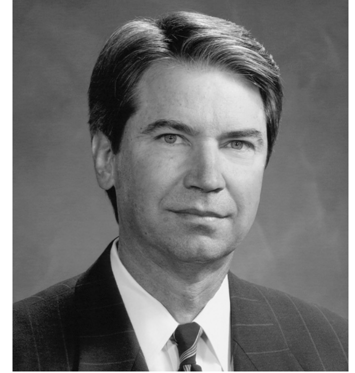
CHOICE HOTELS INTERNATIONAL®

2002 ANNUAL REPORT

Building On Our Shared Success

Building On Our Shared Success

Choice Hotels International is one of the world's largest lodging franchisors, marketing **more than 5,000 hotels** open or under development in **48 countries and territories** under the Comfort Inn, Comfort Suites, Quality, Clarion, Sleep Inn, MainStay Suites, Econo Lodge, and Rodeway Inn brand names.



Charles A. Ledsinger, Jr.

President and Chief Executive Officer

Dear Shareholders:

As I write this year's report to you, we find ourselves in an economic and geopolitical climate marked by much uncertainty. One might be tempted to fall victim to the "doom and gloom" forecasts of some observers. But I remain optimistic that we will weather the storm ahead and find better days awaiting us in the not-too-distant future.

Part of this optimism comes from the gratifying results our company has achieved in the past two years, despite the sluggish economy, reduced travel demand and a world in turmoil. It also stems from our commitment to build our business through shared success with our franchisees, vendor partners, associates and shareholders.

After all, we can only succeed when our various stakeholders succeed. The inherent mutual reliance of a franchise system calls for trust, common goals and hard work if such an enterprise is to prosper.

Choice Hotels continues to thrive in a turbulent environment because of the fundamental soundness of its franchising business model and the clarity of our business strategy. Using the size, scale and distribution of more than 5,000 hotels open and under development in all 50 states and 48 countries and territories, Choice continues to **reach more consumers**, **deliver exceptional services** and **build strong brands**.

For the year 2002, our company earned diluted earnings per share of $1.52, compared to $0.32 for 2001. The company also enjoyed domestic unit growth of 4.7% and grew royalty fees by 2.0% while generating system-wide domestic revenues of $3.4 billion. We also generated nearly $100 million in cash flows from operations.

These results confirm what we already knew—our franchising model is largely resistant to industry fluctuations and economic swings. In fact, customers value the franchise affiliation even more during uncertain economic times. Our royalty revenue stream has steadily increased because of our successful unit growth.

For our more than 2,500 franchisees, our franchise success system offers stability, performance and value in an unsettled lodging environment. With a stable management team and a sound strategic direction in place, we provide our hotel owners with a high degree of confidence that we can help them compete effectively for market share in a diminished travel market. This franchisee support, in turn, builds the attractiveness of our brands for new development and generates further growth.

Unit Growth Fuels Success

For a franchising business, unit growth is the fuel that fires the engine. In Choice's case, we have made great strides in building our development expertise and in winning a greater market share of lodging franchises.

Our product offering, with a mix of new build and conversion hotel brands in the mid-priced and economy segments, provides us with great flexibility to drive unit growth even in tougher economic times.

In 2002, we saw unit growth increase 4.7% domestically and 2.6% globally, very good numbers relative to the industry. In fact, Choice is one of the very few companies continuing to gain development market share of recent hotel openings among franchisors.

At year's end, we had signed 304 new contracts, representing 25,657 rooms, compared to 300 new deals, representing 25,757 rooms, in the prior year. Of our contracts in 2002, 241 or almost

79% were for conversions. At the same time, our retention rate for domestic franchisees remains high, with only 1% of franchisees choosing to leave the system in 2002 while terminations were down 14%. The result is a more stable, growing franchise system that contributes positively to the overall predictability of our business.

For the near term, our development opportunities remain in the conversion arena, where existing hotels seek new brand affiliations that can build their business. Our enhanced leadership in franchise development, along with a stronger sales staff and a performance pay system, is definitely paying off.

We have increased the size of our franchise sales staff and improved it by bringing a singular focus to sell all of our brands more effectively. In addition, we have created more cost-effective prototypes for our new construction brands that will position us very well once the hotel market improves.

A larger Choice franchise system benefits our franchisees by providing even more size, scale and distribution to drive cost efficiencies and deliver more value-added services.

Proven Strategy for All Scenarios

In my report last year, I stated our commitment to pursuing our overarching strategic goals of **reaching more consumers**, **delivering exceptional services** and **building strong brands**. Underpinning these three cornerstones is our drive to **leverage our size**, **scale and distribution**.

Our strategy remains unchanged. It has proven the right course in a challenging economic time and has the opportunity to be even more successful when the economy and the lodging industry rebound.

In terms of **reaching more consumers**, we have adopted a multi-brand marketing approach that increases the visibility of all Choice brands efficiently while driving local market penetration through effective co-op marketing with our franchisee associations.

Our seasonal promotions aimed at both leisure and business travelers have relied on value-added promotions with key partners through co-branding. For example, we have teamed up with the major domestic airlines to offer triple miles promotions to drive more business travelers to our hotels. In the summer, our brands have linked up with McDonald’s, major gasoline companies and Lowe’s Home Improvement Warehouse in special promotions aimed at the leisure traveler.

On the reservations side of the business, we continue to see a continued shift away from the toll-free telephone to the Internet as the primary tool for booking reservations. As a result, we have revamped our proprietary Web site, choicehotels.com, to improve functionality and enhance content for consumers.

We also are working to improve our positioning through negotiated contracts and co-op marketing with third-party Web sites. In this manner, we can help our franchisees deal with the complexity of a multitude of Internet travel sites and better manage their inventory.

This year we have already created a Best e-Rate Guarantee for our Choice Internet site and also will leverage technology for one-on-one marketing with our frequent traveler program members.

Our drive to **deliver exceptional services** to our franchisees calls for providing a complete life-cycle service that meets their needs, from site selection and prototypes through construction and training, and finally on to sales and marketing, purchasing and operations.

In a time when our franchisees are under pressure to preserve rates and occupancy, our field services are focused on providing the tools and technology needed to maximize profitability for our franchisees. Historical data collected through our central reservations system and our property management systems can help them forecast individual hotel performance. We also work with the hotels to analyze competitive rates across all distribution channels to better manage inventory and maximize rate potential.

Through our Partner Services capabilities, we offer on-line purchasing with endorsed vendors for lodging goods and services that saves money and simplifies operations for hotel owners while generating revenue for Choice.

We already have a broad portfolio of well-recognized brands that offer franchisees excellent opportunities for success. Part of **building strong brands** is our emphasis on better integrating brand and development strategy in order to enhance consumer brand positioning through attention to rate, location, amenities and service. We are improving brand consistency through more control at the franchise point-of-entry and focusing our brands where they can attract the most business. In this manner, we can protect the investment of those franchisees who support our standards and goals. We also can improve overall system quality.

We continue to build brand equity by increasing brand awareness and enhancing the images of our brands. Now we have to sharpen our focus to make sure the brands deliver on the guest experience they promise. This year we have set a goal of instituting a new Quality Assurance System that will involve direct guest feedback and should result in greater guest satisfaction.

Facing Our Future with Confidence

When I assumed the role of president and chief executive officer a little over four years ago, I encountered a franchisor-franchisee relationship that was strained. Management changes and shifts in strategy had left franchisees confused about the company's direction.

Since then, I, along with our management team and all Choice associates, have worked tirelessly to forge a more trusting and consistent relationship with our franchisees. Today I can say that our franchisees have a much better understanding of our strategy and much greater faith in our commitment to shared success.

I also enjoy the benefit of a very fine Board of Directors, whose wise counsel and strong support mean so much to the success of Choice Hotels. I am especially pleased that we welcomed Ervin Shames to the Board this past April. His consumer marketing background has added considerable value.

Together we have weathered a great deal of challenge in the face of real uncertainty and adversity. The mutual success of the past four years has built a much stronger foundation for the future and a much healthier Choice franchise system.

During my tenure, we also have worked diligently to strengthen our balance sheet and increase shareholder value through targeted stock repurchases. For a business that generates significant free cash flow, stock buybacks have proven to be an efficient way to build shareholder value and help generate strong EPS.

The future we face together may seem cloudy and uncertain. But it is a future we face with confidence, knowing that we already have endured some of the worst days our industry has ever faced. And, it is a future that holds great promise once the geopolitical climate stabilizes and the economy begins to grow more vigorously.

I thank our franchisees, hotel guests, vendor partners, associates, Board members and all of you for your support. With a firm commitment to shared success, Choice Hotels can continue to grow and prosper in the years ahead.

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

March 20, 2003

A Choice Year in Review

January

- The first non-MainStay Suites Express Services Kiosk is installed in the Comfort Inn DFW Airport South of Irving, Tex.
- Choice launches a triple miles promotion with American Airlines, Delta Air Lines, Northwest Airlines and US Airways.

February

- Print and television ads (which air during the 2002 Winter Olympics) are launched to promote the “Triple Miles” and “Thanks a Million” sweepstakes.
- Choice’s Strategic Alliances department negotiates a low-cost benefits package for medical, dental, vision, prescription drug and life insurance coverage that franchisees can offer to their employees.

March

- Four new senior directors are selected to complete the new brand management team under Thom Hall, national vice president, Brand Management and Strategies.

April

- Franchisees and hotel managers gain access to each brand’s Rules and Regulations via ChoiceCentral, an on-line information source.

May

- Rudy Guiliani, former mayor of New York City, speaks to more than 4,000 attendees at Choice’s 48th Annual Convention in Atlanta.
- Revamped Franchise Services makes its debut at the Annual Convention with Janna Morrison, senior vice president, discussing the changes with Chuck Ledsinger, president and chief executive officer.
- Choice’s mid-priced brands offer a “Free Fuel, Free McDonald’s Meal” promotion at 2,400 hotels nationwide to launch the summer travel season.

June

- The Econo Lodge and Rodeway Inn brands team up with Lowe’s Home Improvement Warehouse for the “Race In, You Could Win” promotion, giving away collectible scratch-and-win cards.
- HVS Executive Search names Chuck Ledsinger, Choice’s president and chief executive officer, as the lodging industry’s top chief executive officer for 2001.
- Sports Web site, www.choicesportstravel.com, makes booking rooms for teams, athletes and fans easier by offering a streamlined on-line booking process.

July

- Choice acquires a 55% controlling interest in Melbourne-based Flag Choice Hotels of Australia with an option to purchase the remaining 45% over a five-year period.
- The Minority Incentive Program is created to encourage franchise sales to African American, Hispanic and Native American developers.
- Redesigned ChoiceBuys.com offers franchisees an enhanced on-line shopping experience with new time- and money-saving features.

August

- “Room in a Can” is launched, providing franchisees with an integrated turnkey solution for a property’s furniture, fixture and equipment, operation supplies, and procurement requirements.

September

- Choice offers a “Get Together Sweepstakes” to promote fall leisure travel.
- Sleep Inn brand celebrates milestone of 300 hotels in the United States with the opening of the Sleep Inn, Inn & Suites hotel of Bensalem, Pa.

October

- International Operators Council, the Choice Hotels International Foundation and franchisees donate more than $56,000 to three non-profit agencies that provide financial assistance to families of Navy, Army, Marine and Air Force personnel.

November

- Choice extends the contract of Chuck Ledsinger as president and chief executive officer for another four years through October 2006.
- Brent Russell is named chief executive officer of Flag Choice Hotels of Australia.
- Choice Hotels Canada launches its Choice Club Plus program, which builds on the amenities and services club members already receive in Choice Club.

December

- New prototypes for the Econo Lodge brand include a first-ever “Inn & Suites” option.
- The Quick Check Review is added to the Quality Assurance Review system, giving properties receiving award-eligible scores an abbreviated consumer-focused review.

TABLE OF CONTENTS

Financial Highlights	F-1
Management's Discussion and Analysis of Financial Condition and Results of Operations	F-2
Report of Independent Accountants	F-13
Report of Independent Public Accountants	F-14
Consolidated Financial Statements	F-15
Notes to Consolidated Financial Statements	F-19

Financial Highlights

	As of or for the years ended December 31,				
	2002	**2001**	**2000**	**1999**	**1998**
	(in millions, except per share data)		As Revised (See Note 1 to the Consolidated Financial Statements)		
Company Results					
Total Assets	**$ 314.4**	$ 321.2	$ 484.1	$ 464.7	$ 398.2
Long-Term Debt	**307.8**	281.3	297.2	307.4	279.2
Total Revenues	**365.6**	341.4	352.8	324.2	295.4
Net Income	**60.8**	14.3	42.4	57.2	55.3
Cash Flow from Operations	**99.0**	101.7	53.9	65.0	40.5
Basic Earnings per Share	**$ 1.55**	$ 0.32	$ 0.80	$ 1.04	$ 0.94
Diluted Earnings per Share	**$ 1.52**	$ 0.32	$ 0.80	$ 1.03	$ 0.93
System Results – (Unaudited)					
Domestic:					
Revenues (estimated in millions)	**$ 3,406**	$ 3,375	$ 3,423	$ 3,256	$ 3,063
Franchise Hotels	**3,482**	3,327	3,244	3,123	3,039
Franchise Hotels Under Development	**310**	462	493	596	866
Franchise Rooms	**282,423**	270,514	265,962	258,120	252,357
Revenue Per Available Room	**$ 34.48**	$ 35.83	$ 36.72	$ 35.33	$ 34.35
Total (Domestic and International)					
Franchise Hotels	**4,664**	4,545	4,392	4,248	3,670
Franchise Hotels Under Development	**474**	689	703	761	1,005
Franchise Rooms	**373,722**	362,549	350,351	338,254	305,171

Management's Discussion and Analysis of Financial Condition and Results of Operations

Choice Hotels International, Inc. and subsidiaries (together "the Company") is one of the largest hotel franchisors in the world with 4,664 hotels open and 474 hotels under development as of December 31, 2002, representing 373,722 rooms open and 41,565 rooms under development in 48 countries and territories. The Company franchises hotels under the Comfort, Comfort Suites, Quality, Clarion, Sleep Inn, Econo Lodge, Rodeway Inn, MainStay Suites and Flag Choice Hotels brand names. The Company's franchises operate in all 50 states, Puerto Rico and 38 additional countries and territories. Approximately 96% of the Company's franchising revenue is 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; operating performance, including occupancy and room rates, achieved by the hotels under franchise; the number and relative mix of franchised hotels; the effective royalty rate achieved; 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. Our variable overhead costs associated with franchise system growth have historically been 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.

