FINANCIAL HIGHLIGHTS

	Year ended December 31, 1999	Year ended December 31, 1998	Seven months ended December 31, 1997	Fiscal Year ended May 31, 1997
Company Results (In millions, except per share data)				
Royalty Fees	$128.7	$115.2	$ 70.3	$ 97.2
Total Recurring Revenues	157.7	143.6	83.8	126.7
Recurring Income from Operations	94.5	80.0	46.4	59.6
Recurring Net Income	57.2	46.7	27.3	34.7
Net Income	57.2	55.3	27.3	34.7
Cash Flow from Operations	79.5	44.6	33.6	45.5
Basic Earnings per Share (a)	$1.04	$0.94	$0.46	$0.55
Diluted Earnings per Share (a)	$1.03	$0.93	$0.45	$0.55
System Results – Domestic only				
Revenues (estimated in millions)	$3,256	$3,063	$1,862	$2,678
Franchise Hotels Open	3,123	3,039	2,880	2,781
Franchise Hotels Under Development	596	866	725	710
Revenue Per Available Room	$35.33	$34.35	$36.39	$32.52

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

When I joined Choice in the fall of 1998, I knew our Company had solid business fundamentals and a broad operational scope that positioned it well for future growth...

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

A web-based support desk in Choice's London office (right) serves European hotels, featuring assistance in seven languages. Available 24 hours a day via the Internet, the site will be expanded to serve the remaining international hotels in 2000.

We enjoyed a terrific year in 1998, and our company continued its strong performance in 1999. Recurring net income increased 23 percent to $57.2 million, with recurring diluted earnings per share growing 32 percent to $1.03.

As pleased as I am with this strong performance, I recognize that we still have not tapped our full potential. Given the scope of our franchise operations - more than 4,200 branded hotels open in 35 countries - we have additional growth opportunities in terms of available room nights and the services we can offer consumers. Put another way, we will help our franchisees sell more existing rooms even as we add new units to our overall system. And, we will continue to develop new distribution channels that will allow us to take full advantage of the Internet and e-commerce in dealing with franchisees and guests.

The good news is that much of the infrastructure needed is in place. The challenge that lies ahead is **Unlocking the Power of Choice.** To achieve our true potential, and realize more shareholder value, we have to reach and serve more consumers, deliver exceptional services to our franchisees and our guests, and continue to build strong brands.

Choice's senior management team has spent considerable time in the past few months addressing this challenge. We now are implementing a new strategic plan to carry out a host of initiatives that will support future growth. Let me share with you just a few of the highlights:

Reaching More Consumers

As a franchise company, we focus on two levels of customers: our franchisees and our hotel guests. It's critical that we continue to provide our franchisees with a broad range of services and support to help them market and operate their properties. At the same time, we will continue to interact with the hotel guests through our reservations system and through the various travel sales distribution channels, including travel agents, tour operators, the Internet and the global distribution systems run by airlines and other travel outlets.

A key ingredient in providing these different levels of service is technology. As a worldwide lodging leader, we deliver proprietary technology to manage reservations and help


CHOICE H OTELS
ITERNA IONAL

properties improve their yield management and room inventory control. Profit Manager, our state-of-the-art property management system, now operates in almost 2,000 Choice brand hotels, with completion of deployment expected by the end of this year. Those hotels with the system in place enjoy the benefit of improved revenue per available room, on average about 7 percent. They also can operate more efficiently and deliver better service to guests.

In the past year alone, Choice invested $1.5 million in new computer systems and enhancements to our consumer Internet site. But even before these enhancements were developed, our Internet bookings increased 186 percent in 1999, resulting in revenues of $43.6 million. We anticipate even more dramatic growth in this reservations channel as more and more consumers log on to the Internet.

We also want to capitalize on the growth of the Internet by providing in-room technology at our hotels that will provide guests connectivity without having to bring their own computers. In a test at four locations, these in-room computers won overwhelming consumer acceptance, with average system usage of about 50 percent. This system allows guests to check their e-mail, access business services and enjoy a wide range of entertainment and shopping options. The potential room rate premium for this technology is in the $5 to $10 range, and the system allows for an advertising capability to generate additional revenues. We are in the final stages of determining the proper model to roll out to our franchisees. Clearly this capability will help us attract greater market share of both business and leisure travelers.

Delivering Exceptional Services

Technology and innovation dominate today's business world. But the real power in any business enterprise is its people. Technology is only as good as the people behind it and the integrity and pride they bring to their work. Choice's 2,100 associates recognize that technology gives them merely the tools to do their jobs better – it is their inherent commitment to provide exceptional service that will make the difference in a competitive environment.

Part of that exceptional service is developing better products for customers. At Choice, we have created an on-line purchasing capability called ChoiceBuys.com for our franchisees. Through this portal, our franchisees have easy access to more than 150 vendors who can deliver 7,000 products needed to operate and market hotels. Using the advantage of our wide distribution, we have negotiated favorable rates with these vendors for our hotels. As a result, already 1,200 properties are using ChoiceBuys.com to purchase a wide array of goods and services at significant savings.

As a means of ingraining a higher level of service in our associates and our franchisees, Choice opened The Learning Center at its Silver Spring headquarters last fall. The curriculum at The Learning Center focuses on how franchisees can get the full value of Choice's support services and how they can leverage the strength of our systems to deliver exceptional service to guests at the individual property level. At the same time, our associates receive training in a multitude of courses that reflect our drive to unlock the Power of Choice.

Building Strong Brands

Choice offers hotel developers established brands ranging from the economy to the lower upscale segments: Econo Lodge, Rodeway Inn, Sleep, Comfort, MainStay Suites, Quality and Clarion. Over time, these brands have achieved broad consumer acceptance and support, beginning with the opening of the first Quality properties more than 60 years ago.

As the industry becomes even more competitive, the need to bring better definition to our brands and greater focus to our marketing efforts has led to a tightening of quality standards, which will protect brand integrity and build franchise value. Our development focus in 2000 is to bring new properties into our system that will enhance the brands and drive more consumer acceptance. Much of this effort will continue to bring more consistency to our hotel products while allowing targeted development to move forward.

We also are reviewing the brands to see if there are opportunities to reposition them within segments to give consumers a clearer choice among our offerings. To date, research shows that market share can be gained through better brand positioning and definition. This, in turn, will strengthen the product we offer to potential and existing franchisees. To back that product up, we also adopted in 1999 a Franchise Trust Pact that spells out our code of conduct as a franchisor.

Stronger brands also give us greater opportunity globally. Our International division enjoyed terrific growth in 1999, as we added 493 hotels to our system. We now have more than 1,100 hotels open outside of the United States. Our development partners in Europe, the Middle East, Latin America and the Asia-Pacific region have embarked on ambitious growth plans that will add significantly to our Comfort, Quality, Clarion and Sleep hotel brands.

As more international travelers experience and enjoy our brands in their own countries, they likely will select our brands on visits to the United States. Conversely, as more of our American guests travel internationally for business and pleasure, they will seek out our brands if we can develop properties in the right gateway destinations.

Our vision is simple: Reach More Consumers, Deliver Exceptional Services, Build Strong Brands. These elements serve as the hallmarks of our day-to-day operations. This year's report tells the story of how we are carrying out our vision every hour of every day.

A Word of Thanks

Choice could not embark on this new strategic course without the support and talent of our associates. We are fortunate to have a unique blend of dedicated, long-term employees and relative newcomers who enthusiastically share our vision for Choice. The Company's strong 1999 performance speaks to our associates' ability to pull together and achieve successfully. I thank each and every one of them for their effort and support.

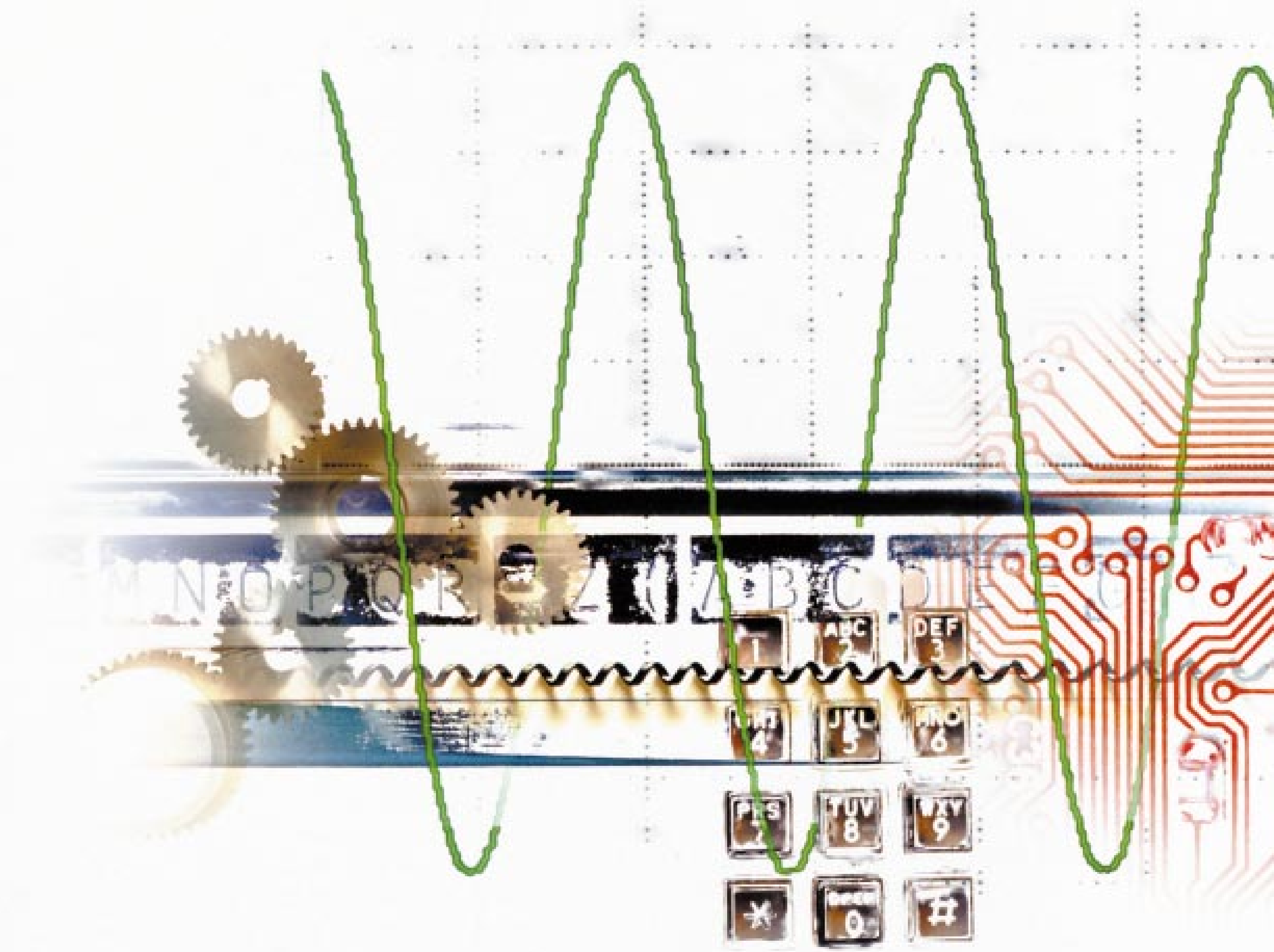
At the same time, Choice has a superb Board of Directors, led by Stewart Bainum, Jr., that provides our management team with sound advice and guidance. The Board's individual and collective support has contributed greatly to our success.

This spring Jim Rempe will be stepping down from our Board. We wish Jim well and thank him for his 30 years of outstanding service to our Company as a member of management and as a director. A recent addition to our board is William L. Jews, president and chief executive officer of CareFirst BlueCross BlueShield, the largest health insurer in the greater Washington, D.C. region. Bill's 25-year career in healthcare administration demonstrates his business acumen, which is complemented by his inspiring sense of service to his community.

Given the fine support of these associates and directors, I look forward to even greater progress for Choice as we build on our achievements and set our sights on new horizons.

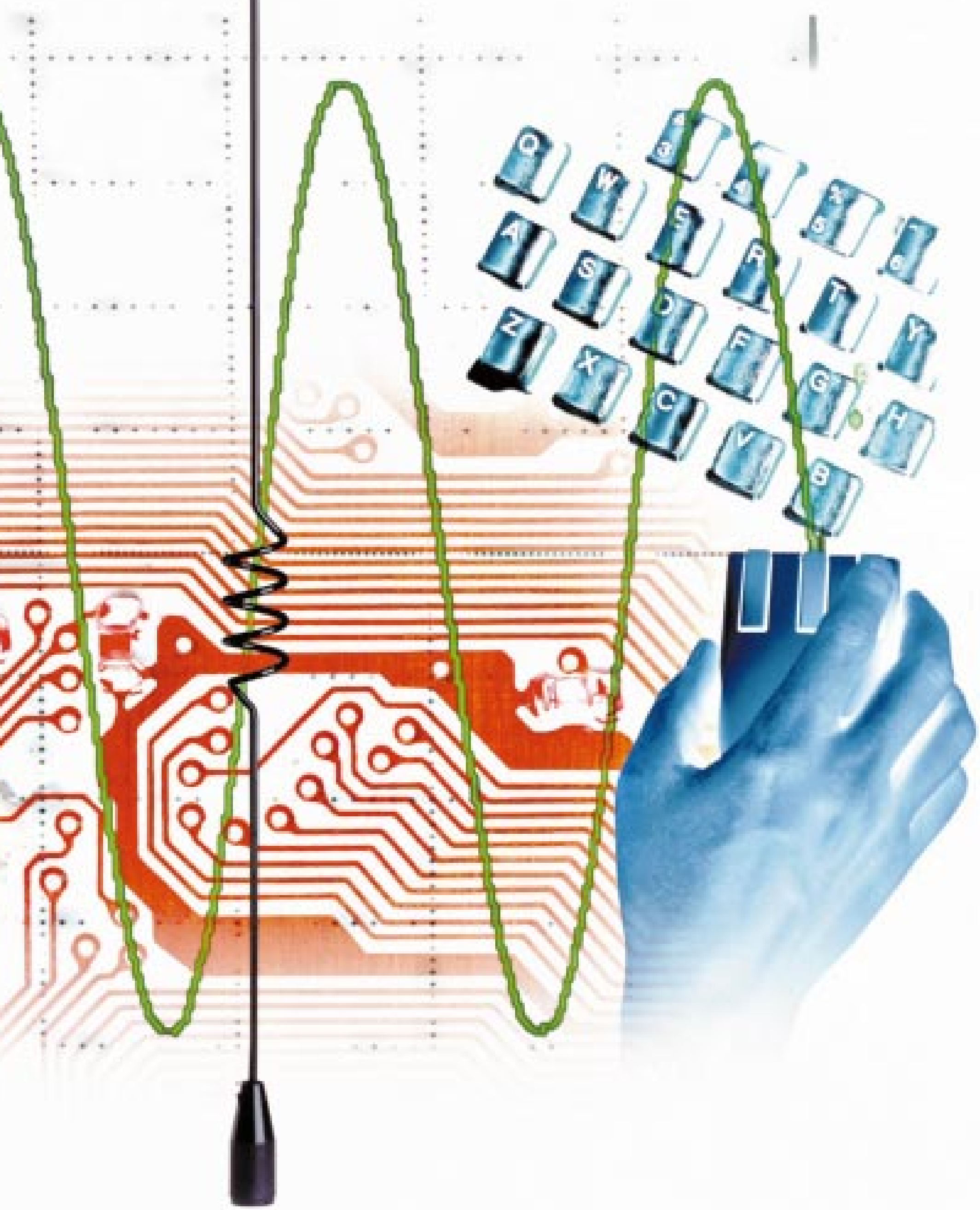
Charles A. Ledsinger, Jr.
President and Chief Executive Officer

March 15, 2000



pow-er \ˈpau̇(-ə)r\ n.

