foreign currency translation adjustments	**(1,786)**	(108)	10,048
Unrealized holding gains (losses) arising during the period, net	**(176)**	601	380
Less: reclassification adjustments for gains (losses) included in net income	**703**	(1,400)	—
Net unrealized holding gains (losses) arising during the period	**$ 527**	$ (799)	$ 380

17. Earnings Per Share

The following table illustrates the reconciliation of the earnings and number of shares used in the basic and diluted earnings per share calculations.

	Years Ended December 31,	
(In millions, except per share amounts)	2000	1999
Computation of Basic Earnings Per Share:		
Net income	$42.4	$57.2
Weighted-average shares outstanding	52.9	54.9
Basic earnings per share	$0.80	$1.04
Computation of Diluted Earnings Per Share:		
Net income for diluted earnings per share	$42.4	$57.2
Weighted-average shares outstanding	52.9	54.9
Effect of Dilutive Securities:		
Employee stock option plan	0.4	0.8
Shares for diluted earnings per share	53.3	55.7
Diluted earning per share	$0.80	$1.03

The effect of dilutive securities is computed using the treasury stock method and average market prices during the period. In 2000 and 1999, the Company excluded 2,725,696 and 206,031, respectively, anti-dilutive options from the computation of diluted earnings per share.

18. Leases

Rental expense under non-cancelable operating leases was approximately $5.1 million, $3.9 million and $1.7 million for the years ended December 31, 2000, 1999 and 1998, respectively. The Company paid office rent of $51,662 and $977,500 to Sunburst for the years ended December 31, 1999 and 1998, respectively, based on the portion of total space occupied by the Company. Future minimum lease payments are as follows:

Year	(In thousands)
2001	$ 3,281
2002	3,255
2003	3,242
2004	3,331
2005	3,422
Thereafter	27,126
Total	**$43,657**

During 1998, the Company recorded an extraordinary gain for the early extinguishment of debt associated with a capitalized lease obligation. The Company retired $13.7 million in debt and removed related assets of $1.8 million from the consolidated balance sheets. Accordingly, an extraordinary gain of $7.2 million was recognized, after income tax expense of $4.7 million, or $0.12 per diluted share.

19. Reportable Segment Information

The Company has a single reportable segment encompassing its franchising business. Franchising revenues are comprised of royalty fees, initial franchise and relicensing fees, and partner services revenue and other. Marketing and reservation fees and expenses are excluded from reportable segment information as such fees and associated expenses are reported net. Corporate and other revenue consists of the operations of three MainStay hotels, product sales and European hotel operations. The Company does not allocate interest income, interest expense or income taxes to its franchising segment.

The following table presents the financial information for the Company's franchising segment:

	Year ended December 31, 2000		
	Franchising	Corporate and Other	Consolidated
Revenues	**$166,222**	**$ 1,252**	**$167,474**
Operating income (loss)	**136,985**	**(44,558)**	**92,427**
Depreciation and amortization	**100**	**11,523**	**11,623**
Capital expenditures	**8,665**	**7,925**	**16,590**
Total assets	**251,586**	**232,534**	**484,120**

	Year ended December 31, 1999		
	Franchising	Corporate and Other	Consolidated
Revenues	$157,729	$ 3,871	$161,600
Operating income (loss)	124,293	(30,123)	94,170
Depreciation and amortization	730	6,957	7,687
Capital expenditures	16,515	14,118	30,633
Total assets	248,028	216,630	464,658

	Year ended December 31, 1998		
	Franchising	Corporate and Other	Consolidated
Revenues	$143,628	$ 21,846	$165,474
Operating income (loss)	113,175	(28,024)	85,151
Depreciation and amortization	221	6,489	6,710
Capital expenditures	15,500	1,988	17,488
Total assets	208,096	190,129	398,225

The Company's international operations had revenues of $5.3 million, $6.9 million and $5.8 million for the years ended December 31, 2000, 1999 and 1998, respectively. Long-lived assets related to international operations were $10.9 million and $20.7 million as of December 31, 2000 and 1999, respectively. All other long-lived assets of the Company are associated with domestic activities. In addition, the Company had a $34.6 million and $41.2 million investment in Friendly as of December 31, 2000 and 1999, respectively.