Critical Accounting Policies

Revenue Recognition

The Company accounts for initial franchise fees in accordance with Statement of Financial Accounting Standards ("SFAS") No. 45, "Accounting for Franchise Fee Revenue." The Company enters into franchise agreements committing to provide franchisees with various marketing services, a centralized reservation system and limited rights to utilize the Company's registered tradenames and trademarks. These agreements typically have an initial term of twenty years with provisions permitting franchisees to terminate after five, ten, or fifteen years under certain circumstances. In most instances, initial franchise fees are recognized upon execution of the franchise agreement because the initial franchise fee is non-refundable and the Company has no continuing obligations related to the franchisee. The initial franchise fee related to executed franchise agreements which include incentives, such as future potential rebates, are deferred and recognized when the incentive criteria are met or the agreement is terminated, whichever occurs first.

Royalty fees, which are typically based on a percentage of gross room revenues of each franchisee, are recorded when earned. Reserves for uncollectible royalty fees 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, including marketing and reservation fees, which are used exclusively by the Company for expenses associated with providing franchise services such as national marketing, media advertising, central reservation systems and technology services. 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 Company revised its presentation of marketing and reservation revenues during the fourth quarter of 2001 to comply with Emerging Issues Task Force ("EITF") Issue No. 99-19 "Reporting Revenue Gross as a Principal versus Net as an Agent." The Company had previously presented these revenues net of related expenses on its consolidated statements of income. EITF 99-19 requires that these revenues be recorded gross and accordingly, the Company has revised its financial statement presentation for all periods presented. In addition,

net advances to and repayments from the franchise system for marketing and reservation activities have been reclassified to present these activities as cash flows from operating activities for all periods presented. These revisions had no effect on the net income or cash flows reported during the periods revised.

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. Cumulative excess or shortfall amounts from the operation of these programs are recorded as a marketing or reservation fee payable or receivable. Under the terms of the franchise agreements, the Company may advance capital as necessary for marketing and reservation activities and recover such advances through future fees (see Note 6 to the Consolidated Financial Statements).

The Company generates partner services revenues from hotel industry vendors. Partner services revenues are generally earned based on the level of goods or services purchased from endorsed vendors by hotel owners and hotel guests who stay in the Company's franchised hotels. The Company accounts for these revenues in accordance with Staff Accounting Bulletin No. 101, ("SAB 101") "Revenue Recognition." SAB 101 provides guidance on the recognition, presentation and disclosure of revenue in financial statements. The Company recognizes partner services revenues when the services are performed or the product delivered, evidence of an arrangement exists, the fee is fixed and determinable and collectibility is probable. SAB 101 requires the Company to defer the recognition of partner services revenues related to upfront fees. Such upfront fees are generally recognized over a period corresponding to the Company's estimate of the life of the arrangement.

Impairment Policy

The Company evaluates the impairment of property and equipment and other long-lived assets, including franchise rights and other definite-lived intangibles, in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 states that an impairment of long-lived assets has occurred 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 fair value. The Company did not record any impairment on long-lived assets during the years ended December 31, 2002, 2001 or 2000.

The Company evaluates the impairment of goodwill in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," which requires goodwill to be assessed on at least an annual basis for impairment using a fair value basis. Because the Company operates in one reporting segment in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" and related interpretations, the fair value of the Company's total assets are used to determine if goodwill may be impaired. According to SFAS No. 142, quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement if available. The Company did not record any impairment of goodwill in 2002, 2001 or 2000 based on assessments performed by the Company.

The Company evaluates the collectibility of notes receivable in accordance with SFAS No. 114, "Accounting by Creditors For Impairment of a Loan." SFAS No. 114 states that a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement. The Company reviews outstanding notes receivable on a periodic basis to ensure that each is fully collectible by reviewing the financial condition of its debtors. If the Company concludes that it will be unable to collect all amounts due, the Company will record an impairment charge based

on the present value of expected future cash flows, discounted at the loan's effective interest rate. The Company did not record any impairment charges related to notes receivable during the years ended December 31, 2002 or 2001. During the year ended December 31, 2000, the Company recorded $7.6 million of impairment losses related to its subordinated term note to Sunburst Hospitality Corporation (see Note 7).

Stock Compensation

The Company accounts for its stock-based employee compensation plans in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, compensation expense related to fixed employee stock options is recorded only if on the date of grant the fair value of the underlying stock exceeds the exercise price. The Company adopted the disclosure only requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," which allows entities to continue to apply the provisions of APB Opinion No. 25 for transactions with employees and to provide pro forma net income disclosures as if the fair value based method of accounting, described in SFAS No. 123 had been applied to employee stock option grants.

Effective January 1, 2003, the Company adopted, in accordance with SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure," the fair value based method of accounting for stock option awards granted on or after January 1, 2003.

Comparison of 2002 Operating Results and 2001 Operating Results

The Company recorded net income of $60.8 million for the year ended December 31, 2002, an increase of $46.5 million from net income of $14.3 million for the year ended December 31, 2001. Net income in 2001 included an impairment charge of $22.7 million associated with the Company's determination to write-off its entire investment in Friendly Hotels PLC (currently known as C.H.E. Group PLC) ("Friendly"). Net income for 2001 also reflects $10.3 million of equity losses (net of taxes) in Friendly.

Summarized financial results for the years ended December 31, 2002 and 2001 are as follows:

	2002	2001
	(In thousands)	
REVENUES:		
Royalty fees	**$142,943**	$140,185
Initial franchise and relicensing fees	**12,881**	12,887
Partner services	**11,860**	12,042
Marketing and reservation	**190,145**	168,170
Hotel operations	**3,331**	3,215
Other	**4,402**	4,929
Total revenues	**365,562**	341,428
OPERATING EXPENSES:		
Selling, general and administrative	**54,904**	56,075
Restructuring charges	**1,616**	5,940
Impairment of Friendly investment	**—**	22,713
Depreciation and amortization	**11,251**	12,452
Marketing and reservation expense	**190,145**	168,170
Hotel operations	**2,946**	2,501
Total operating expenses	**260,862**	267,851
Operating income	**104,700**	73,577
Interest expense	**13,136**	15,445
Interest and other investment income	**(4,549)**	(4,329)
Equity in net losses of affiliates	**71**	16,436
Other	**224**	608
Income before income taxes	**95,818**	45,417
Income taxes	**34,974**	31,090
Net income	**$ 60,844**	$ 14,327

Management analyzes its business based on net franchise revenues, which is total revenues excluding marketing and reservation revenues and hotel operations, and franchise operating expenses that are reflected as selling, general and administrative expenses.

Franchise Revenues: Net franchise revenues were $172.1 million for the year ended December 31, 2002 compared to $170.0 million for the year ended December 31, 2001. Royalty fees increased $2.7 million to $142.9 million from $140.2 million in 2001, an increase of 1.9%. The increase in royalties is primarily attributable to a 4.4% increase in the number of domestic franchised hotel rooms and an increase in the effective royalty rate of the domestic hotel system to 3.97% from 3.95%, offset by a 3.8% decrease in RevPAR. Domestic initial fee revenue, included in the initial franchise and relicensing fees caption above, generated from executed franchise contracts increased 7.8% to $8.3 million for the year ended December 31, 2002 from $7.7 million for the year ended December 31, 2001. Relicensing fees declined 11.5% to $4.6 million for the year ended December 31, 2002 from $5.2 million for the year ended December 31, 2001. Relicensing fees are charged to the new property owner of a franchised property whenever an ownership change occurs and the property remains in the franchise system. The decrease in relicensing fees in 2002 reflects a lower number of such ownership changes in 2002 compared to 2001. Total domestic franchise agreements executed in 2002 were 304, compared to 300 total agreements executed in 2001. The number of rooms covered by contracts executed were 25,657 in 2002 compared to 25,757 in 2001. Revenues generated from partner services was $11.9 million, compared to $12.0 million in 2001.

The number of domestic rooms on-line increased to 282,423 from 270,514, an increase of 4.4% for the year ended December 31, 2002. For 2002, the total number of domestic hotels on-line grew 4.7% to 3,482 from 3,327 for 2001. International rooms on-line decreased slightly to 91,299 as of December 31, 2002 from 92,035 as of December 31, 2001, a decrease of 0.8%. The total number of international hotels on-line decreased to 1,182 from 1,218, a decrease of 3.0% for the year ended December 31, 2002. The decrease in international hotels online is primarily due to termination of certain Flag properties which failed to maintain the Company's brand standards or which declined to formalize a franchise relationship following the Company's acquisition of a controlling interest in Flag Choice Hotels during 2002. As of December 31, 2002, the Company had 310 franchised hotels with 23,766 rooms either in design or under construction in its domestic system. The Company has an additional 164 franchised hotels with 17,799 rooms under development in its international system as of December 31, 2002.

Franchise Expenses: The cost to operate the franchising business is reflected in selling, general and administrative expenses. Selling, general and administrative expenses were $54.9 million for the year ended December 31, 2002, a decrease of $1.2 million from the year ended December 31, 2001 total of $56.1 million. As a percentage of net franchise revenues, selling, general and administrative expenses declined to 31.9% in 2002 from 33.0% in 2001. This decline, which increased franchising margins from 67.0% to 68.1%, was largely due to reductions in selling, general and administrative expenses resulting from the Company's 2001 and 2000 restructurings.

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 for expenses associated with providing franchise services such 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.

Total marketing and reservation revenues were $190.1 million and $168.2 million for the years ended December 31, 2002 and 2001, respectively. Depreciation and amortization attributable to marketing and reservation activities was $13.0 million and $11.8 million for the years ended December 31, 2002 and 2001, respectively. Interest expense attributable to reservation activities was $1.4 million and $2.0 million for the years ended December 31, 2002 and 2001, respectively. Marketing and reservation activities provided a positive cash flow of $17.2 million and $20.3 million for the years ended December 31, 2002 and 2001, respectively. As of December 31, 2002 and 2001, the Company's balance sheet includes a receivable of $44.9 million and $49.4 million, respectively, for marketing and reservation fees. The Company has the contractual authority to require that the franchisees in the system at any given point repay the Company for any deficits related to marketing and reservation activities. The Company's current franchisees are legally obliged to pay any assessment the Company imposes on its franchisees to obtain reimbursement of such deficit regardless of whether those constituents continue to generate gross room revenue. The Company has no present intention to accelerate repayment of the deficit from current franchisees.

Hotel Operations: In September 2000, the Company received title to three MainStay properties from Sunburst Hospitality Corporation ("Sunburst") as consideration for $16.3 million of the then $149 million amount due under a note receivable from Sunburst. Revenues from hotel operations were $3.3 million and $3.2 million for the years ended December 31, 2002 and 2001, respectively. Selling, general and administrative expenses from hotel operations were $2.9 million and $2.5 million for those years, respectively.

Depreciation and Amortization: Depreciation and amortization decreased to $11.3 million in the year ended December 31, 2002 from $12.5 million in the year ended December 31, 2001. This decrease is primarily attributable to the Company's adoption of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets", pursuant to which the Company stopped amortizing goodwill effective January 1, 2002.

Friendly: The Company's entire investment in Friendly was written off in 2001, accordingly, the Company's 2002 results of operations do not include any equity method losses or other amounts related to Friendly. In addition to the $22.7 million impairment described below, the Company recorded equity method losses associated with its investment in Friendly totaling $10.3 million (net of tax) for the year ended December 31, 2001.

On February 21, 2002, Friendly announced that it had been unable to find an acceptable buyer for its business and would terminate such efforts at that time. Given the bid period termination and the adverse economic conditions of Friendly, the Company disposed of its entire preferred and common equity interest in Friendly on March 20, 2002, and immediately relinquished its three seats on Friendly's board of directors. Accordingly, the Company reduced its investment in Friendly to zero through a $22.7 million charge to reflect the permanent impairment of this asset as of December 31, 2001.

Interest and Other: Interest expense of $13.1 million in the year ended December 31, 2002 is down $2.3 million from $15.4 million in the year ended December 31, 2001 due primarily to lower effective interest rates. The Company's weighted average interest rate as of December 31, 2002 was 4.39% compared to 4.52% as of December 31, 2001. Included in the results for 2002 and 2001 is approximately $4.6 million and $4.2 million, respectively, of interest income earned on the note receivable from Sunburst. The note from Sunburst accrued interest up until June 2002, at which point interest became payable semi-annually in arrears. As of December 31, 2002, the Company's balance sheet includes an interest receivable from Sunburst of $2.3 million which is included in other current assets in the accompanying consolidated balance sheets and was paid to the Company by Sunburst in January 2003.