1. Ability to do or act; capability of doing or accomplishing something;
2. Great or marked ability to do or act; strength; might; force



POWER.

A simple word with strong meaning. Especially in a highly competitive business, where lodging giants fight harder than ever for market share. For the hotel guest, it means a wider array of services and amenities as hotel companies create more focused marketing programs. For the hotel franchisee or developer, it means a broader range of support services from the franchisor to attract guests.

Unlocking The Power Of Choice

At Choice, more than 2,100 associates work hard every day to enhance the Company's powerful array of brands by delivering exceptional services to franchisees and guests alike and by strengthening the brands with more focused marketing and higher quality standards.

Working in 17 offices worldwide, with responsibilities ranging from sales support and reservations to development and hotel services, these associates face the daily challenges of a dynamic business being transformed by technology.

Stop and consider this: just five years ago, how many people could book hotel reservations over the Internet? How about two or three years ago? In a remarkably short amount of time, individual travelers have opened up a new world of possibilities through the Internet. The result is a literal explosion of e-commerce, as more people take advantage of the new technology.

Choice has been at the forefront of this revolution, creating a pioneer web site in 1995 for booking reservations. Already this business has grown from less than half a percent of all reservations in 1996 to more than 3 percent in 1999. This spring the company is unveiling a new, improved Internet site that will provide users with a wider range of travel information and options, along with a more streamlined booking capability.

To handle this new capability, Choice invested $1.5 million in new computer systems to carry the higher Internet demand. And the innovation continues.

"The new system's architecture allows the processors to access memory more directly and thus faster," explained Gary Thomson, vice president, information systems technologies. "Our worldwide system has been revitalized with increased capacity, faster processing

Most Choice brand hotels provide a free continental or full breakfast for guests to enjoy, along with a 100 percent satisfaction guarantee.

9:41 a.m. MST

A visitor might mistake the sight for a NASA flight center or NORAD control room, with row after row of workstations staffed by employees speaking into headsets and punching furiously at keyboards, causing their glowing screens to do a colorful dance.

Telephone sales agents on duty at Choice's Phoenix Reservations Call Center engage in nearly simultaneous conversations, handling as many as 20,000 calls per day.

Phoenix is the hub of Choice's North American reservations network. Some 250 agents work at the main call center, at home or at two satellite centers established at nearby Glendale and Scottsdale community colleges.

"All of Choice's advertising, promotions and publicity come to a head when we receive a consumer call," said Don Brockway, Choice vice president of reservations operations. "This is where our sales agents convert potential interest into room nights; this where the revenue trail begins."

The nerve center of Choice's worldwide computer operations in Phoenix is a hub of activity 24 hours a day, as associates monitor the demand on various information systems and ensure that they deliver strong performance.

speed and more nimble software to handle the rapidly growing volume as well as accommodate new capabilities in the future."

Of critical importance is the technology link between Choice's central reservations system in Phoenix and the individual hotel property. For the past three years, the company has been rolling out a proprietary property management system called Profit Manager. By the end of this year, Profit Manager will be in place throughout the entire domestic system. Already the impact on performance is powerful.

"The revenue management component of the system has helped our hotels benefit from an average 4 percent premium in rate over their competitive set and has averaged RevPAR gains of 7.4 percent for those with the system in place," noted Janna Morrision, vice president, property systems.

Technology also is driving training for franchisees and Choice associates. Last fall, the Company opened The

Choice's call centers handle 19 million reservations calls annually, with the Phoenix center averaging as high as 20,000 calls per day.

Choice's franchised hotels worldwide generated about $4.2 billion in revenues in 1999.

7:21 a.m. MST

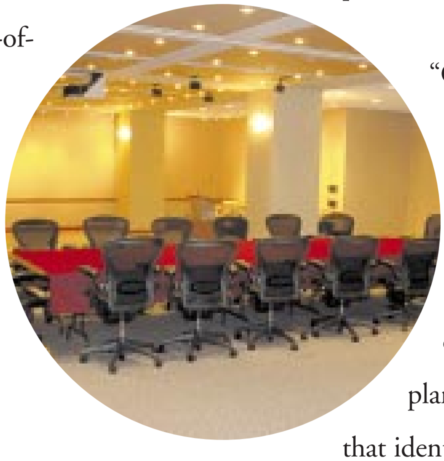
The sun is rising over the mountains in Phoenix as a group of Choice programmers and computer analysts convene a strategy session to discuss ideas for incorporating new functionality into Profit Manager, Choice's proprietary property management system.

The assemblage at Choice's Western Regional Headquarters includes experts in complementary fields including Spencer Leibow, seated left, of the Information Technology Central Reservations department, and Michael Woods, standing right, of the Product Management department.

Todd Reeser, seated at right, and Larry Gorman, standing left, represent the Property Systems Development department. Laura Williams brings the viewpoint of the Quality Assurance department.

Many similar meetings and interviews with Choice franchisees culminated with the third-quarter introduction of Profit Manager 4.0, the latest version of the software that incorporates major improvements including enhanced security, more robust housekeeping and maintenance management functions and customizable guest forms.

Learning Center at its Silver Spring headquarters. Here, hotel owners and general managers attend training to learn all about the myriad of support services and marketing programs available from Choice in a program named Total Lodging by Choice. The facility includes a state-of-the-art computer lab for on-line training as well as a multimedia room, large auditorium and classrooms for small-group instruction.



"The new Total Lodging by Choice training program helps franchisees leverage Choice's proven business systems, proprietary technology and strategic partnerships to compete successfully in the marketplace," noted Pat Murphy, senior director, instructional design.

In addition, Choice associates receive technical training in computer skills and can earn college credits for work-related courses taught by faculty from nearby colleges.

Out in the field, around the globe, Choice associates support hotels with on-site visits to consult on marketing programs, assist with technology installations, conduct quality assurance inspections and accompany hotel staff on local sales calls. New this year is a domestic hotel sales support program designed to help new properties ramp up in local markets more quickly.

"Our sales support directors work with the hotel and Choice's franchise sales director to create a sales action plan for the new hotel that identifies major sources of business as well as advertising and direct-mail opportunities," said Mike Parent, vice president, new hotel sales support.

By using the local hotel's first year's marketing fees for targeted assistance in getting the property open and running, Choice gives its franchisees a "power boost" over the competition.

The Learning Center features an auditorium (above) for large group meetings, complete with full audio-visual support, a dining area and service kitchen.

11:36 a.m. EST

With their auditory and visual attention captured by headsets and flat-screen computer monitors, franchisees and general managers are immersed in mandatory weeklong instruction at The Learning Center, Choice's new state-of-the-art training facility in Silver Spring, Md.

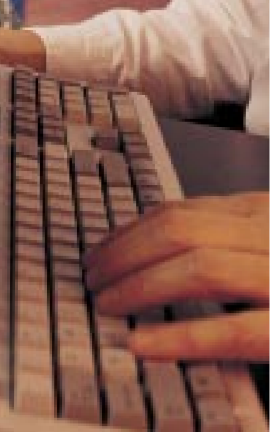
Before returning home, these members of the "Class of 1999" will have learned about the many resources and programs available from Choice to help them realize the full financial potential of their hotels.

The curriculum, titled Total Lodging by Choice, addresses marketing, reservations, guest relations, staffing management, operations, budgeting, competition and how to expedite the process of constructing and furnishing a hotel.

"Total Lodging by Choice is our equivalent to handing new owners and managers an instruction manual for operating their new properties," said Sarah Sims, Choice learning center specialist.

"The Learning Center provides a wonderful broad-based learning experience that successfully integrates classroom and case study exercises," said Susan daSiva, general manager of the Comfort Inn & Suites hotel of Revere, Mass.


TOTAL LODGING
by CHOICE



Guests at the Comfort Inn Airport in North Linthicum, Md., enjoy access to the Internet through in-room computers. Both business and leisure travelers show a strong acceptance of the technology, using the system for business and entertainment purposes. Choice will begin a broader rollout of the "room of the future" to more hotels in 2000.

Another "power boost" for franchisees is Choice's new on-line purchasing site, www.ChoiceBuys.com, which gives hotel owners access to more than 150 vendors for easy, one-stop shopping at favorable prices.

"With this system, our franchisees can review more than 7,000 products, place orders directly with endorsed vendors, pay on-line and track delivery via the Internet," said Brad Douglas, vice president, strategic partnerships. "We expect that franchisees ultimately will purchase goods and services valued at $1.5 billion annually through ChoiceBuys.com."

More than 1,200 hotels have signed up for this system since its debut last year. For Choice, it provides both a revenue stream and a way to drive product consistency and quality. For the hotel owner, it offers access to an efficient, cost-effective and comprehensive purchasing solution 24 hours a day.

The e-commerce model demonstrated by ChoiceBuys.com lends itself to another exciting venture: in-room Internet access for hotel guests through computers and dedicated high-speed access lines. In a test at four hotels last fall, the company confirmed that guests are enthusiastic about having Internet access in their rooms as a portal for business and entertainment applications.

Choice has more than 2,300 franchisees, with no single franchisee accounting for more than 5 percent of its total revenues.

5:42 a.m. MST

If Greg Roth could patent his daily commute, he would be a millionaire. The hike from his breakfast table to his office involves 15 steps and takes a mere minute. And he never has to leave the confines of his Scottsdale, Ariz., home.

Roth is one of 16 Choice reservations sales agents who work at home. He begins his six-hour shift at 5:30 every morning after sipping a glass of juice, taking the stairs to a second-story loft and booting up a personal computer.

As Sebastian, his loyal Yorkshire Terrier, watches patiently from a perch on a nearby couch, Roth dials into Choice's central reservations computer system some 10 miles away in Phoenix.

Within seconds, he cheerfully begins answering calls that are routed to his home one after another, as quickly and efficiently as they reach his colleagues who work inside Choice's Phoenix Reservations Call Center.

During the course of one hour, Roth will answer as many as 20 calls from prospective hotel guests and generate sales of $1,400. That high productivity and a 1997 honor as Employee of the Year earned him the right to work at home, according to Angie Trumble, Choice Director of Call Center Operations in Phoenix.

"This in-room technology creates the hotel room of the future, where guests can check e-mail, shop for quality merchandise, book future travel and access entertainment and news services," said Daniel Rothfeld, vice president, partner services. "It's a valuable amenity for both business and leisure travelers that opens up new revenue streams for Choice and its business partners."

Strongly backing all of these initiatives is Choice's commitment to unleash the full power of its resources on behalf of franchisees and guests. Central to this commitment is the company's Market Area structure that divides the United States into five regions where Choice associates are deployed to assist local hotel owners and to bring new properties into the system.

In addition, Choice operates three international regions to assist its global development partners.

The underpinning of Choice's development effort is its new Franchise Trust Pact, which spells out a code of conduct for relations with franchisees on a host of issues such as system standards, sales ethics, nonrenewals, terminations, impact, supplier options, database information and dispute resolution.

"Our Franchise Trust Pact pledges that Choice will deal with franchisees fairly and forthrightly," said Steve Schultz, executive vice president, franchise operations. "Our Trust Pact is a powerful statement of Choice's determination to deliver maximum value to our franchisees."

Power. How to tap it, how to use it to maximum effect. By building reaching more consumers, delivering exceptional services and building strong brands, Choice associates worldwide are **Unlocking the Power of Choice** for franchisees and shareholders alike.

To promote its Quality Sleeper by Serta mattress to AAA travel agents, the Quality brand team delivers a mattress to a lucky winner in AAA's Columbia, Md., office. AAA generates almost $400 million in revenue for Choice brand hotels each year.

2:52 p.m. PST

The handshake conveys trust and understanding. It is a handshake between two lodging professionals who represent different interests yet consider themselves allies in a competitive war in which the best properties and the best brands win.

Scott Seymore, left, vice president and general manager of the Quality Suites Silicon Valley of Santa Clara, Calif., greets Reginald Newson, Choice Franchise Service Director, in the hotel lobby for a regular meeting to update the hotel's sales plan.

Newson is one of 72 Choice field representatives who are assigned to support individual hotels throughout the United States.

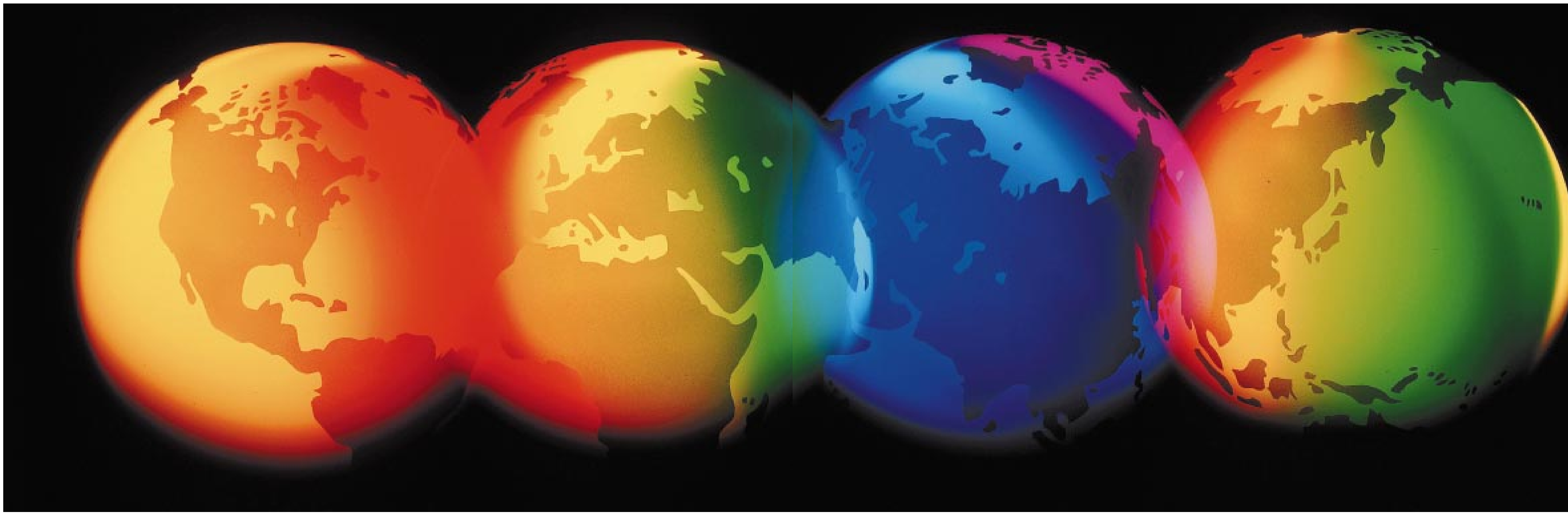
He relishes those tasks and appreciates the opportunity to work with top hotel professionals like Seymore. "With Scott Seymore and the Quality Suites Silicon Valley, learning is a two-way street," Newson said.

