ASHFORD HOSPITALITY TRUST INC
Form 10-Q
May 09, 2007

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**
**FORM 10-Q**

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the quarterly period ended March 31, 2007.**

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the Transition Period From __________ to __________.**
**Commission file number: 001-31775**
**ASHFORD HOSPITALITY TRUST, INC.**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Maryland | 86-1062192 |
| (State or other jurisdiction of incorporation or organization) | (IRS employer identification number) |
| 14185 Dallas Parkway, Suite 1100<br>Dallas, Texas | 75254 |
| (Address of principal executive offices) | (Zip code) |

Registrant s telephone number, including area code: (972) 490-9600

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

| Class | Outstanding at May 9, 2007: |
|---|---|
| Common Stock, $0.01 par value per share | 122,598,915 |

**ASHFORD HOSPITALITY TRUST, INC.**
**FORM 10-Q**
**FOR THE QUARTER ENDED MARCH 31, 2007**
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## ASHFORD HOSPITALITY TRUST, INC.

## CONSOLIDATED BALANCE SHEETS
**(In Thousands, Except Share and Per Share Amounts)**
**(Unaudited)**

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| **ASSETS** | | |
| Investment in hotel properties, net | $ 1,619,714 | $ 1,632,946 |
| Cash and cash equivalents | 65,084 | 73,343 |
| Restricted cash | 16,689 | 9,413 |
| Accounts receivable, net of allowance of $367 and $384, respectively | 30,544 | 22,081 |
| Inventories | 2,062 | 2,110 |
| Assets held for sale | 106,452 | 119,342 |
| Notes receivable | 94,800 | 102,833 |
| Deferred costs, net | 12,694 | 14,143 |
| Prepaid expenses | 10,781 | 11,154 |
| Other assets | 52,163 | 7,826 |
| Due from third-party hotel managers | 18,222 | 15,964 |
| Due from related parties | 2,306 | 757 |
| Total assets | $ 2,031,511 | $ 2,011,912 |
| **LIABILITIES AND OWNERS EQUITY** | | |
| Indebtedness | $ 1,082,638 | $ 1,091,150 |
| Capital leases payable | 106 | 177 |
| Accounts payable | 50,720 | 16,371 |
| Accrued expenses | 34,838 | 32,591 |
| Dividends payable | 21,039 | 19,975 |
| Deferred income | 283 | 294 |
| Deferred incentive management fees | 3,701 | 3,744 |
| Unfavorable management contract liability | 14,857 | 15,281 |
| Due to third-party hotel managers | 1,993 | 1,604 |
| Due to related parties | 2,359 | 4,152 |
| Total liabilities | 1,212,534 | 1,185,339 |
| Commitments and contingencies (see Note 13) | | |
| Minority interest | 108,926 | 109,864 |
| Preferred stock, $0.01 par value: | | |
| Series B Cumulative Convertible Redeemable Preferred Stock, 7,447,865 issued and outstanding at March 31, 2007 and December 31, 2006, respectively | 75,000 | 75,000 |
| Preferred stock, $0.01 par value, 50,000,000 shares authorized: | | |
| | 23 | 23 |

| | | |
|---|---|---|
| Series A Cumulative Preferred Stock, 2,300,000 issued and outstanding at March 31, 2007 and December 31, 2006, respectively | | |
| Common stock, $0.01 par value, 200,000,000 shares authorized, 73,754,500 shares issued and 73,717,915 shares outstanding at March 31, 2007 and 72,942,841 shares issued and outstanding at December 31, 2006 | 737 | 729 |
| Additional paid-in capital | 709,211 | 708,420 |
| Accumulated other comprehensive income (loss) | (120) | 111 |
| Accumulated deficit | (74,360) | (67,574) |
| Treasury stock, at cost (36,585 shares) | (440) | |
| Total owners equity | 635,051 | 641,709 |
| Total liabilities and owners equity | $ 2,031,511 | $ 2,011,912 |

See notes to consolidated financial statements.

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**ASHFORD HOSPITALITY TRUST, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**
**(In Thousands, Except Share and Per Share Amounts)**
**(Unaudited)**

| | Three Months Ended March 31, 2007 | Three Months Ended March 31, 2006 |
|---|---|---|
| **REVENUE** | | |
| Rooms | $ 113,391 | $ 78,467 |
| Food and beverage | 31,210 | 14,785 |
| Other | 5,014 | 3,448 |
| Total hotel revenue | 149,615 | 96,700 |
| Interest income from notes receivable | 3,355 | 3,946 |
| Asset management fees from affiliates | 331 | 318 |
| **Total Revenue** | **153,301** | **100,964** |
| **EXPENSES** | | |
| Hotel operating expenses | | |
| Rooms | 25,120 | 16,847 |
| Food and beverage | 22,696 | 11,501 |
| Other direct | 2,367 | 1,592 |
| Indirect | 43,232 | 29,603 |
| Management fees third-party hotel managers | 3,125 | 2,352 |
| Management fees related parties (see Note 12) | 2,396 | 1,536 |
| Total hotel expenses | 98,936 | 63,431 |
| Property taxes, insurance, and other | 8,011 | 5,192 |
| Depreciation and amortization | 16,918 | 10,008 |
| Corporate general and administrative | 4,594 | 4,810 |
| **Total Operating Expenses** | **128,459** | **83,441** |
| **OPERATING INCOME** | **24,842** | **17,523** |

See notes to consolidated financial statements.