Comparison of 2001 Operating Results and 2000 Operating Results

The Company recorded net income of $14.3 million for the year ended December 31, 2001, a decrease of $28.1 million, compared to net income of $42.4 million for the year ended December 31, 2000. Operating income of $73.6 million in 2001 was $18.8 million less than 2000 operating income of $92.4 million due to an impairment charge of $22.7 million associated with the Company's investment in Friendly. Net income for 2001 was further adversely affected by a $10.3 million equity loss (net of taxes) in Friendly. The Friendly equity loss was due to mid-year adverse fixed asset valuation adjustments due to a decline in economic conditions and other incremental professional fees associated with Friendly's continuing restructuring program.

Summarized financial results for the years ended December 31, 2001 and 2000 are as follows:

	2001	2000
	(In thousands)	
		As Revised
REVENUES:		
Royalty fees	$140,185	$137,721
Initial franchise and relicensing fees	12,887	12,154
Partner services	12,042	10,300
Marketing and reservation	168,170	185,367
Hotel operations	3,215	1,249
Other	4,929	6,050
Total revenues	341,428	352,841
OPERATING EXPENSES:		
Selling, general and administrative	56,075	57,178
Restructuring charges	5,940	5,637
Impairment of Friendly investment	22,713	—
Depreciation and amortization	12,452	11,623
Marketing and reservation expense	168,170	185,367
Hotel operations	2,501	609
Total operating expenses	267,851	260,414
Operating income	73,577	92,427
Interest expense	15,445	18,490
Interest and other investment income	(4,329)	(15,534)
Equity loss on Friendly	16,436	12,071
Loss on Sunburst note	—	7,565
Other	608	253
Income before income taxes	45,417	69,582
Income taxes	31,090	27,137
Net income	$ 14,327	$ 42,445

Franchise Revenues: Net franchise revenues were $170.0 million for the year ended December 31, 2001 and $166.2 million for the year ended December 31, 2000. Royalties increased $2.5 million to $140.2 million from $137.7 million in 2000, an increase of 1.8%. The increase in royalties is attributable to a 1.7% increase in the number of domestic franchised hotel rooms and an increase in the effective royalty rate of the domestic hotel system to 3.95% from 3.85%. Domestic initial fee revenue generated from franchise contracts signed increased 20.3% to $7.7 million from $6.4 million for the year ended December 31, 2000. Total domestic franchise agreements signed in 2001 were 300, compared to 298 total agreements executed in 2000. The number of rooms added increased to 25,757 in 2001 from 24,582 in 2000. Revenues generated from partner service relationships increased 16.5% to $12.0 million from $10.3 million in 2000, related primarily to revenues earned from increased financial service programs and usage of construction material and service providers available to franchisees. 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 270,514 from 265,962, an increase of 1.7% for the year ended December 31, 2001. For 2001, the total number of domestic hotels on-line grew 2.6% to 3,327 from 3,244 for 2000. International rooms on-line increased to 92,035 as of December 31, 2001 from 84,389, an increase of 9.1%. The total number of international hotels on-line increased to 1,218 from 1,148, an increase of 6.1% for the

year ended December 31, 2001. The growth in international hotels and rooms on-line is primarily due to European growth. As of December 31, 2001, the Company had 462 franchised hotels with 36,406 rooms either in design or under construction in its domestic system. The Company has an additional 227 franchised hotels with 19,954 rooms under development in its international system as of December 31, 2001.

Franchise Expenses: The cost to operate the franchising business is reflected in selling, general and administrative expenses. Selling, general and administrative expenses were $56.1 million for the year ended December 31, 2001, a decrease of $1.1 million from the year ended December 31, 2000 total of $57.2 million. As a percentage of net franchise revenues, selling, general and administrative expenses declined to 33.0% in 2001 from 34.4% in 2000. This decline, which increased franchising margins from 65.6% to 67.0%, was largely due to reductions resulting from the 2000 and 2001 restructurings and the economies of scale generated from operating a larger franchisee base.

Marketing and Reservations: The total marketing and reservation fees received by the Company were $168.2 million and $185.4 million for the years ended December 31, 2001 and 2000, respectively. Depreciation and amortization attributable to marketing and reservation activities was $11.8 million and $10.5 million for the years ended December 31, 2001 and 2000, respectively. Interest expense attributable to reservation activities was $2.0 million and $4.8 million for the years ended December 31, 2001 and 2000, respectively. Marketing and reservation activities provided a positive cash flow of $20.3 million in 2001, versus a negative cash flow of $14.5 million in 2000. As of December 31, 2001, the Company's balance sheet includes a receivable of $49.4 million for marketing and reservation activities.

Hotel Operations: Revenue from hotel operations were $3.2 million and $1.2 million for the years ended December 31, 2001 and 2000, respectively. Selling, general and administrative expenses from hotel operations were $2.5 million and $0.6 million for those years, respectively.

Depreciation and Amortization: Depreciation and amortization increased to $12.5 million in the year ended December 31, 2001 from $11.6 million in the year ended December 31, 2000. This increase was primarily attributable to new computer systems installations and corporate office renovations.

Friendly: The Company's investment in Friendly resulted in equity losses associated with Friendly's comprehensive restructuring program totaling $16.4 million and $12.1 million for the years ended December 31, 2001 and 2000, respectively. Mid-year adverse fixed asset valuation adjustments due to a decline in economic conditions and incremental professional fees associated with the reorganization primarily account for the $16.4 million charge.

On February 21, 2002, Friendly announced that it had been unable to find an acceptable buyer for its business and would terminate such efforts at that time. Given the bid period termination and the adverse economic conditions of Friendly, the Company disposed of its entire preferred and common equity interest in Friendly on March 20, 2002, and immediately relinquished its three seats on Friendly's board of directors. Accordingly, the Company reduced its investment in Friendly to zero through a $22.7 million charge to reflect the permanent impairment of this asset as of December 31, 2001.

Interest and Other: Interest expense of $15.4 million in the year ended December 31, 2001 is down $3.1 million from $18.5 million in the year ended December 31, 2000 due to lower interest rates. Included in the results for 2001 and 2000 is approximately $4.2 million and $15.2 million, respectively, of interest income earned on the note receivable from Sunburst. The Company recognized a $7.6 million loss associated with the monetization of $137.5 million of the Sunburst note during the year ended December 31, 2000.

Liquidity and Capital Resources

Net cash provided by operating activities was $99.0 million for the year ended December 31, 2002, representing a slight decrease of $2.7 million from $101.7 million for the year ended December 31, 2001. The decrease in cash provided by operating activities was primarily due to lower repayments related to marketing and reservation activities offset by improved management of working capital. As of December 31, 2002, the total long-term debt outstanding for the Company was $307.8 million, $23.8 million of which matures in the next twelve months.

During each of the past three years, the Company has realigned its corporate structure to increase its strategic focus on delivering value-added services and support to franchisees, including centralizing the Company's franchise service and sales operations, consolidating its brand management functions and realigning its call center operations. The Company recorded a $1.6 million restructuring charge in 2002 of which approximately $0.4 million was paid in 2002. The restructuring charges represented employee severance and termination benefits. The restructuring was initiated and completed in 2002 and the Company expects the remaining liability to be paid during 2003. The Company paid $3.1 million related to the 2001 restructuring liability during the year ended December 31, 2002, and expects the remaining $0.6 million liability to be substantially paid in 2003. The Company paid $0.2 million related to the 2000 restructuring liability for the year ended December 31, 2002, which completed the restructuring.

The Company received net cash repayments related to marketing and reservation activities totaling $17.2 million and $20.3 million during the years ended December 31, 2002 and 2001, respectively. The 2002 and 2001 net repayments are associated with cost reductions from restructured operations, growth in fees from normal operations and increases in property and yield management fees. The Company expects marketing and reservation activities to generate positive cash flows between $16.0 million and $19.0 million in 2003.

Cash (utilized in) provided by investing activities for the years ended December 31, 2002, 2001 and 2000, was ($14.7 million), $87.7 million and ($16.6 million), respectively. During the years ended December 31, 2002, 2001 and 2000, capital expenditures totaled $12.2 million, $13.5 million and $16.6 million, respectively. Capital expenditures include the installation of system-wide property and yield management systems, upgrades to financial and reservation systems, computer hardware and renovations to the Company's corporate headquarters (including a franchisee learning and training center). During 2001, the Company received a cash payment of $101.9 million from Sunburst related to a note receivable due to the Company.

On September 1, 2000, the Company monetized $16.3 million in principal and interest of the $115 million principal, five-year Subordinated Term Note (the "Old Note") to Sunburst issued in October 1997. The Company received three MainStay Suites properties through the monetization transaction. In connection with an amendment of the strategic alliance agreement between the Company and Sunburst, effective October 15, 2000, interest payable on the Old Note accrued at a rate of 11% per annum compounded daily. The Company implemented this amendment prospectively beginning on January 1, 1999, and recognized interest on the outstanding principal and accrued interest amounts at an effective rate of 10.58%. Total interest accrued at December 31, 2000 was $42.2 million. 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% (the "New Note") in settlement of the balance of the Old Note. In 2000, the Company recognized a pre-tax loss of $3.5 million resulting from this transaction. The New Note accrued interest up until June 2002, at which point interest became payable semi-annually in arrears. As of December 31, 2002, the Company's balance sheet includes an interest receivable from Sunburst of $2.3 million which is included in other current assets in the accompanying consolidated balance sheets and was paid to the Company by Sunburst in January 2003.

Financing cash flows relate primarily to the Company's borrowings under its credit lines and treasury stock purchases. In June 2001, the Company entered into a five-year $265 million competitive advance and multi-currency credit facility. The credit facility provides for a term loan of $115 million and a revolving credit facility

of $150 million, $37 million of which is available in foreign currency borrowings. As of December 31, 2002, the Company had $98.7 million of term loans and $102.0 million of revolving loans outstanding. The term loan is payable over the next four years, $17.3 million of which is due in 2003. 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. Borrowings under the credit facility are, at the option of the borrower, at one of several rates including LIBOR plus .60% to 2.0% basis points, based upon the credit rating of the Company 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 1⁄15 of 1% to 1⁄2 of 1% based upon the credit rating of the Company. The proceeds from the credit facility are used for general corporate purposes, including working capital, debt repayment, stock repurchases, investments and acquisitions.

In 1998, the Company completed a $100 million senior unsecured note offering ("the Notes"), bearing a coupon rate of 7.13% with an effective rate of 7.22%. The Notes will mature on May 1, 2008, with interest on the 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 previous credit facility.

In August 2002, the Company entered into a new $10.0 million revolving line of credit with a maturity of August 2003. The new line of credit includes customary financial and other covenants that require the maintenance of certain ratios identical to those included in the Company's existing senior credit facility. Borrowings under the line of credit bear interest at rates established at the time of borrowing based on prime minus 175 basis points. The Company had $6.4 million outstanding at December 31, 2002 under this line of credit.

Through December 31, 2002, the Company had repurchased 26.5 million shares of its common stock at a total cost of $434.9 million, including 5.4 million shares at a cost of $120.9 million during the year ended December 31, 2002. Subsequent to December 31, 2002 and through March 11, 2003, the Company repurchased 1.3 million shares of common stock at a total cost of $30.3 million.

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

Impact of Recently Issued Accounting Standards

In April 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145, among other matters, updates and clarifies existing accounting pronouncements related to gains and losses from the extinguishment of debt and certain lease modifications that have economic effects similar to sale-leaseback transactions. The provisions of SFAS No. 145 were generally effective as of May 15, 2002. The adoption of SFAS No. 145 did not have a material impact on our results of operations or financial position.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires companies to recognize costs associated with exit (including restructuring) or disposal activities at fair value when the related liability is incurred rather than at the date of a commitment to an exit or disposal plan as previously required. Costs covered by the standard include certain contract termination costs, certain employee termination benefits and other costs to consolidate or close facilities and relocate employees that are associated with an activity being exited or long-lived assets being disposed. As permitted by SFAS No. 146, we adopted SFAS No. 146 in 2002.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." Such Interpretation elaborates on the disclosures to be made by a guarantor about its obligations under certain guarantees issued. It

also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this Interpretation apply to guarantees issued or modified after December 31, 2002. We will adopt these provisions on January 1, 2003. The disclosure provisions of this Interpretation are effective for financial statements with annual periods ending after December 15, 2002. We have applied the disclosure provisions of this Interpretation as of December 31, 2002, as required (See Note 19 to the Consolidated Financial Statements).

On December 31, 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure." This standard amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. This standard also requires prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We have applied the disclosure provisions of SFAS No. 148 as of December 31, 2002. (See Note 1 to the Consolidated Financial Statements).

As permitted by SFAS No. 123, during 2002, we measured stock-based compensation using the intrinsic value approach under Accounting Principles Board Opinion No. 25. Accordingly, we did not recognize compensation expense upon the issuance of our stock options because the option terms were fixed and the exercise price equaled the market price of the underlying common stock on the grant date. We complied with the provisions of SFAS No. 123 by providing pro forma disclosures of net income and related per share data giving consideration to the fair value method provisions of SFAS No. 123.