Seymore echoes the sentiment, saying: "Over the years we have thoroughly enjoyed working with Reggie and the entire FSD team. The value of our partnership can be experienced at all levels. Most importantly we have been both inspired and challenged to become the best hotel we can possibly be."

Global Highlights

United States: Choice enjoyed another strong development year, adding 301 new properties to its system. To help franchisees improve their hotels' performance, the company introduced new training programs, unveiled a Technology Service Program to help finance equipment, maintenance and training for property management systems and revamped its franchisee awards program to recognize quality within the system by introducing Bronze and Silver Hospitality Awards.

Europe, Middle East and Africa: Friendly Hotels, master franchisor for Western Europe, added 121 properties in 1999, a 60 percent increase to its Choice system. At year's end, the Choice Hotels Europe portfolio included 302 hotels open and 24 under development in the United Kingdom, France, Germany, Ireland, Belgium, Czech Republic, Switzerland, Italy, Portugal and Spain. Within the next four years, Friendly plans to open 50 Sleep Inn hotels in the United Kingdom and 25 in Spain. Choice Hotels Scandinavia added six new properties and more than 2,000 rooms to its system, bringing its portfolio at year's end to 92 hotels.



The Americas: Choice Hotels Canada continued to enjoy strong growth and wider consumer acceptance. For the fourth consecutive year, the company was named the Hotel Chain of the Year by the North West Commercial Travelers Association of Canada. In South America, Choice Atlantica Hotels, the master franchisor, has 12 hotels open and signed its 50th contract for development of Clarion, Quality, Comfort and Sleep hotels.

Asia Pacific: Choice's strategic alliance with Flag International in Australia brought 385 hotels on line in 1999, with plans to convert another 66 properties to Choice brands in 2000. Over the next four years, almost 250 Flag hotels will be converted to Clarion, Quality and Comfort brand hotels. In Japan, the Vessel group broke ground for the first of 20 Sleep Inn hotels in western Japan, with the Greens Hotel Company signing on to develop properties in eastern Japan. The Quality Resort Terraces in New Zealand became the first international property to win a Platinum award, Choice's highest recognition for quality.

Comfort Inn

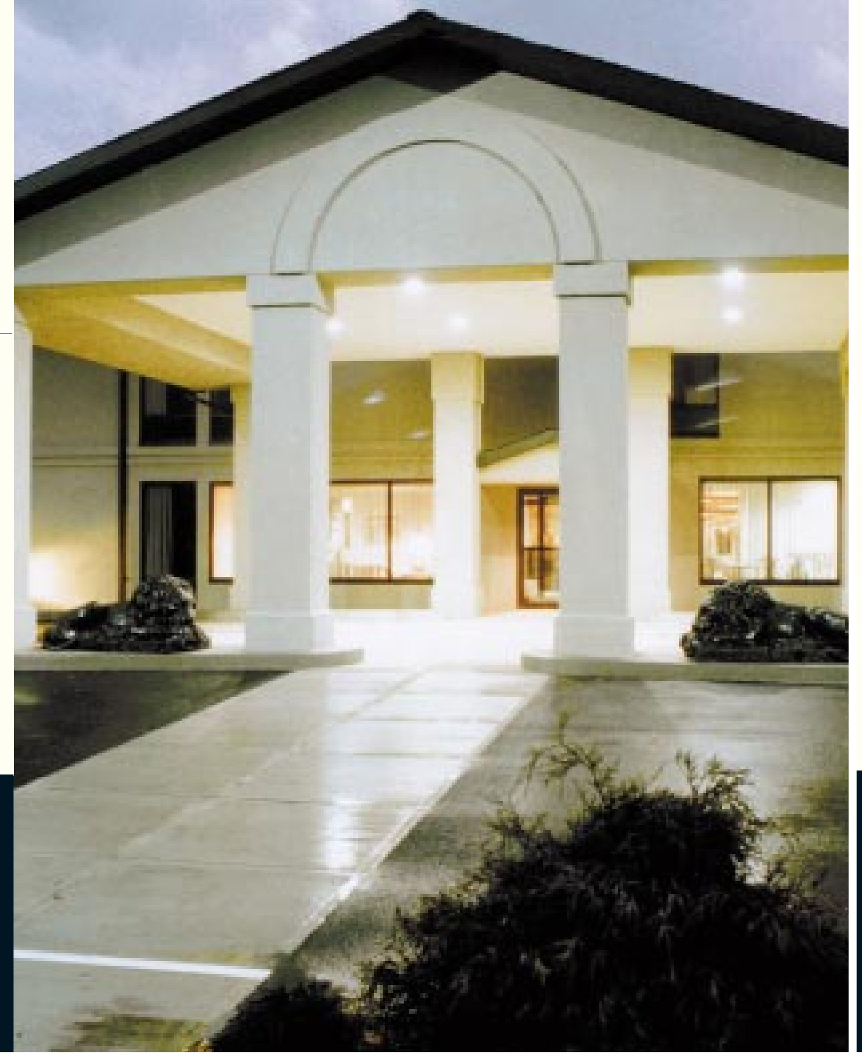
The Comfort Inn brand is a leading limited service hotel chain offering highly competitive rates, free deluxe continental breakfast and exceptional rooms and amenities, all backed by a 100 percent satisfaction guarantee.

1999 Highlights:

- Successful summer advertising promotion, partnered with Sea World, offered a Shamu plush toy to family summer vacation travelers
- Named one of top 100 franchises by *Success* magazine

1999 Inn of the Year: the Comfort Inn hotel of Blairsville, Pa.

	HOTELS	ROOMS
Open:	1,246	97,592
Under Development	128	9,229
Total	1,374	106,821



Sleep

The Sleep brand offers consistent quality with an all-new construction, mid-priced product featuring a walk-in, oversized shower, complimentary continental breakfast and affordable rates, all backed by a 100 percent satisfaction guarantee.

1999 Highlights:

- Introduced a Sleep Inn & Suites hotel prototype, featuring a mix of standard rooms and suites to suit a wide range of travel needs
- Opened 200th Sleep Inn in the Buckhead section of Atlanta

1999 Inn of the Year: the Sleep Inn hotel of Columbus, Neb.

	HOTELS	ROOMS
Open:	224	17,199
Under Development	149	11,355
Total	373	28,554

Econo Lodge

The Econo Lodge brand is among the best roadside names in its category, offering clean, affordable economy lodging for travelers who know "Our Rates Are Low, Not Our Standards."

1999 Highlights:

- Named top budget hotel chain by *Business Travel News*
- Successfully completed rollout of nationwide clean room and housekeeping certification initiative in conjunction with Procter & Gamble's Mr. Clean brand

1999 Inn of the Year: the Econo Lodge hotel of Branson, Mo.

	HOTELS	ROOMS
Open:	691	43,754
Under Development	45	2,854
Total	736	46,608

MainStay Suites

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

1999 Highlights:

- Introduced CD-ROM training program for hotel staff on guest service
- Established sales support program with Choice's 13 national sales directors

The MainStay Suites hotel of Plano, Texas

	HOTELS	ROOMS
Open:	29	2,681
Under Development	21	1,701
Total	50	4,382

Clarion

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

1999 Highlights:

- Launched new marketing campaign built around the "Use Every Advantage" theme, which positions the brand as an upscale alternative
- Created an Internet "electronic brochure" program for all Clarion hotels worldwide

1999 Inn of the Year: the Clarion Inn & Suites hotel of Gatlinburg, Tenn.

	HOTELS	ROOMS
Open:	112	18,815
Under Development	16	2,121
Total	128	20,936

Quality

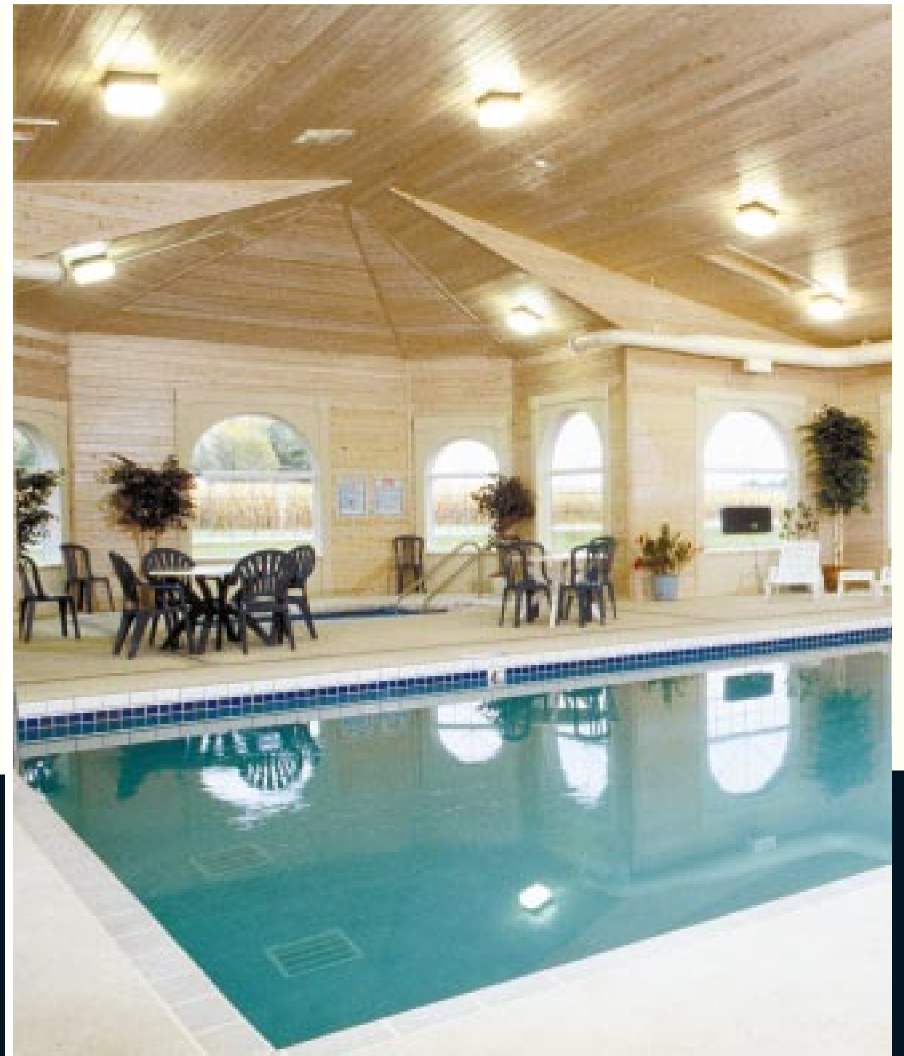
The Quality brand offers an established mid-priced lodging product with rooms designed for today's business travelers. The Quality Sleeper by Serta mattress, a signature item, gives travelers added value and comfort.

1999 Highlights:

- Started year-long celebration of brand's 60th anniversary, marketing it as the first successful branded hotel product
- Named one of the top 100 franchises by *Success* magazine

1999 Inn of the Year: the Quality Hotel Maingate of Anaheim, Calif.

	HOTELS	ROOMS
Open:	431	49,331
Under Development	74	7,030
Total	505	56,361



Rodeway Inn

The Rodeway Inn brand offers economy hotels with national consumer exposure specializing in meeting the needs of the senior travel markets in cities and towns large and small.

1999 Highlights:

- Printed new brand directory featuring color photography of individual hotels
- Gained admittance to AAA's "Show Your Card and Save" program as a result of a higher percentage of AAA approved properties

1999 Inn of the Year: the Rodeway Inn hotel of Jefferson, Wis.

	HOTELS	ROOMS
Open:	166	10,613
Under Development	22	1,373
Total	188	11,986

Comfort Suites

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

1999 Highlights:

- Outperformed its competitive set in occupancy, revenue per available room and average room rate
- New marketing campaign, "More Room to Practice Your Sales Pitch," and "More Room to Think," features a spacious room with separate sleeping and living areas

1999 Inn of the Year: the Comfort Suites hotel of Mineral Wells, W.Va.

	HOTELS	ROOMS
Open:	224	18,135
Under Development	141	11,001
Total	365	29,136

International Offices

The Americas Region

Jim Jaffre, Vice President
Choice Hotels International
10750 Columbia Pike
Silver Spring, MD 20901
Phone: (301) 592-6166

Europe, Middle East and Africa Region

Roy Murray, Vice President
Choice Hotels International
One Warwick Row
London, England SW1E 5ER
Phone: 44-171-808-5656

Asia Pacific Region

Bruce McKenzie, Vice President
Choice Hotels International
65 Chulia Street, #40-45
OCBC Center
Singapore 049513
Phone: 65-535-8226

International Winner

International

Choice's international presence represents approximately 25 percent of the total system, exceeding more than 1,100 properties open outside the United States in 34 countries. The total includes in the three regions: 248 in the Americas, 387 in Europe, the Middle East and Africa, and 490 in Asia Pacific.

1999 Highlights:

- Opened regional office in Singapore to oversee development, franchise services, sales and marketing for hotels in Asia Pacific
- Signed area representation agreement with Windsor Hotels of Cairo to develop hotels in Egypt, Africa and the Middle East

1999 Inn of the Year: the Comfort Suites Turks & Caicos of the Turks and Caicos Islands

	HOTELS	ROOMS
Open:	1,125	80,134
Under Development	165	17,431
Total	**1,290**	**97,565**

Table of Contents

The Company is one of the largest hotel franchisors in the world with 4,248 hotels open and 761 hotels under development as of December 31, 1999 representing 338,254 rooms open and 64,095 rooms under development in 40 countries. The Company franchises hotels under the Comfort, Quality, Econo Lodge, Sleep Inn, Clarion, Rodeway Inn and MainStay Suites brand names. The Company has over 2,300 franchisees in the franchise system with no single franchisee accounting for more than 5% of its royalty or total revenues. The Company operates in all 50 states and the District of Columbia and 34 additional countries with 95% of its franchising revenue derived from hotels franchised in the United States.