20. Commitments and Contingencies

The Company is a defendant in a number of lawsuits arising in the ordinary course of business. In the opinion of management and general counsel to the Company, the ultimate outcome of such litigation will not have a material adverse effect on the Company's business, financial position, results of operations or cash flows.

In January 2001, the Company provided Friendly, in association with Friendly's restructuring (see Note 5 to Consolidated Financial Statements), with a letter of credit in an amount up to £7.8 million (approximately US $11.4 million) to guarantee additional credit facilities from Friendly's banks.

From time to time, the Company establishes programs or helps franchisees obtain financing. One of the past programs was a "Construction to Permanent Financing" program under which Salomon Smith Barney together with Suburban Capital Markets, Inc. offered $100 million in financing per year to qualified franchises and the Company guaranteed such loans with a maximum guarantee amount of $10 million. At December 31, 2000 and 1999, loans outstanding under this program were $6.0 million and $14.3 million, respectively, and the Company's guarantee covered $3.0 million and $7.2 million, respectively, of these loans. In 2001, the $6.0 million loan was settled, removing the Company's open guarantee of $3.0 million.

21. Fair Value of Financial Instruments

The balance sheet carrying amount of cash and cash equivalents and receivables approximate fair value due to the short-term nature of these items. Long-term debt consists of bank loans and senior notes. Interest rates on bank loans adjust frequently based on current market rates; accordingly, the carrying amount of bank loans is equivalent to fair value.

The Note from Sunburst has an approximate fair value of $139.4 million and $135.0 million at December 31, 2000 and 1999, respectively, based on its current yield to maturity. The $100 million unsecured senior notes have an approximate fair value at

December 31, 2000 and 1999 of $97.9 million and $93.9 million, respectively, based on their current yield to maturity.

22. Impact of Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board (Board) issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which established accounting and reporting standards for derivative instruments, including derivative instruments embedded in other contracts, and for hedging activities. SFAS No. 133 requires the recognition of the fair value of derivatives in the statement of financial position, with changes in the fair value recognized either in earnings or as a component of other comprehensive income dependent upon the hedging nature of the derivative. In June 1999, the Board issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133," which deferred the effective date of SFAS No. 133 until fiscal years beginning after June 15, 2000. SFAS No. 133 does not have a material impact on the Company's earnings or other comprehensive income.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition," which requires revenues to be recognized when realized and earned. Revenue is generally realized and earned when all of the following criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the selling price must be fixed or determinable; and, (iv) collectibility is reasonably assured. The Company implemented SAB No. 101 in 2000.

23. Selected Quarterly Financial Data — (Unaudited)

(In thousands, except per share data)

2000	First	Second	Third	Fourth	Total Year
Revenue	$31,647	$41,165	$50,113	$44,549	$167,474
Operating income	16,916	24,041	32,797	18,673	92,427
Income before income taxes	14,439	19,079	31,921	4,143	69,582
Net income	8,808	11,638	19,472	2,527	42,445
Per basic share:					
Net income	$0.16	$0.22	$0.37	$0.05	$0.80
Per diluted share:					
Net income	$0.16	$0.22	$0.37	$0.05	$0.80

1999	First	Second	Third	Fourth	Total Year
Revenues	$30,805	$39,763	$48,016	$43,016	$161,600
Operating income	16,250	24,282	30,290	23,348	94,170
Income before income taxes	17,272	24,280	30,381	22,538	94,471
Net income	10,277	14,531	18,338	14,009	57,155
Per basic share:					
Net income	$0.18	$0.26	$0.34	$0.26	$1.04
Per diluted share:					
Net income	$0.18	$0.26	$0.33	$0.26	$1.03

BOARD OF DIRECTORS

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Sunburst Hospitality Corporation

Barbara Bainum
Vice Chairman:
Commonweal Foundation
Realty Investment Company, Inc.

William L. Jews
President and Chief Executive Officer:
CareFirst BlueCross BlueShield
Director:
Ecolab, Inc.
MBNA
Ryland Group, Inc.