On January 1, 2003, we adopted the fair value method of accounting for stock-based compensation provisions of SFAS No. 123, which is considered by the FASB to be the preferable accounting method for stock-based employee compensation, and have elected to use the prospective method permitted by SFAS No. 148. Therefore, the transition provisions of SFAS No. 148 will be adopted concurrently with the fair value based recognition provisions of SFAS No. 123 on January 1, 2003. Subsequently, we will expense all future employee stock awards over the vesting period based on the fair value of the award on the date of grant in accordance with the prospective transition method.

Forward-Looking Statements

Certain statements in this report 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 and geopolitical events such as acts of war or terrorism; the availability of capital to allow us and potential hotel owners to fund investments in 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 September 30, 2001. Given these uncertainties, you are cautioned not to place undue reliance on such statements. We also undertake no obligation to publicly update or revise any forward-looking statement to reflect current or future events or circumstances.

Report of Independent Accountants

To the Board of Directors and Stockholders
of Choice Hotels International, Inc. and subsidiaries:

In our opinion, the accompanying consolidated balance sheet as of December 31, 2002 and the related consolidated statements of income, shareholders' equity (deficit) and comprehensive income and cash flows present fairly, in all material respects, the financial position of Choice Hotels International, Inc. and it's subsidiaries at December 31, 2002, and the results of their operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. The financial statements of the Company as of December 31, 2001, and for each of the two years in the period ended December 31, 2001, were audited by other independent accountants who have ceased operations. Those independent accountants expressed an unqualified opinion on those financial statements in their report dated March 20, 2002.

As discussed above, the financial statements of the Company as of December 31, 2001, and for each of the two years in the period ended December 31, 2001, were audited by other independent accountants who have ceased operations. As described in Note 3, these financial statements have been revised to include the transitional disclosures required by Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets", which was adopted by the Company as of January 1, 2002. We audited the transitional disclosures described in Note 3. In our opinion, the transitional disclosures for 2001 and 2000 in Note 3 are appropriate. However, we were not engaged to audit, review, or apply any procedures to the 2001 or 2000 financial statements of the Company other than with respect to such disclosures and, accordingly, we do not express an opinion or any other form of assurance on the 2001 or 2000 financial statements taken as a whole.

PricewaterhouseCoopers LLP

Washington, DC
February 7, 2003

WE ARE INCLUDING IN THIS REPORT, PURSUANT TO RULE 2-02(E) OF REGULATION S-X, A COPY OF THE LATEST SIGNED AND DATED REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS FROM OUR PRIOR INDEPENDENT PUBLIC ACCOUNTANTS, ARTHUR ANDERSEN LLP. THIS REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS WAS PREVIOUSLY ISSUED BY ARTHUR ANDERSEN, FOR FILING WITH OUR ANNUAL REPORT ON FORM 10-K FILED BY CHOICE HOTELS INTERNATIONAL, INC. WITH THE SECURITIES AND EXCHANGE COMMISSION ON MARCH 25, 2002, AND HAS NOT BEEN REISSUED BY ARTHUR ANDERSEN LLP. NOTE THAT THIS PREVIOUSLY ISSUED REPORT INCLUDES REFERENCES TO CERTAIN FISCAL YEARS AND PERIODS, WHICH ARE NOT REQUIRED TO BE PRESENTED IN THE ACCOMPANYING FINANCIAL STATEMENTS AS OF AND FOR THE FISCAL YEARS ENDED DECEMBER 31, 2002.

Report of Independent Public Accountants

To Choice Hotels International, Inc. and subsidiaries:

We have audited the accompanying consolidated balance sheets of Choice Hotels International, Inc. and subsidiaries, as of December 31, 2001 and 2000, and the related consolidated statements of income, shareholders' equity and comprehensive income and cash flows for each of the three years in the period ended December 31, 2001. 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 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, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

As explained in Note 1 to the consolidated financial statements, Choice Hotels International, Inc. and subsidiaries have given retroactive effect to the change in accounting for the presentation of marketing and reservation fees and expenses.

Arthur Andersen LLP

Vienna, Virginia
March 20, 2002

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
	2002	**2001**	**2000**
	(In thousands, except per share amounts)		As Revised (See Note 1)
REVENUES:			
Royalty fees	**$142,943**	$140,185	$137,721
Initial franchise and relicensing fees	**12,881**	12,887	12,154
Partner services	**11,860**	12,042	10,300
Marketing and reservation	**190,145**	168,170	185,367
Hotel operations	**3,331**	3,215	1,249
Other	**4,402**	4,929	6,050
Total revenues	**365,562**	341,428	352,841
OPERATING EXPENSES:			
Selling, general and administrative	**54,904**	56,075	57,178
Restructuring charges	**1,616**	5,940	5,637
Impairment of Friendly investment	**—**	22,713	—
Depreciation and amortization	**11,251**	12,452	11,623
Marketing and reservation expense	**190,145**	168,170	185,367
Hotel operations	**2,946**	2,501	609
Total operating expenses	**260,862**	267,851	260,414
Operating income	**104,700**	73,577	92,427
OTHER INCOME AND EXPENSES:			
Interest expense	**13,136**	15,445	18,490
Interest and other investment income	**(4,549)**	(4,329)	(15,534)
Equity in net losses of affiliates	**71**	16,436	12,071
Loss (gain) on disposition of property	**224**	(42)	253
Write-off of deferred financing costs	**—**	650	—
Loss on Sunburst note	**—**	—	7,565
Total other income and expenses	**8,882**	28,160	22,845
Income before income taxes	**95,818**	45,417	69,582
Income taxes	**34,974**	31,090	27,137
Net income	**$ 60,844**	$ 14,327	$ 42,445
Weighted average shares outstanding-basic	**39,333**	44,174	52,895
Weighted average shares outstanding-diluted	**40,057**	44,572	53,253
Basic earnings per share	**$ 1.55**	$ 0.32	$ 0.80
Diluted earnings per share	**$ 1.52**	$ 0.32	$ 0.80

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

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31, 2002	December 31, 2001
	(In thousands, except share amounts)	
ASSETS:		
Current assets		
Cash and cash equivalents	**$ 12,227**	$ 16,871
Receivables (net of allowance for doubtful accounts of $6,035 and $5,392, respectively)	**32,451**	25,223
Other current assets	**3,349**	889
Total current assets	**48,027**	42,983
Property and equipment, at cost, net	**64,650**	70,458
Goodwill	**60,620**	60,620
Franchise rights, net	**36,336**	36,257
Receivable—marketing and reservation fees	**44,916**	49,358
Note receivable from Sunburst	**41,318**	39,059
Other assets	**18,515**	22,443
Total assets	**$ 314,382**	$ 321,178
LIABILITIES AND SHAREHOLDERS' DEFICIT:		
Current liabilities		
Current portion of long-term debt	**$ 23,796**	$ 13,563
Accounts payable	**23,142**	24,724
Accrued expenses and other	**29,686**	30,054
Income taxes payable	**8,879**	2,836
Total current liabilities	**85,503**	71,177
Long-term debt	**283,995**	267,733
Deferred income taxes and other liabilities	**58,683**	46,807
Total liabilities	**428,181**	385,717
Commitments and Contingencies		
SHAREHOLDERS' DEFICIT:		
Common stock, $ .01 par value; 160,000,000 shares authorized; 62,755,708 shares issued; 37,163,216 and 41,997,637 shares outstanding at December 31, 2002 and 2001, respectively	**371**	420
Additional paid-in-capital	**73,100**	70,130
Accumulated other comprehensive income (loss)	**42**	(354)
Deferred compensation	**(3,492)**	(2,857)
Treasury stock (25,592,492 and 20,758,071 shares at December 31, 2002 and 2001, respectively)	**(423,839)**	(311,053)
Retained earnings	**240,019**	179,175
Total shareholders' deficit	**(113,799)**	(64,539)
Total liabilities and shareholders' deficit	**$ 314,382**	$ 321,178

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

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2002	2001	2000
	(In thousands)		As Revised (See Note 1)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	**$ 60,844**	$ 14,327	$ 42,445
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**11,251**	12,452	11,623
Non-cash interest and other investment income	**(2,128)**	(4,219)	(15,170)
Provision for bad debts	**1,256**	476	(585)
Non-cash stock compensation and other charges	**1,666**	2,210	787
Equity in net losses of affiliates	**71**	16,436	12,071
Impairment of Friendly investment	**—**	22,713	—
Write-off of deferred financing costs	**—**	650	—
Loss on early prepayment of Sunburst note	**—**	—	6,520
Changes in assets and liabilities, net of acquisitions:			
Receivables	**(5,360)**	6,465	(2,245)
Prepaid expenses and other current assets	**—**	—	30
Receivable—marketing and reservation fees, net	**17,219**	20,267	(14,532)
Current liabilities	**(4,054)**	9,381	1,714
Income taxes payable/receivable and other assets	**5,391**	6,361	(278)
Deferred income taxes and other liabilities	**12,881**	(5,807)	11,499
Net cash provided by operating activities	**99,037**	101,712	53,879
CASH FLOWS FROM INVESTING ACTIVITIES			
Investment in property and equipment	**(12,233)**	(13,532)	(16,590)
Investment in Flag Choice Hotels	**(2,173)**	—	—
Proceeds from Sunburst note	**—**	101,954	—
Other items, net	**(296)**	(684)	(27)
Net cash (used in) provided by investing activities	**(14,702)**	87,738	(16,617)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from long-term debt	**314,400**	772,028	85,500
Principal payments of long-term debt	**(288,220)**	(790,795)	(95,757)
Purchase of treasury stock	**(120,931)**	(185,807)	(20,893)
Proceeds from exercise of stock options	**5,772**	12,294	1,739
Net cash used in financing activities	**(88,979)**	(192,280)	(29,411)
Net change in cash and cash equivalents	**(4,644)**	(2,830)	7,851
Cash and cash equivalents at beginning of period	**16,871**	19,701	11,850
Cash and cash equivalents at end of period	**$ 12,227**	$ 16,871	$ 19,701
Supplemental disclosure of cash flow information			
Cash payments during the year for:			
Income taxes, net of refunds	**$ 14,674**	$ 29,013	$ 15,674
Interest	**14,132**	18,039	22,145
Non-cash investing activities:			
Conversion of note receivable into Flag equity interest	**$ 1,061**	$ —	$ —
Properties assumed through the restructuring of Sunburst note	**—**	1,475	—
Properties assumed through put/call transaction	**—**	—	12,233
Reduction in Sunburst note from put/call transaction	**—**	—	16,333
Non-cash financing activities:			
Income tax benefit realized from employee stock options exercised	**$ 1,762**	$ 3,895	$ 1,602

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

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT) AND COMPREHENSIVE INCOME
(In thousands, except share amounts)

	Common Stock Shares Outstanding	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, 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 currency translation adjustments	—	—	—	—	—	—	(1,786)	—	(1,786)
Unrealized gain on securities, net of taxes, net of reclassification adjustment (Note 15)	—	—	—	—	—	—	527	—	527
Other comprehensive loss	—	—	—	(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
Comprehensive income									
Net income	—	—	—	—	—	—	14,327	14,327	14,327
Other comprehensive income:									
Foreign currency translation adjustments	—	—	—	—	—	—	(414)	—	(414)
Unrealized loss on securities, net of taxes, net of reclassification adjustment (Note 15)	—	—	—	—	—	—	(310)	—	(310)
Other comprehensive loss	—	—	—	(724)	—	—	(724)	—	—
Comprehensive income							$13,603		
Deferred gain on hedge	—	—	—	424	—	—		—	424
Exercise of stock options/grants, net	1,287,454	13	14,885	—	—	1,503		—	16,401
Issuance of restricted stock	155,515	1	—	—	(2,304)	2,303		—	—
Amortization of deferred compensation	—	—	—	—	747	—		—	747
Treasury purchases	(12,006,900)	(120)	—	—	—	(185,687)		—	(185,807)
Balance as of December 31, 2001	41,997,637	$ 420	$70,130	$ (354)	$(2,857)	$(311,053)		$179,175	$ (64,539)
Comprehensive income									
Net income	**—**	**—**	**—**	**—**	**—**	**—**	**60,844**	**60,844**	**60,844**
Other comprehensive income:									
Foreign currency translation adjustments	**—**	**—**	**—**	**—**	**—**	**—**	**341**	**—**	**341**
Amortization of deferred gain							**(67)**		**(67)**
Unrealized loss on securities, net of taxes, net of reclassification adjustment (Note 15)	**—**	**—**	**—**	**—**	**—**	**—**	**122**	**—**	**122**
Other comprehensive income	**—**	**—**	**—**	**396**	**—**	**—**	**396**	**—**	**—**
Comprehensive income							**$61,240**		
Exercise of stock options/grants, net	**442,869**	**4**	**1,762**	**—**	**—**	**5,768**		**—**	**7,534**
Issuance of restricted stock	**109,894**	**1**	**—**	**—**	**(2,301)**	**2,300**		**—**	**—**
Stock compensation related restructuring	**—**	**—**	**1,208**	**—**	**—**	**—**	**—**	**—**	**1,208**
Amortization of deferred compensation	**—**	**—**	**—**	**—**	**1,666**	**—**		**—**	**1,666**
Treasury purchases	**(5,387,184)**	**(54)**	**—**	**—**	**—**	**(120,854)**		**—**	**(120,908)**
Balance as of December 31, 2002	**37,163,216**	**371**	**$73,100**	**$ 42**	**$(3,492)**	**$(423,839)**		**$240,019**	**$(113,799)**

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

CHOICE HOTELS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Company Information and Significant Accounting Policies

Company Information.