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

During 1997, the Company changed its fiscal year end from May 31 to December 31. Accordingly, the following discussion includes a discussion of the results of the seven months ended December 31, 1997, as compared to unaudited results from the comparable seven-month period in 1996.

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

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

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

(In thousands)	**1999**	1998
Revenues:		
Royalty fees	**$128,653**	$115,171
Initial franchise & relicensing fees	**13,910**	16,571
Partner services revenue	**9,055**	6,370
Other revenue	**6,111**	5,516
Product sales	**3,871**	20,748
European hotel operations	-	1,098
Total revenues	**161,600**	**165,474**
Operating Expenses:		
Selling, general & administrative	**55,860**	52,948
Depreciation & amortization	**8,023**	6,753
Product cost of sales	**3,883**	19,532
European hotel operations	**-**	1,133
Total operating expenses	**67,766**	**80,366**
Operating income	**93,834**	85,108
Loss (gain) on sale of investments	**68**	(2,370)
Interest expense	**19,387**	19,133
Interest and dividend income	**(20,092)**	(14,055)
Income before income taxes and extraordinary item	**94,471**	82,400
Income taxes	**37,316**	34,327
Net income before extraordinary item	**57,155**	48,073
Gain on early extinguishment of debt, net of $4,732 of income taxes	**-**	7,232
Net income	**$ 57,155**	**$ 55,305**

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

Net franchise revenues were $157.7 million for Calendar 1999 and $143.6 million for Calendar 1998. Royalties increased $13.5 million to $128.7 million from $115.2 million in Calendar 1998, an increase of 11.7 %. The increase in royalties is attributable to a 2% increase in the number of domestic franchised hotel rooms, an increase in the effective royalty rate of the domestic hotel system to 3.7% from 3.6%, and an improvement in domestic RevPAR of 3.0%. Domestic initial fee revenue generated from franchise contracts signed was $10.1 million down from $13.1 million in Calendar 1998. Total franchise agreements signed in Calendar 1999 were 318, a decline from the 440 total agreements executed in Calendar 1998. An increasingly competitive hotel franchising environment, coupled with stricter hotel brand standards being enforced by the Company contributed to the decline in the total franchise agreements signed in the period. Revenues generated from partner service relationships increased to $9.1 million from $6.4 million in Calendar 1998. 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 258,120 from 252,357, an increase of 2% for the year ended December 31, 1999. For 1999, the total number of domestic hotels on-line grew 3% to 3,123 from 3,039 for 1998. The total number of international hotels on-line increased to 1,125 from 632, an increase of 78% for the year ended December 31, 1999. International rooms on-line increased to 80,134 as of December 31, 1999 from 53,095, an increase of 51%. As of December 31, 1999, the Company had 596 franchised hotels with 46,664 rooms either in design or under construction in its domestic system. The Company has an additional 165 franchised hotels with 17,431 rooms under development in its international system as of December 31, 1999.

Franchise Expenses: The cost to operate the franchising business is reflected in selling, general and administrative expenses. Selling, general and administrative expenses were $55.9 million for Calendar 1999, an increase of $3.0 million from the Calendar 1998 total of $52.9 million. As a percentage of net franchise revenues, selling, general and administrative expenses declined to 35.4% in Calendar 1999 from 36.8% in Calendar 1998. The improvement in the franchising margins relates to the economies of scale generated from operating a larger franchisee base and improvements in franchised hotel performance.

Marketing and Reservations: The 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 to reimburse the Company for expenses associated with providing such franchise services as central reservation and yield management systems, national marketing and media advertising. The Company is contractually obligated to expend the reservation and marketing fees it collects from franchisees in accordance with the franchise agreements; as such, no income or loss to the Company is generated. During the second quarter of 1998, the Company changed its presentation of marketing and reservation fees such that the fees collected and associated expenses are reported net. All prior periods have been reclassified to conform to the new presentation.

The total marketing and reservation fees received by the Company (previously reported as revenue) were $146.0 million and $127.4 million for the years ended December 31, 1999 and December 31, 1998, respectively. Depreciation and amortization charged to the marketing and reservation funds was $9.6 million and $6.2 million for the years ended December 31, 1999 and December 31, 1998, respectively. Interest expense incurred by the reservation fund was $3.3 million and $1.8 million for the years ended December 31, 1999 and 1998, respectively. Reservation fees and marketing fees not expended in the current year are carried over to the next fiscal year and expended in accordance with the franchise agreements. Shortfall amounts are similarly recovered in subsequent years. Excess or shortfall amounts from the operation of these programs are recorded as a payable or receivable from the particular fund. Under the terms of the franchise agreements, the Company may advance capital as necessary to the marketing and reservation funds and recover such advances through future fees. As of December 31, 1999, the Company's balance sheet includes a receivable of $37.7 million related to advances made to the marketing ($12.5 million) and reservation ($25.2 million) funds. As of December 31, 1998, the Company's balance sheet includes a receivable of $ 18.7 million related to advances made to the marketing ($7.8 million) and reservation ($10.9 million) funds. The Company has the ability under existing franchise agreements and expects to recover these advances through future marketing and reservation fees.

Product Sales: The group purchasing program utilizes bulk purchases to obtain favorable pricing from third party vendors for franchisees ordering similar products. The Company acts as a clearinghouse between the franchisee and the vendor, and orders are shipped directly to the franchisee. Sales made to franchisees through the Company's group purchasing program declined $16.8 million to $3.9 million in Calendar 1999 from $20.7 million in Calendar 1998. Similarly, product cost of sales decreased $15.6 million to $3.9 million from Calendar 1998. In the fourth quarter of 1998, the Company discontinued this group purchasing program as previously operated.

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

Depreciation and Amortization: Depreciation and amortization increased to $8.0 million in Calendar 1999 from $6.8 million in Calendar 1998. This increase was primarily attributable to new computer systems installations and corporate office renovations.

Interest Expense and Interest and Dividend Income: Interest expense of $19.4 million in Calendar 1999 is up slightly from $19.1 million in Calendar 1998 due to higher interest rates and increased debt financing. Included in Calendar 1999 and Calendar 1998 results is approximately $14.2 million and $10.4 million, respectively, of interest income earned on the note receivable from Sunburst Hospitality Corporation. The Company's investment in Friendly resulted in $2.2 million and $2.1 million in dividend income in Calendar 1999 and Calendar 1998, respectively.

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

Comparison of Calendar Year 1998 Operating Results and Calendar Year 1997 Operating Results

The Company recorded net income of $55.3 million for the year ended December 31, 1998 ("Calendar 1998"), an increase of $16.6 million compared to net income of $38.7 million for the year ended December 31, 1997 ("Calendar 1997"). The increase in net income for Calendar 1998 was primarily attributable to an increase in franchise revenue as a direct result of the addition of new franchised hotels to the system, improvements in the operating performance of hotels and an increase in the effective royalty rates achieved. Additionally, in Calendar 1998 the Company recognized an extraordinary gain on early extinguishment of debt of $7.2 million.

Summarized financial results for the years ended December 31, 1998 and 1997 are as follows:

(In thousands)	1998	1997 (unaudited)
Revenues:		
Royalty fees	$115,171	$106,299
Initial franchise & relicensing fees	16,571	16,096
Partner services revenue	6,370	7,079
Other revenue	5,516	4,833
Product sales	20,748	23,806
European hotel operations	1,098	17,303
Total revenues	**165,474**	**175,416**
Operating Expenses:		
Selling, general & administrative	52,948	50,782
Depreciation & amortization	6,753	9,173
Product cost of sales	19,532	22,769
European hotel operations	1,133	15,624
Total operating expenses	**80,366**	**98,348**
Operating income	85,108	77,068
Gain on sale of investments	(2,370)	—
Interest expense	19,133	13,295
Interest and dividend income	(14,055)	(2,503)
Income before income taxes and extraordinary item	82,400	66,276
Income taxes	34,327	27,604
Net income before extraordinary item	48,073	38,672
Gain on early extinguishment of debt, net of $4,732 of income taxes	7,232	—
Net income	**$ 55,305**	**$ 38,672**

Franchise Revenues: Net franchise revenues were $143.6 million for Calendar 1998 and $134.3 million for Calendar 1997. Royalties increased $8.9 million to $115.2 million from $106.3 million in Calendar 1997, an increase of 8.4%. The increase in royalties is attributable to a net increase of 159 franchised hotels during the period representing an additional 10,196 rooms added to the system, an improvement in domestic RevPAR of 2.3% and an increase in the effective royalty rate of the domestic hotel system to 3.6% from 3.5%. Domestic initial fee revenue generated from franchise contracts signed increased 4.0% to $13.1 million from $12.6 million in Calendar 1997. Total franchise agreements signed in Calendar 1998 were 440, up 4.5% from the total contracts signed in Calendar 1997 of 421. Revenues generated from partner service relationships decreased to $6.4 million from $7.1 million in Calendar 1997.

The number of domestic rooms under development increased to 75,232 from 62,384, an increase of 20.6% for the year ended December 31, 1998. The total number of international hotels on-line increased to 632 from 605, an increase of 4.5% for the year ended December 31, 1998. International rooms on-line increased to 53,095 as of December 31, 1998 from 50,639, an increase of 4.9%. The total number of international hotels under development increased to 611 from 119 for the year ended December 31, 1998. The number of international rooms under development increased to 40,375 as of December 31, 1998 from 12,029 as of December 31, 1997. These increases are primarily attributable to a strategic alliance in June 1998 with Flag International Limited.

Franchise Expenses: Selling, general and administrative expenses were $52.9 million for Calendar 1998, an increase of $2.1 million from the Calendar 1997 total of $50.8 million. As a percentage of net franchise revenues, selling, general and administrative expenses declined to 36.9% in Calendar 1998 from 37.8% in Calendar 1997. The improvement in the franchising margins relates to the economies of scale generated from operating a larger franchisee base, cost control initiatives, and improvements in franchised hotel performance.

Marketing and Reservations: The total marketing and reservation fees received by the Company (previously reported as revenue) were $127.4 million and $110.2 million for the years ended December 31, 1998 and December 31, 1997, respectively. Depreciation and amortization charged to the marketing and reservation funds was $6.2 million and $2.9 million for the years ended December 31, 1998 and December 31, 1997, respectively. As of December 31, 1998 the Company's balance sheet includes a receivable of $18.7 million related to advances made to the marketing ($7.8 million) and reservation ($10.9 million) funds. As of December 31, 1997, the Company's balance sheet includes a receivable of $5.2 million related to advances made to the marketing fund and a current liability in accounts payable of $4.5 million related to excess monies in the reservation fund.

Product Sales: Sales made to franchisees through the Company's group purchasing program declined $3.1 million to $20.7 million in Calendar 1998 from $23.8 million in Calendar 1997. Similarly, product cost of sales decreased $3.2 million (or 14.2%) from Calendar 1997. The product services margins increased for the year ended December 31, 1998 to 5.9% from 4.4% in Calendar 1997.

Depreciation and Amortization: Depreciation and amortization decreased to $6.8 million in Calendar 1998 from $9.2 million in Calendar 1997. This decrease was primarily attributable to the sale of the Company's European hotels.

Interest Expense and Interest and Dividend Income: The increase in interest expense of $5.8 million in Calendar 1998 from $13.3 million in Calendar 1997 resulted from additional debt incurred in connection with the Sunburst Distribution (as defined in the Notes to the Consolidated Statements). Included in Calendar 1998 results is approximately $10.4 million of interest income earned on the note receivable from Sunburst Hospitality Corporation and $2.1 million in dividend income from the Company's investment in Friendly.

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

Comparison of Seven Month Period Ended December 31, 1997 Operating Results and Seven Month Period Ending December 31, 1996 Operating Results

The Company recorded net income of $27.3 million for the seven months ended December 31, 1997, an increase of $4.0 million compared to net income of $23.3 million for the seven months ended December 31, 1996. The increase in net income for the seven months ended December 31, 1997 was primarily attributable to an increase in franchise revenue as a direct result of the addition of new franchised hotels to the system, improvements in the operating performance of hotels and an increase in the effective royalty rates achieved.

Summarized financial results for the seven months ended December 31, 1997 and 1996 are as follows:

(In thousands)	1997	1996 (unaudited)
Revenues:		
Royalty fees	$ 70,308	$ 61,821
Initial franchise & relicensing fees	8,597	9,304
Partner services revenue	3,510	1,510
Other revenue	1,359	1,651
Product sales	13,524	14,717
European hotel operations	10,541	10,975
Total revenue	**107,839**	**99,978**
Operating Expenses:		
Selling, general & administrative	29,454	28,132
Depreciation & amortization	3,977	3,153
Product cost of sales	13,031	13,481
European hotel operations	9,203	9,745
Total operating expenses	**55,665**	**54,511**
Operating income	52,174	45,467
Interest expense, net	5,791	5,784
Income before income taxes	46,383	39,683
Income taxes	19,096	16,338
Net income	**$ 27,287**	**$23,345**

Franchise Revenues: Net franchise revenues were $83.8 million for the seven months ended December 31, 1997 and $74.3 million for the seven months ended December 31, 1996. Royalties increased $8.5 million to $70.3 million from $61.8 million for the seven months ended December 31, 1996, an increase of 13.7%. The increase in royalties is attributable to a net increase of 264 franchised hotels during the period representing an additional 19,881 rooms added to the system, an improvement in domestic RevPAR of 2.4% and an increase in the effective royalty rate of the domestic hotel system to 3.5% from 3.4%. Domestic initial fee revenue generated from franchise contracts signed declined to $6.4 million from $7.8 million for the seven months ended December 31, 1997 as compared to the seven months ended December 31, 1996. Total franchise agreements signed for the seven months ended December 31, 1997 were 368, down 14.0% from the total contracts signed during the seven months ended December 31, 1996 of 428. The decline in initial fees is partly a result of the Company's sales force reorganization and the resulting temporary displacement of the sales force. The reorganization of the regional market management sales and support force was completed in September 1997. Revenues generated from partner service relationships increased to $3.5 million from $1.5 million for the seven months ended December 31, 1996.

The number of domestic rooms under development as of December 31, 1997 increased to 62,384 from 59,023 at December 31, 1996, an increase of 5.7%. The total number of international hotels on-line increased to 605 from 548 at December 31, 1996, an increase of 10.4%. International rooms on-line increased 9.0% to 50,639 as of December 31, 1997 from 46,473 as of December 31, 1996. The total number of international hotels under development decreased to 119 from 143, a decrease of 16.8% from December 31, 1996. The number of international rooms under development decreased to 12,029 as of December 31, 1997 from 13,906 as of December 31, 1996, a decrease of 13.5%.