Charles A. Ledsinger, Jr.
President and Chief Executive Officer:
Choice Hotels International, Inc.
Director:
FelCor Lodging Trust, Inc.
Friendly's Ice Cream Corporation
TBC Corporation

Lawrence R. Levitan
Chairman:
IRS Oversight Board
Retired Managing Partner:
Andersen Consulting's
Worldwide Communications Industry Group

Gerald W. Petitt*
President and Chief Executive Officer:
Creative Hotel Associates LLC

**Mr. Petitt will retire from the Board at the May 2001 Annual Meeting.*

Jerry E. Robertson, Ph.D.
Retired Executive Vice President:
3M Life Sciences Sector and Corporate Services
Director:
Coherent Inc.
Steris Corp.

Raymond E. Schultz
Chairman
RES Investments, L.L.C.
Director:
Equity Inns, Inc.
TBC Corporation

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Chairman of the Board

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President and Chief Executive Officer

Steven T. Schultz
Executive Vice President, Domestic Hotels

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Senior Vice President, General Counsel and Secretary

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Thomas Mirgon
Senior Vice President, Administration

Daniel Rothfeld
Senior Vice President,
E-commerce and Emerging Business Opportunities

Joseph M. Squeri
Senior Vice President,
Chief Financial Officer and Treasurer

Gary Thomson
Senior Vice President and Chief Information Officer

Wayne W. Wielgus
Senior Vice President, Marketing

CORPORATE OFFICERS

Don Brockway
Vice President, Reservations Operations

Gregory A. Bublitz
Vice President, Finance and Controller

Brendan M. Ebbs
Senior Vice President, Franchise Operations

Janna Morrison
Vice President, Property Systems

Kevin M. Rooney
Associate General Counsel and Assistant Secretary

William Weatherford
Senior Vice President, Franchise Operations

MARKET AREA VICE PRESIDENTS

Brendan M. Ebbs
Senior Vice President, Franchise Operations
North Market Area

Brent Russell
Vice President, Franchise Operations
West Market Area

William Weatherford
Senior Vice President, Franchise Operations
South Market Area

BRAND MANAGEMENT

Thomas Hall
Vice President and Brand Manager
Emerging Brands

Peter Jordan
Vice President and Brand Manager
Core Brands

Tim Shuy
Vice President and Brand Manager
Economy Brands

CORPORATE INFORMATION

Stock Listing
Choice Hotels International common stock trades on the New York Stock Exchange under the ticker symbol CHH.

Transfer Agent & Registrar
Mellon Investor Services LLC
Overpeck Centre
85 Challenger Road
Ridgefield, NJ 07660
www.chasemellon.com

Independent Auditors
Arthur Andersen LLP
Vienna, Virginia

Annual Meeting Date
Choice Hotels International will hold its Annual Meeting of Stockholders on Tuesday, May 15, 2001, at 8:30 a.m. in The Chesapeake Room of the Learning Center, 10720 Columbia Pike, Silver Spring, Maryland.

Form 10-K
A stockholder may receive without charge a copy of the Form 10-K Annual Report filed with the Securities and Exchange Commission by written request to the Corporate Secretary at the corporate headquarters.

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Choice has embarked on an aggressive drive to recruit new minority franchisees and encourage minority suppliers.

Indicative of the types of franchisees the company seeks are James and Saundra Roath of Marco Island, Florida, who are building a Quality Inn & Suites hotel in nearby Naples, and Sandra Spears of Detroit, who is developing a Quality Suites hotel in Pontiac, Michigan. James Roath was one of the first African-American franchisees for McDonald's and founded Perfection Industrial Distributors, one of the largest black-owned services companies in America.

A former high school and college track star from Pontiac, Sandra Spears is the first black woman to become a Choice franchisee. She founded Spears Global Marketing, a sales consulting firm, and has been active as a member of the Michigan Minority Business Development Council.

The company has increased its presence at such conventions as the annual meeting of the NAACP, the Black Enterprise Conference and regional trade shows aimed at promoting minority franchising. In addition, Choice has started a program of seminars on franchising for minority entrepreneurs at The Learning Center in its Silver Spring headquarters complex. Assisting in the program, entitled "Exploring the Potential of Franchising," are the U.S. Chamber of Commerce, the International Association of Black Hotel Owners & Developers, and the U.S. Department of Commerce Minority Business Development Agency.

Clarion

Quality

Comfort

Comfort
Suites

Sleep

MainStay
Suites

Econo
Lodge

RODEWAY

CHOICE HOTELS
INTERNATIONAL