Choice Hotels International, Inc. and subsidiaries (together "the Company") is in the business of hotel franchising. As of December 31, 2002, the Company had franchise agreements with 4,664 open hotels and 474 hotels under development in 48 countries and territories under the following brand names: Comfort, Comfort Suites, Quality, Clarion, Sleep Inn, Econo Lodge, Rodeway Inn, MainStay Suites and Flag.

Principles of Consolidation.

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.

On July 1, 2002, the Company acquired a controlling interest in Flag Choice Hotels ("Flag"). Flag, based in Melbourne, Australia, is a franchisor of hotels in Australia, Papua New Guinea, Fiji and New Zealand. The results of Flag have been consolidated since that date.

Revenue Recognition.

The Company accounts for initial franchise fees in accordance with Statement of Financial Accounting Standards ("SFAS") No. 45, "Accounting for Franchise Fee Revenue." The Company enters into franchise agreements committing to provide franchisees with various marketing services, a centralized reservation system and limited rights to utilize the Company's registered tradenames and trademarks. These agreements typically have an initial term of twenty years with provisions permitting franchisees to terminate after five, ten, or fifteen years under certain circumstances. In most instances, initial franchise fees are recognized upon execution of the franchise agreement because the initial franchise fee is non-refundable and the Company has no continuing obligations related to the franchisee. The initial franchise fee related to executed franchise agreements which include incentives, such as future potential rebates, are deferred and recognized when the incentive criteria are met or the agreement is terminated, whichever occurs first.

Royalty fees, which are typically based on a percentage of gross room revenues of each franchisee, are recorded when earned. Reserves for uncollectible royalty fees are charged to bad debt expense and are included in selling, general and administrative expenses in the accompanying consolidated statements of income.

The Company generates partner services revenues from hotel industry vendors. Partner services revenues are generally earned based on the level of goods or services purchased from endorsed vendors by hotel owners and hotel guests who stay in the Company's franchised hotels. The Company accounts for these revenues in accordance with Staff Accounting Bulletin No. 101, ("SAB 101") "Revenue Recognition." SAB 101 provides guidance on the recognition, presentation and disclosure of revenue in financial statements. The Company recognizes partner services revenues when the services are performed or the product delivered, evidence of an arrangement exists, the fee is fixed and determinable and collectibility is probable. SAB 101 requires the Company to defer the recognition of partner services revenues related to upfront fees. Such upfront fees are generally recognized over a period corresponding to the Company's estimate of the life of the arrangement.

The Company's franchise agreements require the payment of franchise fees, including marketing and reservation fees, which are used exclusively by the Company for expenses associated with providing franchise services such as national marketing, media advertising, central reservation systems and technology services. 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. As described below, the Company changed its presentation of marketing and reservation revenues and expenses to a gross basis during the fourth quarter of 2001.

Presentation of Marketing and Reservation Revenues and Expenses.

The Company revised its presentation of marketing and reservation revenues during the fourth quarter of 2001 to comply with Emerging Issues Task Force ("EITF") Issue No. 99-19 "Reporting Revenue Gross as a Principal versus Net as an Agent." The Company had previously presented these revenues net of related expenses on its consolidated statements of income. EITF 99-19 requires that these revenues be recorded gross and accordingly, the Company has revised its financial statement presentation for all periods presented. In addition, net advances from and repayments related to marketing and reservation activities have been reclassified to present these activities as cash flows from operating activities for all periods presented. These revisions had no effect on the net income or cash flows reported during the periods revised.

Credit Risk and Exposure.

Substantially all of the Company's trade receivables as well as the receivable for marketing and reservation fees are due from hotel franchisees. However, the Company considers its credit risk associated with trade receivables and the marketing and reservation fees minimal due to the dispersion of the Company's receivables across a large number of geographically diverse franchisees.

The Company records bad debt expense which is included in selling, general and administrative expenses in the accompanying consolidated statements of income based on its assessment of the ultimate realizability of receivables considering historical collection experience and the economic environment. When the Company determines that an account is not collectible, the account is written-off to the associated allowance for doubtful accounts. Bad debts have historically been minimal.

Advertising Costs.

The Company expenses advertising costs as the advertising occurs in accordance with American Institute of Certified Public Accountants, Statement of Position 93-7, "Reporting on Advertising Costs". Advertising expense was $41.8 million, $55.1 million and $48.4 million for the years ended December 31, 2002, 2001, and 2000, respectively. The Company includes advertising costs in marketing and reservation expenses on the accompanying consolidated statements of income.

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. As of December 31, 2002 and 2001, $5.0 million and $8.6 million, respectively, of book overdrafts representing outstanding checks in excess of funds on deposit have been classified in accounts payable in the accompanying consolidated balance sheets.

Capitalization Policies.

Property and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the assets. Major renovations, replacements and interest incurred during construction are capitalized. Upon sale or retirement of property, the cost and related accumulated depreciation are eliminated from the accounts and the related gain or loss is recognized in the accompanying consolidated statements of income. Maintenance, repairs and minor replacements are charged to expense as incurred.

Impairment Policy.

The Company evaluates the impairment of property and equipment and other long-lived assets, including franchise rights and other definite-lived intangibles, in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 states that an impairment of long-lived assets has occurred 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 fair value. The Company did not record any impairment on long-lived assets during the three years ended December 31, 2002.

The Company evaluates the impairment of goodwill in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," which requires goodwill to be assessed on at least an annual basis for impairment using a fair value basis. Because the Company operates in one reporting segment in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" and related interpretations, the fair value of the Company's total assets are used to determine if goodwill may be impaired. According to SFAS No. 142, quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement if available. The Company did not record any impairment of goodwill in 2002, 2001 or 2000 based on assessments performed by the Company.

The Company evaluates the collectibility of notes receivable in accordance with SFAS No. 114, "Accounting by Creditors For Impairment of a Loan". SFAS No. 114 states that a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement. The Company reviews outstanding notes receivable on a periodic basis to ensure that each is fully collectible by reviewing the financial condition of its debtors. If the Company concludes that it will be unable to collect all amounts due, the Company will record an impairment charge based on the present value of expected future cash flows, discounted at the loan's effective interest rate. The Company did not record any impairment charges related to notes receivable during the years ended December 31, 2002 or 2001. During the year ended December 31, 2000, the Company recorded $7.6 million of impairment losses related to its subordinated term note to Sunburst Hospitality Corporation (see Note 7).

Deferred Financing Costs.

Debt financing costs are deferred and amortized, using the effective interest method, over the term of the related debt. As of December 31, 2002 and 2001, deferred financing costs were $2.1 million and $2.7 million, respectively, and are included in other non-current assets on the accompanying consolidated balance sheets.

Investments.

The Company accounts for its investments in the common stock of Choice Hotels Scandinavia ("CHS") in accordance with 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 Choice Hotels Canada, Inc. ("CHC") in accordance with Accounting Principles Board Opinion ("APB") No. 18 "The Equity Method of Accounting for Investments in Common Stock."

Derivatives.

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," establishes 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 balance sheet, 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. SFAS No. 133 also states that any deferred gain on previous hedging activity does not meet the definition of a liability, due to a lack of expected future cash flows and therefore should be included in comprehensive income. Except for the Flag put option discussed in Note 11, the Company has no derivative financial instruments.

Stock-based compensation.

The Company accounts for its stock-based employee compensation plans in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, compensation expense related to fixed employee stock options is recorded only if on the date of grant the fair value of the underlying stock exceeds the exercise price. The Company adopted the disclosure only requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," which allows entities to continue to apply the provisions of APB Opinion No. 25 for transactions with employees and to provide pro forma net income disclosures as if the fair value based method of accounting, described in SFAS No. 123, had been applied to employee stock option grants.

The Company's stock option plans are described more fully in Note 14. No compensation expense related to the Company's stock option plans was reflected in net income for the three years ended December 31, 2002, as all options granted under those plans had an exercise price equal to market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the company had applied the fair value recognition provisions of SFAS No. 123.

	Years Ended December 31,		
	2002	2001	2000
	(In millions, except per share amounts)		
Net income, as reported	$60.8	$14.3	$42.4
Total stock-based employee compensation expense determined under fair value method for all awards, net of tax effects	(2.6)	(3.0)	(3.9)
Pro forma net income	$58.2	$11.3	$38.5
Earnings per share:			
Basic—as reported	$1.55	$0.32	$0.80
Basic—pro forma	$1.48	$0.25	$0.72
Diluted—as reported	$1.52	$0.32	$0.80
Diluted—pro forma	$1.45	$0.25	$0.73

Effective January 1, 2003, the Company adopted, in accordance with SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure," the fair value based method of accounting for stock option awards granted on or after January 1, 2003.

Notes Receivable.

From time to time, the Company provides financing to franchisees for property improvements and other purposes in the form of interest free notes. The notes typically have a term of 10 years and are forgiven and amortized over that time period if the franchisee remains in the system in good standing. As of December 31, 2002 and 2001, other assets included $5.0 million and $1.8 million, respectively, of these notes. Amortization expense related to the notes was $0.4 million, $0.1 million and $35,000, respectively, for the years ended December 31, 2002, 2001 and 2000.

Income Taxes.

Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been included in the financial statements or income tax returns. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted rates expected to apply to taxable income in the years in which those differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Earnings per Share.

Basic earnings per share excludes dilution and is computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings per share, assumes dilution and is computed based on the weighted-average number of common shares outstanding after consideration of the dilutive effect of stock options.

Use of Estimates.

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 those estimates.

2. Property and Equipment

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

	December 31,	
	2002	**2001**
	(In thousands)	
Land	**$ 4,117**	$ 4,090
Facilities in progress	**1,631**	735
Building and improvements	**35,861**	34,210
Furniture, fixtures and equipment	**94,691**	86,301
	136,300	125,336
Less: Accumulated depreciation	**(71,650)**	(54,878)
	$ 64,650	$ 70,458

As facilities in progress are completed and placed in service, they are transferred to appropriate fixed asset categories and depreciation begins. Depreciation expense, excluding amounts attributable to marketing and reservation activities, for the years ended December 31, 2002, 2001 and 2000 was $5.6 million, $4.6 million and $3.0 million, respectively. 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 is based follows:

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

3. Goodwill

Goodwill primarily relates to the excess of the purchase price of the Company's stock in excess of the recorded minority interest acquired. Prior to January 1, 2002, the Company amortized goodwill on a straight-line basis over 40 years. Such amortization amounted to $2.0 million and $2.3 million for the years ended December 31, 2001 and 2000, respectively.

On January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets," pursuant to which the Company is no longer permitted to amortize goodwill. The impact of the adoption of SFAS No. 142 on net income, basic EPS and diluted EPS for the years ended December 31, 2001 and 2000, as if the adoption had taken place on January 1, 2000 is as follows:

	Years Ended December 31,	
	2001	2000
	(In thousands, except per share amounts)	
Reported net income	$14,327	$42,445
Add back: Goodwill amortization	1,995	2,290
Adjusted net income	$16,322	$44,735
Basic earnings per share:		
Reported net income	$ 0.32	$ 0.80
Goodwill amortization	0.05	0.04
Adjusted basic earnings per share	$ 0.37	$ 0.84
Diluted earnings per share:		
Reported net income	$ 0.32	$ 0.80
Goodwill amortization	0.04	0.04
Adjusted diluted earnings per share	$ 0.36	$ 0.84

4. Franchise Rights and Other Intangibles

Franchise rights represent the unamortized purchase price assigned to acquired long-term franchise contracts. As of December 31, 2002 and 2001, the unamortized balance relates primarily to the Econo Lodge and Flag franchise rights. The franchise rights are being amortized over lives ranging from 5 to 15 years. Amortization expense for the years ended December 31, 2002, 2001 and 2000 amounted to $3.1 million, $3.0 million and $3.9 million, respectively. Franchise rights are net of accumulated amortization of $35.1 million and $32.0 million at December 31, 2002 and 2001, respectively. The estimated annual amortization expense related to the Company's franchise rights for 2003 through 2007 is $3.0 million for each of the years then ended.

Other assets includes approximately $5.1 million and $4.8 million of intangible assets related to trademarks at December 31, 2002 and 2001, respectively. The trademarks are being amortized over ten years. Amortization expense for each of the three years ended December 31, 2002 was $0.4 million. The estimated annual amortization expense related to the Company's trademarks for 2003 through 2007 is $0.3 million for each of the years they ended.

5. Investment in Friendly Hotels

As of December 31, 2001, the Company had 1,227,622 shares of common stock and 31,097,755 shares of 5.75% convertible preferred stock in Friendly Hotels PLC (currently known as C.H.E. Group PLC) ("Friendly"), the Company's master franchisor for the United Kingdom, Ireland and continental Europe.

The Company appointed three directors to the board of Friendly giving the Company ability to exercise significant influence over the operations of Friendly. Accordingly, the Company was required to apply the equity method of accounting.

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 for granting the master franchise rights to Friendly, the Company received Friendly common stock and was to receive $8.0 million payable in cash in eight equal annual installments from Friendly.