Franchise Expenses: Selling, general and administrative expenses were $29.5 million for the seven months ended December 31, 1997, an increase of $1.3 million from the comparable period in 1996. The increase in selling, general and administrative expenses was primarily due to additional personnel to support company growth and new company initiatives. As a percentage of net franchise revenues, selling, general and administrative expenses declined to 35.2% for the seven months ended December 31, 1997 from 37.8% for the seven months ended December 31, 1996. The improvement in the franchising margins relates to the economies of scale generated from operating a larger franchisee base, cost control initiatives and improvements in franchised hotel performance.

Marketing and Reservations: The total marketing and reservation fees received by the Company (previously reported as revenue) were $72.3 million and $66.3 million for the seven months ended December 31, 1997 and December 31, 1996, respectively. Depreciation and amortization charged to the marketing and reservation funds was $2.2 million and $1.4 million for the seven months ended December 31, 1997 and December 31, 1996, respectively.

Product Sales: Sales made to franchisees through the Company's group purchasing program declined $1.2 million to $13.5 million for the seven months ended December 31, 1997 from $14.7 million for the seven months ended December 31, 1996. Similarly, product cost of sales decreased $0.4 million (or 3.3%) for the seven months ended December 31, 1997. The product services margins decreased for the seven months ended December 31, 1997 to 3.6% from 8.4% for the seven months ended December 31, 1996.

Depreciation and Amortization: Depreciation and amortization increased to $4.0 million for the seven months ended December 31, 1997 from $3.2 million for the seven months ended December 31, 1996. The increase was primarily due to capital improvements to the Company's financial and billing information systems.

Liquidity and Capital Resources

Net cash provided by operating activities was $79.5 million for the year ended December 31, 1999, an increase of $34.9 million from $44.6 million for the year ended December 31, 1998. The improvement in cash provided was primarily due to improvements in operating income and management of working capital. As of December 31, 1999, the total long-term debt outstanding for the Company was $307 million.

Cash used in investing activities for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997 was $50.5 million, $14.7 million, $149.7 million and $16.9 million, respectively. Investment in property and equipment includes renovations to the Company's corporate headquarters (including a franchisee learning and training center) and installation of system-wide property and yield management systems. During the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997, capital expenditures totaled $30.6 million, $17.5 million, $7.3 million and $10.6 million, respectively. Capital expenditures in prior years include amounts for computer hardware; financial, property and yield management, and reservation systems; and European hotel capital improvements.

The Company made advances to the marketing and reservation funds totaling $15.1 million in Calendar 1999. The advances are associated with a system-wide property and yield management systems implementation, the timing of expenditures associated with specific brand initiatives of the marketing fund and the recognition of costs and the timing of payments received from franchisees in conjunction with the Company's frequency stay program. The Company has the ability under existing franchise agreements and expects to recover these advances through future marketing and reservation fees. The company expects $15.0 to $20.0 million of increases in advances to the marketing and reservation funds in Calendar 2000 due to the continued property and yield management systems implementation and expenditures associated with specific brand initiatives.

On October 15, 1997, the Company funded a $115 million, five year Subordinated Term Note to Sunburst with an initial simple interest rate of 11% per annum. In connection with the amendment of the strategic alliance agreement (as defined in the Notes to the Consolidated Financial Statements), effective October 15, 2000 interest payable shall accrue at a rate of 11% per annum compounded daily. The Company implemented this amendment prospectively beginning on January 1, 1999 and has recognized interest on the outstanding principal and accrued interest amounts at an effective rate of 10.58%. The note is payable in full, along with accrued interest, on October 15, 2002. Total interest accrued at December 31, 1999 and 1998 was $27.0 million and $12.8 million, respectively.

Financing cash flows relate primarily to the Company's borrowings under its credit lines and treasury stock purchases. On October 15, 1997, the Company entered into a five-year $300 million competitive advance and multi-currency revolving credit facility. The credit facility provides for a term loan of $150 million and a revolving credit facility of $150 million, $50 million of which is available in foreign currency borrowings. At the time of the Sunburst Distribution, the Company borrowed $150 million under the term loan and $140 million under the revolving credit facility, the proceeds of which were used to fund the $115 million Sunburst note and to refinance existing indebtedness. As of December 31, 1999, the Company had $112.5 million of term loans outstanding and $82 million of revolving loans. The term loan is payable over five years, $32.5 million of which is due in 2000. The credit facility includes customary financial and other covenants that require the maintenance of certain ratios including maximum leverage, minimum net worth and interest coverage and restrict the Company's ability to make certain investments, repurchase stock, incur debt and dispose of assets. At the Company's option, the interest rate may be based on LIBOR, a certificate of deposit rate or an alternate base rate (as defined) plus a facility fee percentage. The rate is determined based on the Company's consolidated leverage ratio at the time of borrowing.

On May 1, 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 $300 million competitive advance and multi-currency revolving credit facility.

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

As of December 31, 1999, the Company had repurchased 7.5 million shares of its common stock at a total cost of $107.4 million. On February 7, 2000 the Company received authorization from its Board of Directors to repurchase up to an additional 5 million shares.

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

Year 2000 Compliance

The Company has materially remedied the Year 2000 computer problem shared by virtually all companies and businesses. Initially, this Year 2000 problem was associated with two-digit date codes used in many computer programs and embedded chip systems. As an on-going effort, the Company continues to monitor its systems as well as third party vendors and franchisees.

The Company's exposure to potential Year 2000 problems existed in two general areas: technological operations in the sole control of the Company and technological operations dependent in some way on one or more third parties. With respect to the Company's internal systems, no material Year 2000 problems have occurred. The Company previously conducted Year 2000 compliance testing on all of its proprietary software, including its reservations and reservations support systems, its franchise support system and its franchisee property management support systems. Except for two DOS based systems, the proprietary software is Year 2000 compliant. The DOS version of ChoiceLINKS is not Year 2000 compliant and the DOS version of the Company's property management system is only compliant through December 31, 2000. The Company has communicated this to franchisees using these systems and has recommended that they migrate to the Windows based versions of these systems, which are Year 2000 compliant. As of February 7, 2000, 100% have migrated to the Windows version of ChoiceLINKS and 100% have migrated to the Windows version of the Company's property management system.

The Company's inventory of third party software, including PC operating systems and word processing and other commercial software, did not disclose any material compliance issues.

During 1999, the Company's Year 2000 Compliance Committee identified third party vendors and service providers whose non-compliant systems could have a material impact on the Company and undertook an assessment as to such parties' compliant status. These parties included airline global distribution systems (GDS), utility providers, telephone service providers, banks and data processing services. The GDS companies, which provide databases through which travel agents can book hotel rooms, have assured the Company in writing that they are compliant and the Company conducted tests with three of the four major GDS companies. As of February 7, 2000, no material Year 2000 problems have been experienced with the GDS companies and other third parties. Throughout 2000, the committee will continue to monitor all of its material vendors.

Costs of addressing potential Year 2000 problems have not been material to date. The value of employee time devoted to testing and development has been approximately $400,000 over the past two and one half years. Total costs for replacement of hardware and operating systems were approximately $600,000 over the past two and one half years. The replacements to date and on-going replacements are being implemented primarily as part of the Company's on-going technology updating, rather than specifically for Year 2000 compliance reasons. Year 2000 compliance costs have not had a material adverse impact on the Company's financial position, results of operations or cash flows.

While the Company has not experienced any material non-compliance issues to date, it is not in a position to guarantee the performance of others with respect to their Year 2000 compliance or predict whether any of the assurances that others provide regarding Year 2000 compliance may prove later to be inaccurate or overly optimistic.

Impact of Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which requires recognition of the fair value of derivatives in the statement of financial position, with changes in the fair value recognized either in earnings or as a component of other comprehensive income dependent upon the hedging nature of the derivative. Implementation of SFAS No. 133 is required for Fiscal 2001. SFAS No. 133 is not expected to have a material impact on the Company's earnings or other comprehensive income.

Forward-Looking Statements

Certain statements contained in this annual report, including those in the section entitled Management's Discussion and Analysis, contain forward-looking information that involves risk and uncertainties. Forward-looking statements are usually identified by the words "believes," "anticipates," "expects," intends," "estimates," "projects," and other similar expressions, which are predictions of or indicate future events and trends. Such statements are subject to a number of risks and uncertainties which could cause actual results to differ materially from those projected, including: competition within each of our business segments; business strategies and their intended results; the balance between supply of and demand for hotel rooms; our ability to obtain new franchise agreements; our ability to develop and maintain positive relations with current and potential hotel owners; the effect of international, national and regional economic conditions; the availability of capital to allow us and potential hotel owners to fund investments; our ability, and that of other parties upon which our businesses also rely, to modify or replace on a timely basis, their computer software and other systems in order to function properly prior to, in and beyond, the year 2000; and other risks described from time to time in our filings with the Securities and Exchange Commission, including those set forth under the heading "Risk Factors" in our Report on Form 10-Q for the Period ended June 30, 1999. Given these uncertainties, you are cautioned not to place undue reliance on such statements. 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 PUBLIC ACCOUNTANTS

Choice Hotels International, Inc. and Subsidiaries

To Choice Hotels International, Inc.

We have audited the accompanying consolidated balance sheets of Choice Hotels International, Inc. and subsidiaries, as defined under "Background and Basis of Presentation" in the Notes to Consolidated Financial Statements, as of December 31, 1999 and 1998, and the related consolidated statements of income and cash flows for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997, and the consolidated statements of shareholders' equity and comprehensive income for the period from October 15, 1997 (inception) to December 31, 1997 and the years ended December 31, 1998 and 1999. These consolidated financial statements are the responsibility of Choice Hotels International, Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Choice Hotels International, Inc. and subsidiaries as of December 31, 1999 and 1998, and the consolidated results of their operations and their consolidated cash flows for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997, and the consolidated statements of shareholders' equity and comprehensive income for the period from October 15, 1997 (inception) to December 31, 1997 and the years ended December 31, 1998 and 1999, in conformity with accounting principles generally accepted in the United States.

Arthur Andersen LLP

Vienna, Virginia
January 28, 2000

CONSOLIDATED STATEMENTS OF INCOME

Choice Hotels International, Inc. and Subsidiaries

(In thousands)	Years ended December 31, 1999	1998	Seven months ended December 31, 1997	Fiscal year ended May 31, 1997
Revenues				
Royalty fees	**$128,653**	$115,171	$70,308	$ 97,215
Initial franchise and relicensing fees	**13,910**	16,571	8,597	16,802
Partner services revenue	**9,055**	6,370	3,510	4,175
Other revenue	**6,111**	5,516	1,359	8,467
Product sales	**3,871**	20,748	13,524	23,643
European hotel operations	-	1,098	10,541	17,737
Total revenues	**161,600**	165,474	107,839	168,039
Operating Expenses				
Selling, general and administrative	**55,860**	52,948	29,454	51,102
Depreciation and amortization	**8,023**	6,753	3,977	7,643
Product cost of sales	**3,883**	19,532	13,031	22,766
European hotel operations	**-**	1,133	9,203	16,166
Total operating expenses	**67,766**	80,366	55,665	97,677
Operating income	**93,834**	85,108	52,174	70,362
Other				
Loss (gain) on sale of investments	**68**	(2,370)	-	-
Interest on notes payable to Manor Care	**-**	-	-	7,083
Interest expense	**19,387**	19,133	8,788	4,647
Interest and dividend income (including interest income on Sunburst Note of $14.2 million, $10.4 million and $2.7 million for December 31, 1999, 1998 and 1997, respectively)	**(20,092)**	(14,055)	(2,997)	(943)
Total other	**(637)**	2,708	5,791	10,787
Income before income taxes and extraordinary item	**94,471**	82,400	46,383	59,575
Income taxes	**37,316**	34,327	19,096	24,845
Net income before extraordinary item	**57,155**	48,073	27,287	34,730
Gain on early extinguishment of debt (net of taxes of $4,732)	**-**	7,232	-	-
Net income	**$ 57,155**	$ 55,305	$27,287	$ 34,730
Weighted average shares outstanding	**54,859**	58,717	59,798	62,680
Diluted shares outstanding	**55,667**	59,548	61,300	62,680
Basis EPS:				
Income before extraordinary item	**$ 1.04**	$ 0.82	$ 0.46	$ 0.55
Extraordinary item	**-**	0.12	-	-
Net income	**$ 1.04**	$ 0.94	$ 0.46	$ 0.55
Diluted EPS:				
Income before extraordinary item	**$ 1.03**	$ 0.81	$ 0.45	$ 0.55
Extraordinary item	**-**	0.12	-	-
Net income	**$ 1.03**	$ 0.93	$ 0.45	$ 0.55

See notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

Choice Hotels International, Inc. and Subsidiaries

(In thousands) **Assets**	**December 31, 1999**	December 31, 1998
Current assets		
Cash and cash equivalents	**$ 11,850**	$ 1,692
Receivables (net of allowance for doubtful accounts of $6,203 and $8,082, respectively)	**30,035**	28,117
Income taxes receivable	**-**	5,427
Other current assets	**37**	425
Total current assets	**41,922**	35,661
Property and equipment, at cost, net	**58,255**	37,556
Goodwill, net	**64,706**	66,749
Franchise rights, net	**43,101**	44,981
Investment in Friendly Hotels	**41,195**	41,576
Advances to marketing and reservation funds	**37,668**	18,653
Other assets	**35,958**	25,200
Note receivable from Sunburst Hospitality	**141,853**	127,849
Total assets	**$464,658**	$ 398,225
Liabilities and Shareholders' Equity		
Current liabilities		
Current portion of long-term debt	**$ 44,646**	$ 28,846
Accounts payable	**21,362**	16,216
Accrued expenses	**22,283**	19,606
Income taxes payable	**1,367**	-
Total current liabilities	**89,658**	64,668
Long-term debt	**262,710**	250,364
Deferred income taxes ($30,648 and $19,569, respectively) and other liabilities	**46,674**	26,683
Total liabilities	**399,042**	341,715
Shareholders' Equity		
Common stock, $ .01 par value, 160,000,000 shares authorized; 53,833,911 and 56,726,917 shares issued and outstanding at December 31, 1999 and 1998, respectively	**614**	607
Additional paid-in-capital	**52,386**	45,097
Accumulated other comprehensive income	**1,205**	2,112
Deferred compensation	**(1,937)**	(1,665)
Treasury stock	**(108,370)**	(54,204)
Retained earnings	**121,718**	64,563
Total shareholders' equity	**65,616**	56,510
Total liabilities and shareholders' equity	**$464,658**	$398,225

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Choice Hotels International, Inc. and Subsidiaries

	Years Ended December 31, 1999	Years Ended December 31, 1998	Seven Months Ended December 31, 1997	Fiscal Year Ended May 31, 1997
(In thousands)				
Cash Flows From Operating Activities				
Net income	**$57,155**	$ 55,305	$ 27,287	$34,730
Reconciliation of net income to net cash provided by operating activities:				
Depreciation and amortization	**17,576**	13,067	6,159	10,438
Provision for bad debts	**588**	1,473	2,274	2,238
Increase (decrease) in deferred income taxes and other	**10,216**	14,852	(4,828)	3,171
Non cash interest and dividend income	**(16,259)**	(12,364)	(2,997)	(943)
Gain on extinguishment of debt	**—**	(11,964)	—	—
Changes in assets and liabilities:				
Receivables	**(4,006)**	(4,311)	(10,606)	(4,835)
Prepaid expenses and other current assets	**1,355**	(1,849)	2,403	1,615
Current liabilities	**6,086**	(6,180)	11,226	(2,145)
Income taxes payable/receivable	**6,794**	(3,411)	2,689	1,061
Other liabilities	**—**	—	—	175
Net cash provided by operating activities	**79,505**	44,618	33,607	45,505
Cash Flows From Investing Activities				
Investment in property and equipment	**(30,633)**	(17,488)	(7,329)	(10,630)
Purchase of minority interest	**—**	—	—	(2,494)
Repayments from/advances to Sunburst Hospitality	**—**	8,145	(25,066)	—
Note receivable from Sunburst Hospitality	**—**	—	(115,000)	—
Advances to marketing and reservation funds, net	**(15,098)**	(4,154)	(4,487)	—
Other items, net	**(4,762)**	(1,225)	2,143	(3,804)
Net cash utilized in investing activities	**(50,493)**	(14,722)	(149,739)	(16,928)
Cash Flows From Financing Activities				
Proceeds from mortgages and other long term debt	**88,630**	194,901	236,509	31,107
Principal payments of debt	**(59,458)**	(184,300)	(78,851)	(51,260)
Purchase of treasury stock	**(53,166)**	(54,015)	(189)	—
Cash transfers to Manor Care, net	**—**	—	(35,222)	(8,069)
Proceeds from issuance of common stock	**5,140**	4,928	—	—
Net cash (utilized in) provided by financing activities	**(18,854)**	(38,486)	122,247	(28,222)
Net change in cash and cash equivalents	**10,158**	(8,590)	6,115	355
Cash and cash equivalents at beginning of period	**1,692**	10,282	4,167	3,812
Cash and cash equivalents at end of period	**$11,850**	$ 1,692	$ 10,282	$ 4,167

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

Choice Hotels International, Inc. and Subsidiaries

(In thousands, except share amounts)

	Common Stock Shares	Common Stock Amount	Additional Paid-in-Capital	Accumulated Other Comprehensive Income (Loss)	Deferred Compensation	Treasury Stock	Comprehensive Income	Retained Earnings	Total
Initial capitalization – October 15, 1997	59,767,716	$598	$48,064	$(8,662)	$ —	$ —		$ —	$40,000
Comprehensive income									
Net income	—	—	—	—	—	—	$27,287	27,287	27,287
Other comprehensive income:									
Foreign translation adjustments	—	—	—	346	—	—	346	—	346
Comprehensive income							$27,633		
Exercise of stock options/grants, net	71,876	—	(157)	—	—	—		—	(157)
Treasury purchases	(10,714)	—	—	—	—	(189)		—	(189)
Transfers of net income to Sunburst prior to the distribution	—	—	—	—	—	—		(18,029)	(18,029)
Balance as of December 31, 1997	**59,828,878**	**$598**	**$47,907**	**$(8,316)**	**$ —**	**$ (189)**		**$ 9,258**	**$49,258**
Comprehensive income									
Net Income	—	—	—	—	—	—	55,305	55,305	55,305
Other comprehensive income:									
Foreign translation adjustments	—	—	—	—	—	—	10,048	—	10,048
Unrealized gain on securities, net of reclassification adjustment	—	—	—	—	—	—	380	—	380
Other comprehensive income	—	—	—	10,428	—	—	10,428	—	—
Comprehensive income							$ 65,733		
Exercise of stock options/grants, net	667,227	7	5,058	—	—	—		—	5,065
Issuance of restricted stock	160,212	2	2,272	—	(2,274)	—		—	—
Amortization of deferred compensation	—	—	—	—	609	—		—	609
Treasury purchases	(3,929,400)	—	—	—	—	(54,015)		—	(54,015)
Purchase of MainStay brand from Sunburst	—	—	(10,140)	—	—	—		—	(10,140)
Balance as of December 31, 1998	**56,726,917**	**$607**	**$45,097**	**$ 2,112**	**$(1,665)**	**$ (54,204)**		**$ 64,563**	**$56,510**
Comprehensive income									
Net Income	—	—	—	—	—	—	57,155	57,155	57,155
Other comprehensive income:									
Foreign translation adjustments	—	—	—	—	—	—	(108)	—	(108)
Unrealized loss on securities, net of taxes, net of reclassification adjustment	—	—	—	—	—	—	(799)	—	(799)
Other comprehensive income	—	—	—	(907)	—	—	(907)	—	—
Comprehensive income							$56,248		
Exercise of stock options/grants, net	623,647	6	6,275	—	—	—		—	6,281
Issuance of restricted stock	70,260	1	1,014	—	(1,015)	—		—	—
Amortization of deferred compensation	—	—	—	—	743	—		—	743
Treasury purchases	(3,586,913)	—	—	—	—	(54,166)		—	(54,166)
Balance as of December 31, 1999	**53,833,911**	**$614**	**$52,386**	**$ 1,205**	**$(1,937)**	**$(108,370)**		**$121,718**	**$65,616**

See notes to consolidated financial statements.

Background and Basis of Presentation

On March 7, 1996, Manor Care, Inc. ("Manor Care") announced its intention to proceed with the separation of its lodging business ("Choice Hotels Holdings, Inc." or "Holdings") from its health care business via a spin-off of its lodging business (the "Manor Care Distribution"). On September 30, 1996 the Board of Directors of Manor Care declared a special dividend to its shareholders of one share of common stock of Holdings for each share of Manor Care stock, and the Board set the record date and the distribution date. The Manor Care Distribution was made on November 1, 1996 to holders of record of Manor Care's common stock on October 10, 1996. Choice Hotels International, Inc. (the "Company"), which was a subsidiary of Manor Care became a wholly-owned subsidiary of Holdings.

The Manor Care Distribution separated the lodging and health care businesses of Manor Care into two public corporations. The operations of Holdings consisted principally of the hotel franchise operations and the owned and managed hotel operations formerly conducted by Manor Care directly or through its subsidiaries (the "Lodging Business").

On November 1, 1996, concurrent with the Manor Care Distribution, Holdings changed its name from Choice Hotels Holdings, Inc. to Choice Hotels International, Inc. ("CHI") and the Company changed its name to Choice Hotels Franchising, Inc.

On April 29, 1997, CHI's Board of Directors announced its intention to separate CHI's franchising business from its owned hotel business (referred to as the "Sunburst Distribution"). On September 16, 1997, the Board of Directors and shareholders of CHI approved the separation of the business via a spin-off of the Company, along with CHI's European hotel and franchising operations, to its shareholders. The Board set October 15, 1997 as the date of distribution and on that date, CHI shareholders received one share in the Company (renamed "Choice Hotels International, Inc." and referred to hereafter as the "Company") for every share of CHI stock held on October 7, 1997 (the date of record). Concurrent with the October 15, 1997 distribution date, CHI changed its name to Sunburst Hospitality Corporation, (referred to hereafter as "Sunburst") and effected a one-for-three reverse stock split of its common stock.

The Company is in the business of hotel franchising. As of December 31, 1999, the Company had franchise agreements with 4,248 hotels open and 761 hotels under development in 40 countries under the following brand names: Comfort, Quality, Econo Lodge, Sleep, Clarion, Rodeway, and MainStay Suites.

The consolidated financial statements present the financial position, results of operations and cash flows and equity of the Company as if it were formed as a separate entity of its parent (Manor Care prior to Manor Care Distribution and Sunburst prior to Sunburst Distribution) which conducted the hotel franchising business and European hotel operations and as if the Company were a separate company for all periods presented. The Parent's historical basis in the assets and liabilities of the Company has been carried over to the consolidated financial statements. All material intercompany transactions and balances between the Company and its subsidiaries have been eliminated. Changes in the investments and advances from parent represent the net income of the Company plus the net change in transfers between the Company and Manor Care through November 1, 1996 and Sunburst through October 15, 1997.

An analysis of the activity in the investments and advances from parent account for the fiscal year ended May 31, 1997 and the period June 1, 1997 through October 15, 1997 is as follows:

	(In thousands)
Balance, May 31, 1996	$ 30,532
Transfers to Parent, net	(8,069)
Net income	34,730
Balance, May 31, 1997	57,193
Transfers to Parent, net through October 15, 1997	(35,222)
Net income from June 1, 1997 through October 15, 1997	18,029
Initial capitalization	(40,000)
Balance, October 15, 1997	$ –

The average balance of the investments and advances from parent was $48.6 million and $43.9 million for the period June 1, 1997 through October 15, 1997 and the fiscal year ended May 31, 1997, respectively.

Reclassifications

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

Significant Accounting Policies

Fiscal Year
During October 1997, the Company changed its fiscal year from a May 31 year end to a December 31 year end.

Consolidation Policy
The consolidated financial statements include Choice Hotels International, Inc. and its subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

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

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

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

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

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

Use of Estimates
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

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

	December 31,	
(In thousands)	**1999**	1998
Land	**$ 1,227**	$ 1,603
Facilities in progress	**1,838**	1,600
Building and improvements	**18,458**	8,023
Furniture, fixtures and equipment	**60,629**	40,486
	82,152	51,712
Less: Accumulated depreciation	**(23,897)**	(14,156)
	$58,255	$37,556

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

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

Goodwill
Goodwill primarily represents an allocation of the excess purchase price of the stock of the Company over the recorded minority interest. Goodwill is amortized on a straight-line basis over 40 years. Such amortization amounted to $2.0 million, $2.0 million, $1.1 million, and $1.9 million for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997, and the fiscal year ended May 31, 1997, respectively. Goodwill is net of accumulated amortization of $10.1 million and $8.1 million at December 31, 1999 and 1998, respectively.

Franchise Rights
Franchise rights are intangible assets and represent an allocation in purchase accounting for the value of long-term franchise contracts. The majority of the balance results from the Econo Lodge and Rodeway acquisitions made in fiscal year 1991. Franchise rights acquired are amortized over an average life of 15 years. Amortization expense for the years

ended December 31, 1999 and 1998, the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997 amounted to $4.3 million, $3.8 million, $1.7 million and $2.9 million, respectively. Franchise rights are net of accumulated amortization of $23.0 million and $18.7 million at December 31, 1999 and 1998, respectively.

The Company periodically assesses the amortization lives of its franchise rights. Effective January 1, 1998, the Company changed its estimate of the useful life of Econo Lodge franchise rights to a 17 year period and Rodeway franchise rights to a 3 year period to more closely match the remaining estimated contract lives of franchise contracts acquired in 1991. The effect of this change in estimate was to increase depreciation and amortization expense by approximately $900,000 and decrease net income by $0.01 per dilutive share for the years ended December 31, 1999 and 1998.

Investment in Friendly Hotels

On May 31, 1996, the Company invested approximately $17.1 million in the capital stock of Friendly Hotels, PLC ("Friendly"). In exchange for the $17.1 million investment, the Company received 750,000 shares of common stock and 10 million newly issued immediately convertible preferred shares. In addition, the Company granted to Friendly a Master Franchise Agreement for the United Kingdom and Ireland in exchange for 333,333 additional shares of common stock. The preferred shares carry a 5.75% dividend payable in cash or in stock, at the Company's option. The dividend accrues annually with the first dividend paid on the earlier of the third anniversary of completion or on a conversion date. As a condition to the investment, the Company has the right to appoint three directors to the board of Friendly. Given the Company's ability to exercise significant influence over the operations of Friendly, the equity method of accounting is applied.

In January 1998, Friendly acquired European hotels owned by the Company for $26.2 million in convertible preferred shares and cash. In exchange for 10 hotels in France, two in Germany and one in the United Kingdom, the Company received $22.2 million in new unlisted 5.75% convertible preferred shares in Friendly at par, convertible for one new Friendly ordinary share for every 150p nominal of the preferred convertible shares.

In 1998, the Company granted Friendly the master franchise rights for Choice's Comfort, Quality and Clarion brand hotels throughout Europe (with the exception of Scandinavia) for a 10 year period. In exchange, the Company will receive from Friendly $8.0 million, payable in eight equal annual installments. The master franchise payment is being recognized over the life of the agreement.

The Company recognized $2.2 million, $2.1 million, $0.6 million and $0.9 million in preferred dividend income from the Friendly investment for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997, respectively. As of December 31, 1999 and 1998, accrued but unpaid preferred dividends were $5.8 million and $3.7 million, respectively. The Company also recognized $2.2 million and $1.4 million in royalty revenue from Friendly for the years ended December 31, 1999 and 1998, respectively.

The Company owned approximately 5.3%, 5.2% and 4.95% of Friendly's outstanding ordinary shares at December 31, 1999, 1998 and 1997, respectively. The fair market value of the ordinary shares at December 31, 1999 and 1998 was $2.0 million and $1.9 million, respectively. Summarized unaudited balance sheet data for Friendly is as follows:

	(Unaudited) December 31,	
(In thousands)	**1999**	1998
Current assets	**$ 43,616**	$ 52,197
Non-current assets	**207,299**	237,654
Current liabilities	**49,622**	60,696
Non-current liabilities	**91,984**	85,919
Redeemable preferred stock	**37,800**	31,558
Shareholders' equity	**174,382**	205,880

Summarized unaudited income statement data for Friendly is as follows:

	(Unaudited) December 31,		
(In thousands)	**1999**	1998	1997
Net revenues	**$150,332**	$130,028	$100,970
Gross profit	**84,852**	73,447	60,184
Income from continuing operations	**8,809**	12,778	11,956
Net (loss) income after preferred dividends	**(4,113)**	18,984	7,684

Revenue Recognition

The Company enters into numerous franchise agreements committing to provide franchisees with various marketing services, a centralized reservation system and limited rights to utilize the Company's registered tradenames. These agreements are typically for a period of twenty years, with certain rights to the franchisee to terminate after five, 10, or 15 years. Initial franchise fees are recognized upon sale because the initial franchise fee is non-refundable and the Company has no continuing obligations related to the franchisee. Royalty fees, primarily based on gross room revenues of each franchisee, are recorded when earned. Reserves for uncollectible accounts are charged to bad debt expense and included in selling, general and administrative expenses in the accompanying consolidated statements of income.