On January 19, 2001, the shareholders of Friendly approved a capital reorganization intended to provide Friendly with a stronger balance sheet and improve its operations. Pursuant to the capital reorganization, the Company waived certain royalty and marketing fees due from Friendly for the period between December 27, 1999 and December 31, 2005, waived the then five remaining annual installments related to the master franchise agreement and provided Friendly with a £7.8 million (approximately US $11.4 million) secured letter of credit in consideration for, among other things, a reduction in the conversion price of the Company's convertible preferred shares from 150p to 60p. The letter of credit was secured by substantially all of Friendly's assets in France, valued in excess of £4.2 million (approximately US $6.1 million). Other modifications to the Company's convertible preferred shares included a change in the dividend rate from 5.75% (payable in cash) to 2% per annum, (payable in additional convertible preferred shares). Friendly was also permitted to elect to pay cash dividends at the rate of 3.5% per annum up until January 13, 2013 and thereafter at the rate of 5.75%. In addition, accrued dividends due to the Company as of February 7, 2001 were converted to additional convertible preferred shares of Friendly. As of December 31, 2001, Friendly had drawn £5.3 million (approximately US $7.7 million) of the available letter of credit and the balance available on the letter of credit was reduced to £5.0 million (approximately US $7.3 million) as of January 21, 2002. The letter of credit was terminated on January 28, 2003.

During 2001, Friendly settled a $4.0 million deferred consideration due to the Company through the issuance of 2,404,013 convertible preferred shares. The effect of the reduction in the conversion price together with the conversion of dividend arrearage to additional convertible preferred shares of Friendly and the settlement of the deferred consideration, both resulting in the issuance of convertible preferred shares, on a fully converted basis, the Company's ownership in Friendly would have been approximately 71%. Due to the restructuring program, the Company recorded equity losses on Friendly of $16.4 million and $12.1 million for the years ended December 31, 2001 and 2000, respectively, in accordance with EITF 99-10, "Percentage Used to Determine the Amount of Equity Method Losses". Mid-year adverse fixed asset valuation adjustments due to a decline in economic conditions and incremental professional fees associated with the reorganization primarily account for the $16.4 million charge in 2001.

The Company also recognized $1.1 million in royalty revenue from Friendly for the year ended December 31, 2000. The Company waived its royalty fees from Friendly for the periods from 2001 through 2005 as part of Friendly's restructuring. No dividends were accrued during 2001 or 2000.

The Company owned approximately 5.4% of Friendly's outstanding ordinary shares at December 31, 2001 and 2000. The fair market value of the ordinary shares at December 31, 2001 and 2000 was $0.3 million and $0.7 million, respectively. Summarized unaudited balance sheet data for Friendly is as follows:

	December 31, 2001
	Unaudited (In thousands)
Current assets	$ 20,530
Non-current assets	107,744
Current liabilities	59,114
Non-current liabilities	45,573
Preferred stock	23,104
Shareholders' equity	23,587

Summarized unaudited income statement data for Friendly is as follows:

	For the Years Ended December 31,	
	2001	2000
	Unaudited (In thousands)	
Net revenues	$124,845	$138,135
Gross profit	69,167	76,032
Loss from continuing operations	(5,023)	(40,193)
Net loss after preferred dividends	(8,036)	(50,640)

On February 21, 2002, Friendly announced that it had been unable to find an acceptable buyer for its business and would terminate efforts to sell its business. Given this termination and the adverse economic conditions of Friendly, the Company disposed of its entire preferred and common equity interest in Friendly on March 20, 2002, and immediately relinquished its three seats on Friendly's board of directors. Accordingly, the Company wrote-off its entire investment in Friendly through a $22.7 million charge to reflect the permanent impairment of this asset as of December 31, 2001.

6. Receivable-Marketing and Reservation Fees

The Company's franchise agreements require the payment of franchise fees which include marketing and reservation fees. The Company is obligated to use the marketing and reservation fees it assesses against the current franchisees comprising its various hotel brand systems to provide marketing and reservation services appropriate for the successful operation of the systems. In discharging its obligation to provide sufficient and appropriate marketing and reservation services, the Company has the right to expend funds in an amount reasonably necessary to ensure the provision of such services, whether or not such amount is currently available to the Company for reimbursement. The franchise agreements provide the Company the right to advance monies to the franchise system when the needs of the system surpass the balances currently available.

Under the terms of these agreements, the Company has the legally enforceable right to assess and collect from its current franchisees fees sufficient to pay for the marketing and reservation services the Company has procured for the benefit of the franchise system, including fees to reimburse the Company for past services rendered. The Company has the contractual authority to require that the franchisees in the system at any given point repay any deficits related to marketing and reservation activities. The Company's current franchisees are legally obliged to pay any assessment the Company imposes on its franchisees to obtain reimbursement of such deficit regardless of whether those constituents continue to generate gross room revenue. The Company has no present intention to accelerate repayment of the deficit from current franchisees.

The marketing and reservation fees receivable at December 31, 2002 and 2001 was $44.9 million and $49.4 million, respectively. Depreciation and amortization expense attributable to marketing and reservation activities was $13.0 million and $11.8 million for the years ended December 31, 2002 and 2001, respectively. Interest expense attributable to reservation activities was $1.4 million and $2.0 million for the years ended December 31, 2002 and 2001, respectively.

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. As it relates to development commitments, the strategic alliance agreement ended October 15, 2002. Liquidated damage provisions extend through the life of existing franchise agreements. The franchise fee credit provisions end in October 2003.

In connection with the spin-off, the Company borrowed $115 million under its then existing credit facility in order to fund a subordinated term note to Sunburst (the "Old Note"). In connection with an amendment of the strategic agreement discussed above, effective October 15, 2000 interest on the Old Note accrued 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 Old Note was scheduled to mature in full, along with accrued interest, on October 15, 2002.

On September 1, 2000, Sunburst transferred title to three MainStay Suites 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 Old Note. The fair market value of the MainStay Suites properties was approximately $12.2 million. Accordingly, the Company recognized a $4.1 million pre-tax loss on the Old Note.

On September 20, 2000, the Company and Sunburst reached agreement on the terms of a proposed restructuring of the Old 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% (the "New Note") in settlement of the balance of the Old Note. In 2000, the Company recognized a pre-tax loss of $3.5 million resulting from this transaction. The New Note accrued interest up until June 2002, at which point interest became payable semi-annually in arrears. As of December 31, 2002, the Company's balance sheet includes an interest receivable from Sunburst of $2.3 million which is included in other current assets in the accompanying consolidated balance sheets and was paid to the Company by Sunburst in January 2003.

The Company recognized interest income of $4.6 million, $4.2 million and $15.2 million for years ended December 31, 2002, 2001 and 2000, respectively.

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 $6.1 million, $7.8 million and $10.3 million for the years ended December 31, 2002, 2001 and 2000, respectively.

8. Restructuring Programs

During 2002, the Company recognized a restructuring charge expense of $1.6 million pursuant to Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The restructuring charge related to employee severance and termination benefits for 23 employees resulting from

corporate realignment initiatives. The restructuring was initiated and completed in 2002. Approximately $0.3 million of the expense related to stock compensation for certain severed employees and was credited directly to additional paid-in capital. The Company paid approximately $0.4 million in cash related to this restructuring during 2002 and the remaining liability of $0.9 million, included in accrued expenses and other in the accompanying consolidated balance sheet, is expected to be paid in cash during 2003.

During 2001, the Company recognized a restructuring charge expense of $5.9 million, pursuant to Emerging Issues Task Force ("EITF") No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". The restructuring charges include $5.3 million related to a corporate realignment designed to increase its strategic focus on delivering value-added services to franchisees, including centralizing the Company's franchise service and sales operations, consolidating its brand management functions and realigning its call center operations. Of this $5.3 million, $5.1 million relates to severance and termination benefits for 64 employees (consisting of brand management and new hotels support, reservation sales and administrative personnel and franchise sales and operations support) and $0.2 million relates to the cancellation of preexisting contracts for termination of domestic leases. The remaining $0.6 million of the $5.9 million is due to exit costs related to the termination of a corporate hotel construction project. Through December 31, 2002, the Company has paid cash of $4.4 million related to this restructuring. Approximately $0.9 million of the expense related to stock compensation for certain severed employees was reclassified from the restructuring liability during 2002 to additional paid-in capital. As of December 31, 2002, a $0.6 million liability is included in accrued expenses and other on the accompanying consolidated balance sheet. The Company expects the remaining liability to be substantially paid in 2003.

During 2000, the Company recognized a restructuring charge expense of $5.6 million, pursuant to Emerging Issues Task Force ("EITF") No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". The restructuring charges include $4.7 million related to a corporate-wide reorganization to improve service and support to the Company's franchisees and to create a more competitive overhead structure. 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. The Company paid $0.2 million related to the 2000 restructuring liability for the year ended December 31, 2002, which completed the restructuring.

9. Accrued Expenses and Other

Accrued expenses and other consisted of the following at:

	December 31,	
	2002	**2001**
	(In thousands)	
Accrued salaries and benefits	**$15,175**	$13,131
Accrued interest	**2,343**	2,616
Accrued restructuring	**1,518**	4,884
Deferred loyalty program	**6,569**	6,397
Other	**4,081**	3,026
Total	**$29,686**	$30,054

Deferred loyalty program accrued expenses consist primarily of liabilities associated with the Company's Choice Privileges program. Choice Privileges is a frequent guest incentive program that enables members to earn points based on their spending levels at participating brands. The points may be redeemed for free accommodation or other benefits. Points can not be redeemed for cash.

The Company collects 5% of program member's room revenue from participating franchises. Revenues are deferred equal to the fair value of the future redemption obligation. Actuarial methods are used to estimate the eventual redemption rates and point values. Upon redemption of points, the Company recognizes the previously deferred revenue as well as the corresponding expense relating to the cost of the awards redeemed.

10. Long-Term Debt

Debt consisted of the following at:

	December 31, 2002	December 31, 2001
	(In thousands)	
$265 million competitive advance and multi-currency revolving credit facility with an effective rate of 3.05% and 3.69% at December 31, 2002 and 2001, respectively	**$200,708**	$180,525
$100 million senior notes with an effective rate of 7.22% at December 31, 2002 and 2001	**99,655**	99,591
$10 million line of credit with an effective rate of 2.50% at December 31, 2002	**6,400**	—
Other notes with an average effective rate of 3.30% and 4.90% at December 31, 2002 and 2001, respectively	**1,028**	1,180
Total debt	**$307,791**	$281,296

Scheduled maturities of debt as of December 31, 2002 were as follows:

Year	(In thousands)
2003	**$ 23,796**
2004	**21,237**
2005	**26,503**
2006	**136,177**
2007	**146**
Thereafter	**99,932**
Total	**$307,791**

On June 29, 2001, the Company refinanced its senior credit facility (the "New Credit Facility") in the amount of $260 million with a new maturity date of June 29, 2006. The New Credit Facility originally provided for a term loan of $150 million and a revolving credit facility of $110 million, $37 million of which is available for borrowings in foreign currencies. On September 29, 2001, the Company signed an amendment to the New Credit Facility, for an additional $5 million under the revolving credit facility, bringing the total amount of available commitments to $265 million. The amendment also transferred $35 million from the term loan to the revolving credit facility. As amended, the term loan amount is $115 million and the revolving credit facility is $150 million. The New 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, among other restrictions. As of December 31, 2002, the Company is in compliance with all covenants under the New Credit Facility. The term loan ($98.7 million of which is outstanding at December 31, 2002) is payable over five years, $17.3 million of which is due in 2003. Borrowings under the New Credit Facility are, at the option of the borrower, at one of several rates including LIBOR plus 0.60% to 2.0%, based upon the credit rating of the Company 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 New Credit Facility. The New Credit Facility requires the Company to pay annual fees of 1⁄15 of 1% to ½ of 1%, based upon the credit rating of the Company.

On May 1, 1998, the Company issued $100 million of senior unsecured notes (the "Notes") at a discount of $0.6 million, bearing a coupon rate of 7.13% with an effective rate of 7.22%. The Notes will mature on May 1, 2008. Interest on the Notes is paid semi-annually.

In August 2002, the Company entered into a new $10.0 million revolving line of credit with a maturity of August 2003. The new line of credit includes customary financial and other covenants that require the maintenance of certain ratios identical to those included in the Company's existing senior credit facility. Borrowings under the line of credit bear interest at rates established at the time of borrowing based on prime minus 175 basis points. The Company had $6.4 million outstanding at December 31, 2002 under this line of credit.

11. 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, 2002, 2001 and 2000 were $6.3 million, $5.2 million and $5.3 million, respectively. Net income (loss) attributable to the Company's foreign operations was $2.4 million, $(35.2 million) and $(12.3 million) for the years ended December 31, 2002, 2001 and 2000, respectively.

Flag Choice Hotels

On July 1, 2002, the Company acquired a controlling interest in Flag Choice Hotels ("Flag") (the "Flag Transaction"). Flag, based in Melbourne, Australia, is a franchisor of certain hotel brands in Australia, Papua New Guinea, Fiji and New Zealand. The acquisition of a controlling interest in Flag gave the Company the ability to control the Choice and Flag brands in Australia, Papua New Guinea and Fiji and the Flag brand in New Zealand.

Pursuant to the Flag Transaction, the Company converted an existing $1.1 million convertible note due from Flag into an additional 15% of Flag's equity (beyond the 15% equity interest held prior to the Flag Transaction) and purchased an additional 25% of Flag's equity for approximately $1.6 million. As of July 1, 2002, the Company's total ownership in Flag is 55%.