The Company's franchise agreements require the payment of franchise fees which include marketing and reservation fees. These fees, which are based on a percentage of the franchisees' gross room revenues, are used exclusively to reimburse the Company for expenses associated with providing such franchise services as central reservation systems, property and yield management systems, national marketing, and media advertising. The Company is contractually obligated to expend the reservation and marketing fees it collects from franchisees in accordance with the franchise agreements; as such, no income or loss to the Company is generated. During the second quarter of 1998, the Company changed its presentation of marketing and reservation fees such that the fees collected and associated expenses are reported net. All prior periods have been reclassified to conform to the new presentation.

The total marketing and reservation fees received by the Company (previously reported as revenue) for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997, and the fiscal year ended May 31, 1997 amounted to $146.0 million, $127.4 million, $72.3 million, and $104.2 million, respectively. Depreciation and amortization charged to the marketing and reservation funds for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997, and the fiscal year ended May 31, 1997 amounted to $9.6 million, $6.2 million, $2.2 million, and $2.8 million, respectively. Under the terms of the franchise agreements reservation fees and marketing fees not expended in the current year are carried over to the next fiscal year and expended in accordance with the franchise agreements. Shortfall amounts are similarly recovered in subsequent years. Excess or shortfall amounts from the operation of these programs are recorded as a payable or receivable, respectively, from the particular fund. As of December 31, 1999 and 1998, the Company's balance sheet includes advances to marketing and reservation funds of $37.7 million and $18.7 million, respectively. The advances made are composed of 1999 and 1998 marketing ($12.5 million and $7.8 million, respectively) and 1999 and 1998 reservation ($25.2 million and $10.9 million, respectively) funds. The Company has the ability under existing franchise agreements and expects to recover these advances through future marketing and reservation fees.

Transactions with Sunburst

Subsequent to the Manor Care Distribution, the Company participated in a cash concentration system with Sunburst and as such maintained no significant cash balances or banking relationships. Substantially all cash received by the Company was immediately deposited in and combined with Sunburst's corporate funds through its cash management system. Similarly, operating expenses, capital expenditures and other cash requirements of the Company have been paid by Sunburst and charged to the Company. The net result of all of these intercompany transactions were reflected in Investments and advances from Parent.

As part of the Sunburst Distribution, Sunburst and the Company have entered into a strategic alliance agreement. Among other things, the agreement provides for: (i) a right of first refusal to the Company to franchise any lodging properties to be acquired or developed by Sunburst; (ii) certain commitments by Sunburst for the development of Sleep Inn and MainStay Suites hotels; (iii) continued cooperation of both parties with respect to matters of mutual interest, such as new product and concept testing; (iv) continued cooperation with respect to third party vendor arrangements; and (v) certain limitations on competition in each others' line of business. The strategic alliance agreement extends for a term of 20 years with mutual rights of termination on the fifth, 10th and 15th anniversaries. In December 1998, the parties amended the strategic alliance agreement: (i) to eliminate Sunburst's option to acquire the MainStay Suites brand; (ii) to amend Sunburst's development commitments; and (iii) to provide certain global amendments to Sunburst's franchise agreements.

In connection with the Sunburst Distribution, the Company borrowed $115 million under its Credit Facility in order to fund a Subordinated Term Note to Sunburst. The Subordinated Term Note of $115 million accrues interest monthly at an initial simple rate of 11% per annum through October 14, 2000. In connection with the amendment of the strategic alliance agreement discussed above, effective October 15, 2000 interest shall accrue at a rate of 11% per annum compounded daily. On January 1, 1999, the Company began recognizing interest on the outstanding principal and accrued interest amounts at an effective rate of 10.58%. The note is payable in full, along with accrued interest, on October 15, 2002. Total interest accrued as of December 31, 1999 and 1998 was $27.0 million and $12.8 million, respectively.

For purposes of providing an orderly transition after the Sunburst Distribution, Sunburst and the Company entered into various agreements, including, among others, a Distribution Agreement, a Tax Sharing Agreement, a Corporate Services Agreement and an Employee Benefits Allocation Agreement. Effective as of October 15, 1997, these agreements provide, among other things, that Sunburst: (i) will receive human resources for certain corporate and support services, such as accounting, tax and computer systems support; (ii) will provide to the Company certain services including asset management, and payables processing; (iii) will adjust outstanding options to purchase shares of Company common stock held by Company employees, Sunburst employees, and employees of Manor Care; (iv) is responsible for filing and paying the related taxes on consolidated federal tax returns and consolidated or combined state tax returns for itself and any of its affiliates (including the Company) for the periods of time that the affiliates were members of the consolidated group; (v) will be reimbursed by the Company for the portion of income taxes paid that relate to the Company and its subsidiaries; and (vi) guarantees that the Company will, at the date of distribution, have a specified minimum level of net worth. These agreements were to extend for a maximum period of 30 months from the Distribution date or until such time as the Company and Sunburst have arranged to provide such services in-house or through another unrelated provider of such services. As of March 31, 1999, all services provided by each party under the Corporate Services Agreement, except for human resources and tax services provided by the Company, were terminated. As of December 31, 1999, the human resources and tax services provided by the Company, were terminated. Costs associated with the Corporate Services Agreement as well as costs of services provided by Sunburst to the Company or provided by the Company to Sunburst have been allocated between the entity providing the services and the entity receiving the services in the accompanying financial statements. As a result, future administrative and corporate expenses are expected to vary from historical results. However, the Company has estimated that general and administrative expenses incurred annually will not materially change.

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 $9.1 million and $11.2 million for the years ended December 31, 1999 and 1998, respectively, $6.2 million for the seven months ended December 31, 1997, and $9.5 million for the fiscal year ended May 31, 1997.

In accordance with the Sunburst Distribution Agreement, the Company agreed to assume and pay certain liabilities of Sunburst, subject to the Company maintaining a minimum net worth of $40 million, at the date of Distribution. As of December 31, 1997, the Company reflected a $25 million receivable due from Sunburst on the consolidated balance sheet. In 1998, net payments of approximately $8 million were collected from Sunburst in cash. On December 28, 1998, the Company and Sunburst amended the strategic alliance agreement entered into in connection with the Sunburst Distribution. As part of that amendment, the Company exchanged the remaining $17 million balance in return for, among other things, the exclusive rights to the MainStay Suites brand from Sunburst. The $17 million, net of income taxes of approximately $7 million, was recorded as an adjustment to additional paid-in-capital as it represents an adjustment to the accounting for the Sunburst Distribution.

Accrued Expenses

Accrued expenses were as follows as of December 31:

(In thousands)	1999	1998
Accrued salaries & benefits	$ 12,813	$ 10,611
Accrued interest	2,911	3,302
Other	6,559	5,693
Total	$ 22,283	$ 19,606

Long -Term Debt and Notes Payable

As of December 31, debt consisted of the following:

(In thousands)	1999	1998
$300 million competitive advance and multi-currency revolving credit facility with an average rate of 6.81% and 5.91% at December 31, 1999 and 1998, respectively	$194,500	$172,000
$100 million senior note offering with an average rate of 7.22% at December 31, 1999 and 1998	99,382	99,382
$15 million line of credit with a rate of 6.90% and 6.10% at December 31, 1999 and 1998	12,000	6,200
Other notes with an average rate of 5.90% and 5.85% at December 31, 1999 and 1998	1,474	1,628
Total indebtedness	$307,356	$279,210

Maturities of debt as of December 31, 1999 were as follows:

Year	(In thousands)
2000	$ 44,646
2001	42,646
2002	119,646
2003	146
2004	146
Thereafter	100,126
Total	$307,356

On October 15, 1997, the Company entered into a $300 million competitive advance and multi-currency revolving credit facility (the "Credit Facility") provided by a group of 13 banks. The Credit Facility provides for a term loan of $150 million and a revolving credit facility of $150 million, $50 million of which is available for borrowings in foreign currencies. The Credit Facility includes customary financial and other covenants that require the maintenance of certain ratios including maximum leverage, minimum net worth and interest coverage and restricts the Company's ability to make certain investments, repurchase stock, incur debt and dispose of assets. The term loan ($112.5 million of which is outstanding at December 31, 1999) is payable over five years, $32.5 million of which is due in 2000. Borrowings under the facility are, at the option of the borrower, at one of several rates including LIBOR plus 20.0 to 87.5 basis points, based upon a defined financial ratio and the loan type. In addition, the Company has the option to request participating banks to bid on loan participation at lower rates than those contractually provided by the facility. The Credit Facility requires the Company to pay annual fees of 1/10 of 1% to 1/3 of 1%, based upon a defined financial ratio of the total loan commitment. The Credit Facility will terminate on October 15, 2002.

On May 1, 1998, the Company issued $100 million of senior unsecured notes (the "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, 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 Credit Facility.

During April 1999, the Company renewed its $15 million revolving line of credit in order to finance short term working capital requirements and other short term general corporate goals. The line of credit is due to expire on April 30, 2000 and bears interest at 6.90%. Interest accrues monthly on the outstanding balance. The line of credit contains essentially the same covenants as the Credit Facility and is prepayable without penalty.

Cash paid for interest was $19.4 million, $19.2 million, $7.9 million and $11.6 million for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997, and the fiscal year ended May 31, 1997, respectively.

Interest Rate Hedges

The Company has entered into an interest rate swap agreement with a notional amount of $115 million at December 31, 1999 to fix certain of its variable rate debt in order to reduce the Company's exposure to fluctuations in interest rates. The interest rate differential to be paid or received on the interest rate swap agreement is accrued as interest rates change and is recognized as an adjustment to interest expense. As of December 31, 1999, the interest rate swap agreement has a life of two months with a fixed rate of 5.85% and variable rate of 6.12%. As of December 31, 1999 and 1998, the interest rate swap agreements have a fair market valuation of approximately $0.1 million and $(2.8) million, respectively.

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, 1999 and 1998, the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997 were $6.9 million, exclusive of $2.5 million of foreign dividends; $5.8 million, exclusive of $2.1 million of foreign dividends; $16.2 million, exclusive of $0.6 million of foreign dividends; and $27.5 million, exclusive of $0.9 million of foreign dividends, respectively. The Company's foreign operations had net income (loss) of $1.0 million, $0.0 million, $0.5 million, and $(3.1 million) for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997.

Pension, Profit Sharing and Incentive Plans

Bonuses accrued for key executives of the Company under incentive compensation plans were $1.0 million and $0.8 million at December 31, 1999 and 1998, respectively.

During 1999 and 1998, employees of the Company participated in 401(k) retirement plans sponsored by the Company. For the years ended December 31, 1999 and 1998, the Company recorded compensation expense of $1.3 million and $1.2 million, respectively, related to the plans. Prior to the Manor Care Distribution and Sunburst Distribution, employees participated in retirement plans sponsored by Manor Care and Sunburst. Costs allocated to the Company under those plans were based on the size of its payroll relative to the sponsor's payroll. Costs allocated to the Company were approximately $1.2 million and $1.4 million for the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997, respectively.

Income Taxes

The Company was included in the consolidated federal income tax returns of Manor Care and Sunburst prior to October 15, 1997. Subsequent to October 15, 1997, the Company is required to make its own filings. The income tax provision included in these consolidated financial statements reflects the historical income tax provision and temporary differences attributable to the operations of the Company on a separate return basis. Deferred taxes are recorded for the tax effect of temporary differences between book and tax income.

Income before income taxes were derived from the following:

(In thousands)	Years ended December 31, 1999	1998	Seven months ended December 31, 1997	Fiscal year ended May 31, 1997
Income before income taxes and extraordinary item:				
Domestic operations	**$92,058**	$ 82,400	$45,866	$62,641
Foreign operations	**2,413**	-	517	(3,066)
Income before income taxes and extraordinary item	**$94,471**	$ 82,400	$46,383	$59,575
The provisions for income taxes follow:				
Current tax expense				
Federal	**$22,038**	$ 15,918	$15,946	$18,208
State	**2,723**	3,482	3,475	3,950
Foreign	**1,422**	2	-	-
Deferred tax (benefit) expense				
Federal	**10,515**	12,420	(223)	2,293
State	**618**	2,505	(102)	394
	$37,316	$ 34,327	$19,096	$24,845

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

(In thousands)	December 31, 1999	1998
Depreciation and amortization	**$(16,582)**	$(16,013)
Prepaid expenses	**(17,542)**	(3,975)
Other	**(6,175)**	(5,316)
Gross deferred tax liabilities	**(40,299)**	(25,304)
Foreign operations	**223**	2,211
Accrued expenses	**9,112**	5,035
Net operating losses	**99**	187
Other	**3,979**	1,860
Gross deferred tax assets	**13,413**	9,293
Net deferred tax liability	**$(26,886)**	$(16,011)

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

(In thousands, except Federal income tax rate)	**Years ended December 31, 1999**	1998	Seven months ended December 31, 1997	Fiscal year ended May 31, 1997
Federal income tax rate	**35%**	35%	35%	35%
Federal taxes at statutory rate	**$33,065**	$28,856	$16,234	$20,853
State income taxes, net of federal tax benefit	**2,172**	3,892	2,192	2,824
Other	**2,079**	1,579	670	1,168
Income tax expense	**$37,316**	$34,327	$19,096	$24,845

Cash paid for state income taxes was $2.3 million, $3.4 million, $0.2 million and $1.3 million for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997, respectively. Federal income taxes were paid by Manor Care for the period ending October 31, 1996. Federal income taxes were paid by Sunburst for the period beginning November 1, 1996 through October 15, 1997. The Company paid $15.5 million, $18.9 million, and $9.1 million for the years ended December 31, 1999 and 1998 and for the seven months ended December 31, 1997, respectively.

Capital Stock

In 1999, the Company granted key employees and non-employee directors 70,260 restricted shares of common stock with a value of $1.0 million on the grant date. The restricted stock vests over a three to five year period with 11,016 shares of the restricted stock vesting over a three year period, 32,180 shares vesting over a four year period and 27,064 shares vesting over a five year period. In 1998, the Company granted key employees and non-employee directors 160,212 restricted shares of common stock with a value of $2.3 million on the grant date. These restricted shares vest over a one to five year period with 22,665 shares of the restricted stock vesting over a one year period, 78,547 shares vesting over a three year period, 40,250 shares vesting over a four year period, and 18,750 shares vesting over a five year period. A total of 46,275 shares of restricted stock were forfeited in 1999 and 1998.

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

The Company has stock option plans for which it is authorized to grant options to purchase up to 7.1 million shares of the Company's common stock, of which 0.8 million shares remain available for grant. Stock options may be granted to officers, key employees and non-employee directors with an exercise price not less than the fair market value of the common stock on the date of grant. In connection with the Sunburst Distribution, the outstanding options held by current and former employees of the Company were redenominated in stock of the newly separated companies and the number and exercise prices of the options were adjusted based on the relative trading prices of the common stock of the two companies in order to retain the intrinsic value of the options.

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

	1999		1998	
Fixed Options	**Shares (000)**	**Weighted-Option Price**	Shares (000)	Weighted-Option Price
Outstanding at beginning of year	**3,969,309**	**$10.13**	4,167,045	$ 8.62
Granted	**732,372**	**13.19**	933,263	13.37
Exercised	**(695,228)**	**7.06**	(738,318)	4.75
Cancelled	**(99,127)**	**12.85**	(392,681)	11.88
Outstanding at end of year	**3,907,326**	**$11.19**	3,969,309	$10.13
Options exercisable at year end	**1,727,748**		1,813,541	
Weighted-average fair value of options granted during the year		**$ 6.20**		$ 7.81

The following table summarizes information about stock options outstanding at December 31, 1999:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number Outstanding at 12/31/99**	**Weighted-Average Remaining Contractual Life**	**Weighted Average Exercise Price**	**Number Exercisable at 12/31/99**	**Weighted Average Exercise Price**
$ 3.01 to 5.00	480,992	1.6 years	$4.01	452,363	$3.95
5.00 to 9.00	388,412	3.7 years	7.03	271,387	6.89
9.00 to 13.00	2,033,777	7.8 years	12.11	721,093	11.59
13.00 to 17.65	1,004,145	8.1 years	14.36	282,905	13.97
	3,907,326			1,727,748	

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

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

	1999	1998
Risk-free interest rate	**6.45%**	4.70%
Volatility	**38.0%**	36.7%
Expected Lives	**10 years**	10 years
Dividend Yield	**0%**	0%

If options had been reported as compensation expense based on their fair value, pro forma net income would have been $56.4 million and $54.0 million for the years ended December 31, 1999 and December 31, 1998, and pro forma diluted earnings per share would have been $1.01 and $0.90, respectively. Since this methodology has not been applied to options granted prior to the Sunburst distribution date, the resulting pro forma compensation cost is not likely to be representative of that to be expected in future years.

Comprehensive Income

As of January 1, 1998, the Company adopted SFAS No. 130, "Reporting Comprehensive Income," which establishes new rules for the reporting and display of comprehensive income and its components; however, the adoption of SFAS No. 130 had no impact on the Company's net income or shareholders' equity. SFAS No. 130 requires unrealized gains or losses on the Company's available-for-sale securities and the foreign currency translation adjustments, which prior to adoption were reported separately in shareholders' equity, to be included in other comprehensive income. Prior year financial statements have been reclassified to conform to the requirements of SFAS No. 130.

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

(In thousands)	December 31, 1999	1998	1997
Unrealized losses on securities available for sale	**$ (419)**	$ 380	$ —
Foreign currency translation adjustments	**1,624**	1,732	(8,316)
Total accumulated other comprehensive income (loss)	**$1,205**	$2,112	$ (8,316)

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

(In thousands)	Amount Before Taxes	Income Tax (Expense)/Benefit	Amount Net of Taxes
Calendar year 1999			
Net unrealized losses	**$(1,024)**	**$ 225**	**$ (799)**
Foreign currency translation adjustments, net	**(108)**	**—**	**(108)**
Total other comprehensive income	**$(1,132)**	**$ 225**	**$ (907)**
Calendar year 1998			
Net unrealized gains	$ 585	$ (205)	$ 380
Foreign currency translation adjustments, net	10,048	—	10,048
Total other comprehensive income	$10,633	$ (205)	$10,428
Fiscal year 1997			
Foreign currency translation adjustments, net	$ (1,298)	$ —	$ (1,298)
Total other comprehensive income	$ (1,298)	$ —	$ (1,298)

Below represents the detail of other comprehensive income:

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

Earnings Per Share

The Company adopted SFAS No. 128, "Earnings Per Share," in 1997. The following table illustrates the reconciliation of the earnings and number of shares used in the basic and diluted earnings per share calculations.

(In millions, except per share amounts)	Years ended December 31, 1999	1998
Computation of Basic Earnings Per Share:		
Net income	**$57.2**	$55.3
Weighted average shares outstanding	**54.9**	58.7
Basic earnings per share	**$1.04**	$0.94
Computation of Diluted Earnings Per Share:		
Net income for diluted earnings per share	**$57.2**	$55.3
Weighted average shares outstanding	**54.9**	58.7
Effect of Dilutive Securities:		
Employee stock option plan	**0.8**	0.8
Shares for diluted earnings per share	**55.7**	59.5
Diluted earning per share	**$1.03**	$0.93

The effect of dilutive securities is computed using the treasury stock method and average market prices during the period. In 1999 and 1998, the Company excluded 206,031 and 497,864, respectively, anti-dilutive options from the computation of diluted earnings per share.

The weighted average number of common shares outstanding is based on the Company's weighted average number of outstanding common shares for the period October 15, 1997 through December 31, 1999, Sunburst's weighted average number of outstanding common shares for the period November 1, 1996 through October 15, 1997 and Manor Care's weighted average number of outstanding common shares prior to November 1, 1996.

Leases

Rental expense under non-cancelable operating leases was approximately $5.5 million, $1.7 million, $181,000 and $171,000 for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997, respectively. The Company paid office rent of $51,662, $977,500 and $1.1 million to Sunburst for the years ended December 31, 1999 and 1998 and the seven months ended December 31, 1997 based on the portion of total space occupied by the Company. Future minimum lease payments are as follows:

Year	(In thousands)
2000	$ 3,606
2001	3,374
2002	3,332
2003	3,259
2004	3,347
Thereafter	30,610
Total	**$ 47,528**

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

Prior to May 31, 1998, the Company was a guarantor of Sunburst's obligations under leases between Sunburst and Manor Care. Additionally, Sunburst and Choice had entered into a sublease agreement with respect to the Company's principal executive offices. On May 31, 1998, the Company and Manor Care entered into a new lease for the Silver Spring, Maryland corporate headquarters and the Company's guarantees of Sunburst lease obligations and the sublease were cancelled. The new lease has a fifteen year term and was subsequently assigned from Manor Care to an unrelated party.

Related Party Transactions

During 1998, the Company entered into an interest free bridge loan agreement with a Company executive approximating $754,000, which is reflected as a receivable at December 31, 1998. The bridge loan was repaid in March 1999.

Reportable Segment Information

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

The following table presents the financial information for the

(In thousands)	Year ended December 31, 1999 Franchising	Corporate & Other	Consolidated
Revenues	**$157,729**	**$ 3,871**	**$161,600**
Operating income (loss)	**124,293**	**(30,459)**	**93,834**
Depreciation and amortization	**730**	**7,293**	**8,023**
Capital expenditures	**16,515**	**14,118**	**30,633**
Total assets	**248,028**	**216,630**	**464,658**

	Year ended December 31, 1998 Franchising	Corporate & Other	Consolidated
Revenues	$143,628	$ 21,846	$165,474
Operating income (loss)	113,175	(28,067)	85,108
Depreciation and amortization	221	6,532	6,753
Capital expenditures	15,500	1,988	17,488
Total assets	208,096	190,129	398,225

	Seven months ended December 31, 1997 Franchising	Corporate & Other	Consolidated
Revenues	$ 83,774	$ 24,065	$ 107,839
Operating income (loss)	67,889	(15,715)	52,174
Depreciation and amortization	24	3,953	3,977
Capital expenditures	5,535	1,794	7,329
Total assets	182,210	204,185	386,395

	Fiscal year ended May 31, 1997 Franchising	Corporate & Other	Consolidated
Revenues	$126,659	$ 41,380	$ 168,039
Operating income (loss)	92,774	(22,412)	70,362
Depreciation and amortization	331	7,312	7,643
Capital expenditures	7,727	2,903	10,630
Total assets	165,766	55,707	221,473

Company's franchising segment.

The Company's international operations had revenues of $6.9 million, $5.8 million, $16.2 million and $27.5 million for the years ended December 31, 1999 and 1998, the seven months ended December 31, 1997 and the fiscal year ended May 31, 1997, respectively. Long-lived assets related to international operations were $20.6 million and $16.4 million as of December 31, 1999 and 1998, respectively. All other long-lived assets of the Company are associated with domestic activities. In addition, the Company had a $41.2 million and $41.6 million investment in Friendly as of December 31, 1999 and 1998, respectively.

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.

Fair Value of Financial Instruments

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

The Note Receivable from Sunburst has an approximate fair value of $135.0 million and $127.5 million at December 31, 1999 and 1998, respectively, based on its current yield to maturity. The $100 million unsecured senior notes have an approximate fair value at December 31, 1999 and 1998 of $93.9 million and $97.6 million, respectively, based on their current yield to maturity.

Impact of Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which requires recognition of the fair value of derivatives in the statement of financial position, with changes in the fair value recognized either in earnings or as a component of other comprehensive income dependent upon the hedging nature of the derivative. Implementation of SFAS No. 133 is required for Fiscal 2001. SFAS No. 133 will not have a material impact on the Company's earnings or other comprehensive income.

Selected Quarterly Financial Data – (Unaudited)

(In thousands, except per share data)

1999	**First**	**Second**	**Third**	**Fourth**	**Total Year**
Revenues	**$30,805**	**$39,763**	**$48,016**	**$43,016**	**$161,600**
Operating income	**16,166**	**24,198**	**30,206**	**23,264**	**93,834**
Income before income taxes	**17,272**	**24,280**	**30,381**	**22,538**	**94,471**
Net income	**10,277**	**14,531**	**18,338**	**14,009**	**57,155**
Per basic share:					
Net income	**$ 0.18**	**$ 0.26**	**$ 0.34**	**$ 0.26**	**$ 1.04**
Per diluted share:					
Net income	**$ 0.18**	**$ 0.26**	**$ 0.33**	**$ 0.26**	**$ 1.03**

1998	First	Second	Third	Fourth	Total Year
Revenues	$ 33,171	$ 44,436	$ 46,731	$ 41,136	$ 165,474
Operating income	14,133	23,519	26,736	20,720	85,108
Income before income taxes and extraordinary item	13,961	22,258	25,224	20,957	82,400
Net income before extraordinary item	8,146	12,988	14,718	12,221	48,073
Net income	8,146	12,988	21,950	12,221	55,305
Per basic share:					
Net income before extraordinary item	$ 0.14	$ 0.22	$ 0.25	$ 0.21	$ 0.82
Extraordinary item	$ 0.00	$ 0.00	$ 0.12	$ 0.00	$ 0.12
Net income	$ 0.14	$ 0.22	$ 0.37	$ 0.21	$ 0.94
Per diluted share:					
Net income before extraordinary item	$ 0.13	$ 0.22	$ 0.25	$ 0.21	$ 0.81
Extraordinary item	$ 0.00	$ 0.00	$ 0.12	$ 0.00	$ 0.12
Net income	$ 0.13	$ 0.22	$ 0.37	$ 0.21	$ 0.93

Subsequent Event (Unaudited)

In February 2000, the Company and Sunburst entered into a second amendment of the strategic alliance agreement which had the effect of: (i) finalizing outstanding operational issues with respect to the MainStay brand; (ii) modifying the royalty payment schedule payable by Sunburst to the Company on the MainStay portfolio; and (iii) ensuring that Sunburst keeps at least 20 MainStay hotels in the franchise system for the period ending October 2002.

In addition, the parties entered into a put call agreement related to three MainStay properties in Pittsburgh, Pennsylvania, Greenville, South Carolina, and Brentwood, Tennessee for a period ending June 30, 2000. During this period, the Company can "call" any property for purchase at Sunburst's original cost (approximately $15 million) and at the end of this period Sunburst may "put" any property at such cost.

Management believes that entering into these agreements will have the effect of solidifying the strategic relationship, particularly with respect to development of MainStay hotels, and ensure that Sunburst will complete its development quota of 25 MainStay hotels.

Board of Directors & Corporate Officers

Board Of Directors

Stewart Bainum, Jr.
Chairman of the Board:
- Manor Care Inc.
- Sunburst Hospitality Corporation

Barbara Bainum
President, Secretary and Director:
- Commonweal Foundation

Secretary and Director:
- Realty Investment Company

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

Director:
- Crown Central Petroleum Corp.
- 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

Larry R. Levitan
Retired Managing Partner:
- Andersen Consulting's Worldwide Communications Industry Group

Gerald W. Pettit
President & Chief Executive Officer:
- Creative Hotel Associates LLC

James H. Rempe
Retired Senior Vice President, General Counsel & Secretary:
- Manor Care Inc.

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

Stewart Bainum
Chairman Emeritus

Corporate Executive Officers

Stewart Bainum, Jr.
Chairman of the Board

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

Steven T. Schultz
Executive Vice President, Franchise Operations

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

Bruno Geny
Senior Vice President, International

Thomas Mirgon
Senior Vice President, Administration

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

Corporate Officers

Eric Bauer
Vice President, Strategy and Business Development

Brendan M. Ebbs
Senior Vice President, Franchise Operations

Daniel Rothfeld
Vice President, Partner Services

Kevin M. Rooney
Associate General Counsel and Assistant Secretary

William Weatherford
Senior Vice President, Franchise Operations

Market Area Vice Presidents

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

William Weatherford
Senior Vice President, Franchise Operations, Southeast Market Area

Michael Barnard
Vice President, Franchise Operations, West Market Area

Gary Decatur
Vice President, Franchise Operations, North Central Market Area

Brent Russell
Vice President, Franchise Operations, South Central Market Area

Brand Management

Michael Cothran
Vice President & Brand Manager Rodeway Inn

Peter Jordan
Vice President & Brand Manager Quality

Donald Kolodz
Vice President & Brand Manager Clarion

Dan Shoen
Vice President & Brand Manager Comfort

Tim Shuy
Vice President & Brand Manager Econo Lodge & MainStay Suites

Corporate Information

Stock Listing

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

Transfer Agent & Registrar

ChaseMellon
Shareholder Services LLC
Overpeck Centre
85 Challenger Road
Ridgefield, NJ 07660
www.chasemellon.com

Independent Auditors

Arthur Andersen LLP
Vienna, Virginia

Annual Meeting Date

Choice Hotels International will hold its Annual Meeting of Stockholders on Wednesday, May 3, 2000, at 9 a.m. in The Chesapeake Room of the Learning Center, 10720 Columbia Pike, Silver Spring, Maryland.

Form 10-K

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

Corporate Headquarters

Choice Hotels International
10750 Columbia Pike
Silver Spring, MD 20901

General Inquiries:

(301) 592-5000

Franchise Sales:

(800) 547-0007

Investor Inquiries:

(301) 592-5026
e-mail: investor_relations@choicehotels.com

Media Relations:

(301) 592-5032

Corporate Web Site:

www.choicehotels.com

Design: Choice Graphic Design & Corporate Identity
Principal Photographer: Cameron Davidson
Printer: GraphTec

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