Pursuant to the Flag Transaction, the Company gave the seller the right to "put" the remaining 45% equity interest in Flag to the Company for approximately $1.1 million. The put right was permitted to be exercised between January 1, 2003 and June 30, 2007. The Company accounts for the put right in accordance with SFAS 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS 133 requires the recognition of all derivatives, except certain qualifying hedges, as either assets or liabilities measured at fair value, with changes in value reflected as current period income or loss unless specific hedge accounting criteria are met. The fair value of the put rights was $0 at December 31, 2002, and accordingly, there was no impact on reported net income for the year ended December 31, 2002. The seller exercised the put right in January 2003 for the remaining 45%. The put transaction closed in February 2003, at which time Flag became a wholly-owned subsidiary.

The Company accounted for the Flag Transaction in accordance with SFAS No. 141, "Business Combinations". The excess of the purchase price over the net tangible assets acquired of approximately $3.1 million has been allocated to identifiable intangible assets as follows:

	Estimated Fair Value	Estimated Useful Lives
	($000)	
Trademarks and non-compete agreements	$ 235	5 years
Franchise rights	2,904	5-15 years
	$3,139	

The purchase price allocation is preliminary and further refinements may be made. The Company began consolidating the results of Flag on July 1, 2002. The pro forma results of operations as if Flag had been combined at the beginning of 2001 and 2002, would not be materially different from the Company's reported results for those periods.

Choice Hotels Scandinavia

The Company accounts for its investment in the common stock of Choice Hotels Scandinavia ("CHS") as an available for sale security in accordance with SFAS 115. The investment is included in other non-current assets in the accompanying consolidated balance sheets at fair value. As of December 31, 2002 and 2001, the fair value of the Company's investment in CHS was $0.6 million, based on quoted market prices. During the years ended December 31, 2002, 2001 and 2000, the Company recognized approximately $89,000, $178,000 and $176,000, respectively of unrealized gains (losses) related to this investment as a component of other comprehensive income or loss.

Choice Hotels Canada, Inc.

The Company has a 50% interest in Choice Hotels Canada, Inc. ("CHC"), a joint venture with a third party. During 2002, the Company recorded $476,000 of dividend income related to this investment in the accompanying consolidated statements of income. The dividend was received by Choice in January 2003 and is included in accounts receivable on the accompanying consolidated balance sheet.

12. Pension, Profit Sharing, and Incentive Plans

During 2002, 2001 and 2000, employees of the Company participated in a 401(k) retirement plan sponsored by the Company. For the years ended December 31, 2002, 2001 and 2000, the Company recorded compensation expense of $1.5 million, $1.7 million and $1.6 million, respectively, related to the plan. In accordance with the plan, the Company is permitted to make its matching contribution with Company stock. On an annual basis, the Company purchases shares with a fair value equal to the Company's matching contribution and deposits the shares in the participant's accounts with the plan investment custodian.

The Company has adopted the Choice Hotels International, Inc. Amended and Restated Supplemental Executive Retirement Plan (the "SERP"), a non-qualified defined benefit plan for certain senior executives. The Company accounts for the SERP in accordance with Statement of Financial Accounting Standards No. 87, "Employers Accounting for Pensions". For the years ended December 31, 2002, 2001 and 2000, the Company recorded $0.3 million, $0.2 million and $0.2 million, respectively, of expense related to the SERP which was included in selling, general and administrative expense in the accompanying consolidated statements of income. As of December 31, 2002 and 2001, a liability of $1.1 million and $0.8 million, respectively, related to the SERP was included in other non-current liabilities in the accompanying consolidated balance sheets.

The Company maintains a non-qualified retirement savings and investment plan for certain employees whose pre-tax deferrals are limited under the Company's 401(k) Plan. Employee and Company contributions are maintained in an irrevocable trust. Legally, the assets remain those of the Company; however, access to the trust assets is severely restricted. The trust cannot be revoked by the employer or an acquiror, but the assets are subject to the claims of the Company's general creditors. The employee has no right to assign or transfer contractual rights in the trust. The Company accounts for the plan in accordance with Emerging Issues Task Force ("EITF") No. 97-14, "Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested." Pursuant to EITF 97-14, as of December 31, 2002 and 2001, the Company has recorded a deferred compensation liability of $8.6 million and $9.0 million, respectively, in other non-current liabilities in the accompanying consolidated balance sheets. The change in the deferred compensation obligation related to

changes in the fair value of the diversified assets held in trust is recorded in compensation expense. The diversified assets held in trust were $7.9 million and $8.2 million as of December 31, 2002 and 2001, respectively, and are recorded at their fair value, based on quoted market prices, in other non-current assets on the accompanying consolidated balance sheets. The change in the fair value of the diversified assets held in trust is recorded in accordance with SFAS 115 as trading security income (loss).

13. Income Taxes

Income before income taxes were derived from the following:

	Years ended December 31,		
	2002	**2001**	**2000**
	(In thousands)		
Income before income taxes:			
Domestic operations	**$93,418**	$ 80,647	$ 80,982
Foreign operations	**2,400**	(35,230)	(11,400)
Income before income taxes	**$95,818**	$ 45,417	$ 69,582

The provisions for income taxes are as follows:

	Years ended December 31,		
	2002	**2001**	**2000**
	(In thousands)		
Current tax expense			
Federal	**$21,374**	$30,890	$20,707
State	**631**	3,675	2,434
Foreign	**661**	665	886
Deferred tax (benefit) expense			
Federal	**11,297**	(3,602)	3,598
State	**1,012**	(597)	(481)
Foreign	**(1)**	59	(7)
Income taxes	**$34,974**	$31,090	$27,137

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

	December 31,	
	2002	**2001**
	(In thousands)	
Depreciation and amortization	**$(20,171)**	$(21,475)
Prepaid expenses	**(16,083)**	(17,736)
Other	**(9,572)**	(8,950)
Gross deferred tax liabilities	**(45,826)**	(48,161)
Foreign operations	**2,549**	19,326
Accrued expenses	**6,239**	5,723
Other	**4,270**	2,578
Gross deferred tax assets	**13,058**	27,627
Deferred tax liability before valuation allowance	**(32,768)**	(20,534)
Valuation allowance	**(12,737)**	(12,737)
Net deferred tax liability	**$(45,505)**	$(33,271)

Included in the accompanying consolidated balance sheet as follows:

	December 31,	
	2002	**2001**
Current net deferred tax assets	**$ 2,229**	$ 1,888
Non-current net deferred tax liabilities	**(47,734)**	(35,159)
Net deferred tax liability	**(45,505)**	(33,271)

No provision has been made for U.S. federal deferred income taxes on approximately $12 million of accumulated and undistributed earnings of foreign subsidiaries at December 31, 2002 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:

	Years ended December 31,		
	2002	**2001**	**2000**
	(In thousands, except Federal income tax rate)		
Federal income tax rate	**35%**	35%	35%
Federal taxes at statutory rate	**$33,536**	$15,896	$24,354
State income taxes, net of federal tax benefit	**1,068**	1,120	1,269
Unrealized tax benefits	**—**	12,737	—
Other	**370**	1,337	1,514
Income tax expense	**$34,974**	$31,090	$27,137

A certain amount of the Company's capital loss carryforwards (which are included in the foreign operations deferred tax asset) are not expected to be realized at this time. Accordingly, a valuation allowance of $12.7 million was established in 2001.

14. Capital Stock

The Company has stock option plans for which it is authorized to grant options to purchase up to 9.3 million shares of the Company's common stock, of which 1.4 million shares remain available for grant as of December 31, 2002. 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.

In 2002, the Company granted key employees and non-employee directors 109,894 restricted shares of common stock with a fair value of $2.3 million on the date of grant, all of which vest over five years. In 2001, the Company granted key employees and non-employee directors 155,515 restricted shares of common stock with a fair value of $2.3 million on the date of grant. The shares vest over a three to five year period with 10,015 shares vesting over a three year period and 145,500 shares vesting over a five year period. In 2000, the Company granted key employees and non-employee directors 14,052 restricted shares of common stock with a fair value of $0.2 million on the date of grant. The shares vest over a three year period. A total of 9,130 and 11,850 shares of restricted stock were forfeited in 2001 and 2000, respectively. The Company incurred compensation expense totaling $1.7 million, $0.7 million and $0.8 million related to the vesting of restricted stock during the years ended December 31, 2002, 2001 and 2000, respectively. The Company also recorded $0.3 million of compensation expense related to the vesting of restricted stock as part of its 2001 restructuring accrual related to 46,064 shares.

A summary of the option activity under the stock option plans is as follows as of December 31, 2002, 2001 and 2000:

Fixed Options	2002 Shares	2002 Weighted Average Exercise Price	2001 Shares	2001 Weighted Average Exercise Price	2000 Shares	2000 Weighted Average Exercise Price
Outstanding at beginning of year	**3,095,589**	**$13.56**	4,306,584	$12.39	3,907,326	$11.19
Granted	**601,895**	**$21.53**	348,836	15.08	1,187,845	15.71
Exercised	**(442,869)**	**$13.01**	(1,363,050)	9.90	(288,634)	7.22
Cancelled	**(142,624)**	**$16.83**	(196,781)	15.52	(499,953)	15.10
Outstanding at end of year	**3,111,991**	**$15.03**	3,095,589	$13.56	4,306,584	$12.39
Options exercisable at year end	**1,533,471**	**$12.96**	1,374,395	$12.52	2,035,332	$10.49
Weighted average fair value of options granted during the year		**$ 8.95**		$ 7.67		$ 3.78

The following table summarizes information about stock options outstanding at December 31, 2002:

Range of Exercise Prices	Options Outstanding: Number Outstanding at 12/31/02	Options Outstanding: Weighted Average Remaining Contractual Life	Options Outstanding: Weighted Average Exercise Price	Options Exercisable: Number Exercisable at 12/31/02	Options Exercisable: Weighted Average Exercise Price
$ 5.00 to 9.00	111,741	3.8 years	$ 7.27	75,741	$ 7.01
9.01 to 13.00	1,206,076	5.2 years	$12.09	887,267	$12.02
13.01 to 17.00	1,208,147	6.2 years	$15.59	566,463	$15.20
17.01 to 21.00	40,000	9.0 years	$19.36	4,000	$17.80
21.01 to 25.00	506,027	9.0 years	$21.22	—	—
25.01 to 29.00	40,000	6.5 years	$26.06	—	—
	3,111,991	6.2 years	$15.03	1,533,471	$12.96

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 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 included in the stock based compensation section of Note 1, 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 the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 2002, 2001 and 2000:

	2002	2001	2000
Risk-free interest rate	**3.58%**	5.03%	5.10%
Volatility	**35.43%**	43.3%	56.6%
Expected Lives	**6 years**	10 years	10 years
Dividend Yield	**0%**	0%	0%

The Company announced a stock repurchase program on June 25, 1998. Treasury stock is carried at cost in the accompany consolidated balance sheets and consolidated statements of shareholders' equity (deficit) and comprehensive income. Through December 31, 2002, the Company had repurchased 26.5 million shares of its

common stock at a total cost of $434.9 million, including 5.4 million shares of common stock at a total cost of $120.9 million during the year ended December 31, 2002. During 2002, the Company repurchased 1.7 million shares at a total cost of $41.7 million from the Company's largest shareholder and family. From December 31, 2002 through March 11, 2003, the Company has purchased 1.3 million shares at a total cost of $30.3 million, including 0.5 million shares at a total cost of $12.3 million from the Company's largest shareholder and family.

The Company paid approximately $41,000 to and received approximately $104,000 from corporations owned or controlled by family members of the Company's largest shareholder related to the lease of personal and real property during 2002.

15. Comprehensive Income

The components of total accumulated other comprehensive income in the balance sheet are as follows:

	December 31,		
	2002	**2001**	**2000**
	(In thousands)		
Unrealized (losses) gains on available-for-sale securities	**$ (80)**	$(202)	$ 108
Foreign currency translation adjustments	**(235)**	(576)	(162)
Deferred gain on hedging activity	**357**	424	—
Total accumulated other comprehensive income (loss)	**$ 42**	$(354)	$ (54)

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

	Amount Before Taxes	Income Tax (Expense)/Benefit	Amount Net of Taxes
		(In thousands)	
2002			
Net unrealized gains	**$ 195**	**$ (73)**	**$ 122**
Foreign currency translation adjustment, net	**341**	**—**	**341**
Amortization of deferred gain on hedge	**(67)**	**—**	**(67)**
Total other comprehensive income	**$ 469**	**$ (73)**	**$ 396**
2001			
Net unrealized losses	$ (179)	$(131)	$ (310)
Foreign currency translation adjustment, net	(414)	—	(414)
Total other comprehensive loss	$ (593)	$(131)	$ (724)
2000			
Net unrealized gains	$ 844	$(317)	$ 527
Foreign currency translation adjustment, net	(1,786)	—	(1,786)
Total other comprehensive loss	$ (942)	$(317)	$(1,259)

Below represents the detail of other comprehensive income:

	December 31,		
	2002	**2001**	**2000**
Unrealized holding gains (losses) arising during the period, net	**$122**	$(352)	$ (176)
Less: reclassification adjustments for losses/gains included in net income	**—**	42	703
Net unrealized holding gains (losses) arising during the period	**$122**	$(310)	$ 527
Foreign currency translation adjustments	**$341**	$(414)	$ (291)
Plus: reclassification of loss on liquidation of foreign subsidiaries	**—**	—	(1,495)
Net foreign currency translation adjustments	**$341**	$(414)	$(1,786)
Amortization of deferred gain on hedging activity	**$ (67)**	$ —	$ —

In December 1999, the Company entered into an interest rate swap agreement to fix certain of its variable rate debt in order to reduce the Company's exposure to fluctuations in interest rates. On March 3, 2000, the interest rate swap agreement was settled resulting in a deferred gain. In accordance with SFAS 133, the unamortized gain was reclassified in 2001 to other comprehensive income and is being amortized over the remaining life of the related debt as a reduction of interest expense. Amortization of approximately $67,000 was recorded in 2002 related to this deferred gain.

16. Earnings Per Share

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

	Years Ended December 31,		
	2002	2001	2000
(In millions, except per share amounts)			
Computation of Basic Earnings Per Share:			
Net income	**$60.8**	$14.3	$42.4
Weighted average shares outstanding-basic	**39.3**	44.2	52.9
Basic earnings per share	**$1.55**	$0.32	$0.80
Computation of Diluted Earnings Per Share:			
Net income for diluted earnings per share	**$60.8**	$14.3	$42.4
Weighted average shares outstanding-basic	**39.3**	44.2	52.9
Effect of Dilutive Securities:			
Employee stock option plan	**0.8**	0.4	0.4
Weighted average shares outstanding-diluted	**40.1**	44.6	53.3
Diluted earning per share	**$1.52**	$0.32	$0.80

The effect of dilutive securities is computed using the treasury stock method and average market prices during the period. In 2002 and 2000, the Company excluded 50,000 and 2,725,696 anti-dilutive options from the computation of diluted earnings per share, respectively.

17. Leases

The Company enters into operating leases primarily for office space and computer equipment. Rental expense under non-cancelable operating leases was approximately $12.9 million, $12.0 million and $10.2 million for the years ended December 31, 2002, 2001 and 2000, respectively. The Company received sublease rental income related to computer equipment leased to franchisees totaling $9.1 million, $7.6 million and $5.0 million during the years ended December 31, 2002, 2001 and 2000, respectively. Future minimum lease payments are as follows:

	2003	2004	2005	2006	2007	Thereafter	Total
				(In thousands)			
Minimum lease payments	$ 9,395	$ 7,258	$ 4,685	$3,457	$3,547	$20,051	$48,393
Minimum sublease rentals	(6,213)	(3,988)	(1,323)	—	—	—	(11,524)
	$ 3,182	$ 3,270	$ 3,362	$3,457	$3,547	$20,051	$36,869

18. Reportable Segment Information

The Company has a single reportable segment encompassing its franchising business. Revenues from the franchising business include royalty fees, initial franchise and relicensing fees, marketing and reservation fees, partner services revenue and other revenue. The Company is obligated under its franchise agreements to provide marketing and reservation services appropriate for the successful operation of its systems. These services do not represent separate reportable segments as their operations are directly related to the Company's franchising business. The revenues received from franchisees that are used to pay for part of the Company's central on-going operations are included in franchising revenues and are offset by the related expenses paid for marketing and reservation activities to calculate franchising operating income. Corporate and other revenue consists of hotel operations. The Company does not allocate interest and dividend 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, 2002			
	Franchising	Corporate & Other	Elimination Adjustments	Consolidated
	(In thousands)			
Revenues	**$362,231**	**$ 3,331**	**—**	**$365,562**
Operating income (loss)	**136,182**	**(31,482)**	**—**	**104,700**
Depreciation and amortization	**13,817**	**10,460**	**(13,026)**	**11,251**
Capital expenditures	**4,925**	**7,308**	**—**	**12,233**
Total assets	**215,427**	**98,955**	**—**	**314,382**

	Year Ended December 31, 2001			
	Franchising	Corporate & Other	Elimination Adjustments	Consolidated
	(In thousands)			
Revenues	$338,213	$ 3,215	—	$341,428
Operating income (loss)	138,988	(65,411)	—	73,577
Equity loss on Friendly investment	—	(16,436)	—	(16,436)
Depreciation and amortization	12,485	11,769	(11,802)	12,452
Capital expenditures	6,997	6,535	—	13,532
Total Assets	215,381	105,797	—	321,178

	Year Ended December 31, 2000			
	Franchising	Corporate & Other	Elimination Adjustments	Consolidated
	(In thousands)			
Revenues	$351,592	$ 1,249	—	$352,841
Operating income (loss)	136,985	(44,558)	—	92,427
Equity loss on Friendly investment	—	(12,071)	—	(12,071)
Depreciation and amortization	10,584	11,523	(10,484)	11,623
Capital expenditures	8,665	7,925	—	16,590
Investment in Friendly	—	34,616	—	34,616
Total assets	251,586	232,534	—	484,120

Long-lived assets related to international operations were $8.1 million, $7.1 million and $10.9 million as of December 31, 2002, 2001 and 2000, respectively. All other long-lived assets of the Company are associated with domestic activities.

19. 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. At December 31, 2001 and 2002, the balance was $7.6 million and $4.4 million, respectively. The balance available on the letter of credit was reduced to £5.0 million (approximately US$7.3 million) during 2002. The letter of credit was terminated on January 28, 2003.

The Company has a $3.0 million letter of credit issued as support for construction and permanent financing of a Sleep Inn and MainStay Suites located in Atlanta, Georgia. The letter of credit expires in December 2003.

In the ordinary course of business, the Company enters into numerous agreements that contain standard guarantees and indemnities whereby the Company indemnifies another party for breaches of representations and warranties. Such guarantees or indemnifications are granted under various agreements, including those governing (i) purchases or sales of assets or businesses, (ii) leases of real estate, (iii) licensing of trademarks, (iv) access to credit facilities, and (v) issuances of debt or equity securities. The guarantees or indemnifications issued are for the benefit of the (i) buyers in sale agreements and sellers in purchase agreements, (ii) landlords in lease contracts, (iii) franchisees in a licensing agreements, (iv) financial institutions in credit facility arrangements, (v) underwriters in debt or equity security issuances and (vi) other operating agreements. In addition, these parties are also indemnified against any third party claim resulting from the transaction that is contemplated in the underlying agreement. While some of these guarantees extend only for the duration of the underlying agreement, many survive the expiration of the term of the agreement or extend into perpetuity (unless subject to a legal statute of limitations). There are no specific limitations on the maximum potential amount of future payments that the Company could be required to make under these guarantees, nor is the Company able to develop an estimate of the maximum potential amount of future payments to be made under these guarantees as the triggering events are not subject to predictability. With respect to certain of the aforementioned guarantees, such as indemnifications of landlords against third party claims for the use of real estate property leased by the Company, the Company maintains insurance coverage that mitigates any potential payments to be made.

20. Fair Value of Financial Instruments

The balance sheet carrying amount of cash and cash equivalents and receivables approximates fair value due to the short term nature of these items. Long-term debt consists of bank loans and senior notes. Interest rates on the Company's bank loans adjust frequently based on current market rates; accordingly, the carrying amount of the Company's bank loans approximates fair value. The $100 million unsecured senior notes have an approximate fair value at December 31, 2002 and 2001 of $102.5 million and $95.9 million, respectively, based on quoted market prices. The New Note from Sunburst has an approximate fair value of $42.7 and $40.5 million at December 31, 2002 and 2001, respectively.

21. Impact of Recently Issued Accounting Standards

In April 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145, among other matters, updates and clarifies existing accounting pronouncements related to gains and losses from the extinguishment of debt and certain lease modifications that have economic effects similar to sale-leaseback transactions. The provisions of SFAS No. 145 were generally effective as of May 15, 2002. The adoption of SFAS No. 145 did not have a material impact on our results of operations or financial position.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires companies to recognize costs associated with exit (including restructuring) or disposal activities at fair value when the related liability is incurred rather than at the date of a commitment to an exit or disposal plan under prior practice. Costs covered by the standard include certain contract termination costs, certain employee termination benefits and other costs to consolidate or close facilities and relocate employees that are associated with an activity being exited or long-lived assets being disposed. As permitted by SFAS No. 146, we adopted SFAS No. 146 in 2002.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." Such Interpretation elaborates on the disclosures to be made by a guarantor about its obligations under certain guarantees issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this Interpretation apply to guarantees issued or modified after December 31, 2002. We will adopt these provisions on January 1, 2003. The disclosure provisions of this Interpretation are effective for financial statements with annual periods ending after December 15, 2002. We have applied the disclosure provisions of this Interpretation as of December 31, 2002, as required (see Note 19—Commitments and Contingencies to our Consolidated Financial Statements).

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition and disclosure provisions of SFAS No. 148 are effective for financial statements for interim and fiscal years ending after December 15, 2002, with early application permitted for entities with a fiscal year ending prior to December 15, 2002. We have adopted the disclosure provisions of SFAS No. 148 effective December 31, 2002 and the transition provisions effective January 1, 2003.

22. Selected Quarterly Financial Data– (Unaudited)

2002	First	Second	Third	Fourth	Total Year
	(In thousands, except per share data)				
Revenues	**$75,753**	**$100,469**	**$105,030**	**$ 84,310**	**$365,562**
Operating income	**16,109**	**27,447**	**36,585**	**24,559**	**104,700**
Income before income taxes	**14,056**	**25,178**	**33,723**	**22,861**	**95,818**
Net income	**8,574**	**15,306**	**21,867**	**15,097**	**60,844**
Per basic share:					
Net income	**$ 0.21**	**$ 0.38**	**$ 0.55**	**$ 0.41**	**$ 1.55**
Per diluted share:					
Net income	**$ 0.20**	**$ 0.38**	**$ 0.54**	**$ 0.40**	**$ 1.52**

2001	First	Second	Third	Fourth	Total Year
	(In thousands, except per share data) As Revised (See Note 1)				
Revenues	$67,755	$ 84,460	$ 97,179	$ 92,034	$341,428
Operating income	17,451	26,356	35,409	(5,639)	73,577
Income before income taxes	12,132	22,238	20,854	(9,807)	45,417
Net income	7,400	13,565	12,508	(19,146)	14,327
Per basic share:					
Net income	$ 0.16	$ 0.31	$ 0.29	$ (0.45)	$ 0.32 a)
Per diluted share:					
Net income	$ 0.16	$ 0.30	$ 0.29	$ (0.45)	$ 0.32 a)

a) Quarterly per share numbers do not accumulate to the year-end per share amount due to rounding.

[THIS PAGE INTENTIONALLY LEFT BLANK]

BOARD OF DIRECTORS

Stewart Bainum Jr.
Chairman of the Board
Sunburst Hospitality Corporation

Barbara Bainum
Vice Chairman
Commonweal Foundation

Vice Chairman
Realty Investment Company, Inc.

William L. Jews
President and Chief Executive Officer
CareFirst BlueCross BlueShield

Director
Ecolab, Inc.
MBNA
Municipal Mortgage and Equity, L.L.C.
Ryland Group, Inc.

Charles A. Ledsinger, Jr.
President and Chief Executive Officer
Choice Hotels International

Director
FelCor Lodging Trust, Inc.
Friendly's Ice Cream Corporation
TBC Corporation

Lawrence R. Levitan
IRS Oversight Board

Retired Managing Partner
Andersen Consulting's Worldwide
Communications Industry Group

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

Ervin R. Shames
Visiting Lecturer
University of Virginia
Darden Graduate School of Business
Consultant to consumer goods and
services companies

Director
OnLine Resources Corporation
Select Comfort Corporation

CORPORATE EXECUTIVE OFFICERS

Stewart Bainum Jr.
Chairman of the Board

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

Michael J. DeSantis
Senior Vice President, General Counsel and Secretary

Bruce N. Haase
Senior Vice President, International

Thomas Mirgon
Senior Vice President, Human Resources and Administration

Janna Morrison
Senior Vice President, Franchise Services

Daniel Rothfeld
Senior Vice President, Partner Services and Emerging Business Opportunities

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

Gary Thomson
Senior Vice President and Chief Information Officer

Wayne W. Wielgus
Senior Vice President, Marketing

CORPORATE OFFICERS

Don Brockway
Vice President, Reservations Operations

Kevin M. Rooney
Associate General Counsel and Assistant Secretary

David L. White
Vice President and Controller

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
PricewaterhouseCoopers LLP
Washington, DC

Annual Meeting Date
Choice Hotels International will hold its Annual Meeting of Stockholders on Monday, April 28, 2003, at 9:00 a.m. in The Chesapeake Room of the Learning Center, 10720 Columbia Pike, Silver Spring, MD.

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. The Form 10-K also is available at www.choicehotels.com under the "Corporate and Board Information" link.

Corporate Headquarters
Choice Hotels International
10750 Columbia Pike
Silver Spring, MD 20901
General Inquiries: (301) 592-5000
Franchise Sales: (800) 547-0007
Investor Inquiries: (800) 404-5050, ext. 5026
or (301) 592-5026
e-mail: investor_relations@choicehotels.com
Media Relations: (301) 592-5032
Corporate Web Site: www.choicehotels.com

Copies of the company's public filings as well as its Corporate Governance Guidelines, Corporate Ethics Policy and charters to the Board Audit Committee and Compensation Committee are available on www.choicehotels.com under the "Corporate and Board Information" link.

Copyright 2003
Choice Hotels International, Inc.

Choice Hotels, Comfort Inn, Comfort Suites, Quality, Sleep Inn, Clarion, MainStay Suites, Econo Lodge, Rodeway Inn, Choice Privileges, EA$Y CHOICE and ChoiceBuys.com are registered trademarks, service marks and trade names owned by Choice Hotels International, Inc. Choice Hotels also owns and uses common law marks, including Profit Manager.

10750 Columbia Pike Silver Spring, MD 20901 www.choicehotels.com