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**ASHFORD HOSPITALITY TRUST, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**(In Thousands)**
**(Unaudited)**

| | Three Months Ended March 31, 2007 | Three Months Ended March 31, 2006 |
|---|---|---|
| **NET INCOME** | $ 11,491 | $ 7,462 |
| Reclassification to Reduce Interest Expense | (151) | (362) |
| Net Unrealized Losses on Derivative Instruments | (80) | (1) |
| Comprehensive Income | $ 11,260 | $ 7,099 |

See notes to consolidated financial statements.

**Ashford Hospitality Trust, Inc.**

**Consolidated Statement of Owners Equity**
**For the Three Months Ended March 31, 2007**
**(In Thousands, Except Per Share Amounts)**
**(Unaudited)**

| | Preferred Stock | | Common Stock | | Additional | Accumulated Other | | Treasury Stock | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Number of Shares | $0.01 Par Value | Number of Shares | $0.01 Par Value | Paid-In Capital | Comprehensive Income (Loss) | Accumulated Deficit | Shares | Cost | Total |
| Balance at December 31, 2006 | 2,300 | $ 23 | 72,943 | $ 729 | $ 708,420 | $ 111 | $ (67,574) | | $ | $ 641,709 |
| Stock-based Compensation | | | | | 1,059 | | | | | 1,059 |
| Forfeitures of Restricted Common Shares | | | (6) | | | | | | | |
| Issuance of Restricted Common Shares to Employees, net | | | 818 | 8 | (268) | | | | | (260) |
| Purchases of Treasury Shares | | | | | | | | (58) | (700) | (700) |
| Reissuances of Treasury Shares | | | | | | | | 21 | 260 | 260 |
| Dividends Declared Common Shares | | | | | | | (15,484) | | | (15,484) |
| Dividends Declared Preferred Shares Series A | | | | | | | (1,229) | | | (1,229) |
| Dividends Declared Preferred Shares Series B | | | | | | | (1,564) | | | (1,564) |
| Net Unrealized Loss on Derivative Instruments | | | | | | (80) | | | | (80) |
| Reclassification to Reduce Interest Expense | | | | | | (151) | | | | (151) |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Net Income | | | | | | | 11,491 | | | 11,491 |
| Balance at March 31, 2007 | 2,300 | $ 23 | 73,755 | $ 737 | $ 709,211 | $ (120) | $ (74,360) | (37) | $ (440) | $ 635,051 |

See notes to consolidated financial statements.

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**ASHFORD HOSPITALITY TRUST, INC.**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(In Thousands)**
**(Unaudited)**

| | Three Months Ended March 31, 2007 | Three Months Ended March 31, 2006 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 11,491 | $ 7,462 |
| Adjustments to reconcile net income to net cash flow provided by operations: | | |
| Depreciation and amortization | 17,196 | 10,935 |
| Gains on sales of properties | (1,388) | |
| Amortization of loan costs | 659 | 514 |
| Write-off of loan costs and exit fees | 703 | 687 |
| Amortization to reduce interest expense from comprehensive income | (151) | (362) |
| Stock-based compensation | 1,059 | 940 |
| Minority interest | 1,827 | 1,585 |
| Changes in assets and liabilities: | | |
| Accounts receivable and inventories | (8,499) | (3,221) |
| Other miscellaneous assets | (5,331) | (8,681) |
| Restricted cash | (7,276) | 18,359 |
| Other miscellaneous liabilities | 7,135 | 3,888 |
| Net cash flow provided by operating activities | 17,425 | 32,106 |
| **Cash flows from investing activities:** | | |
| Proceeds from payments of notes receivable | 8,019 | |
| Acquisitions of hotel properties | (119) | (28,524) |
| Deposits and costs related to future acquisition of CNL Portfolio | (14,929) | |
| Proceeds from sales of discontinued operations | 30,602 | 17,445 |
| Improvements and additions to hotel properties | (19,929) | (9,689) |
| Net cash flow provided by (used in) investing activities | 3,644 | (20,768) |
| **Cash flows from financing activities:** | | |
| Payments of dividends | (19,975) | (13,703) |
| Borrowings on indebtedness and capital leases | 20,000 | 10,000 |
| Payments on indebtedness and capital leases | (28,583) | (105,222) |
| Payments of deferred financing costs | (70) | (187) |
| Proceeds received from follow-on public offerings | | 128,135 |
| Payments for purchases of treasury stock | (700) | |
| Payments to convert partnership units into common stock | | (33) |
| Net cash flow (used in) provided by financing activities | (29,328) | 18,990 |

| | | | | |
|---|---|---|---|---|
| Net change in cash and cash equivalents | | (8,259) | | 30,328 |
| Cash and cash equivalents, beginning balance | | 73,343 | | 57,995 |
| Cash and cash equivalents, ending balance | $ | 65,084 | $ | 88,323 |

See notes to consolidated financial statements.

**ASHFORD HOSPITALITY TRUST, INC.**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**March 31, 2007**
**(Unaudited)**

**1. Organization and Description of Business**

Ashford Hospitality Trust, Inc. and subsidiaries (the Company ) is a self-advised real estate investment trust ( REIT ), which commenced operations on August 29, 2003 when it completed its initial public offering ( IPO ) and concurrently consummated certain other formation transactions, including the acquisition of six hotels ( initial properties ). The Company owns its lodging investments and conducts its business through Ashford Hospitality Limited Partnership, its operating partnership. Ashford OP General Partner LLC, its wholly-owned subsidiary, serves as the sole general partner of the Company s operating partnership.

The Company elected to be treated as a REIT for federal income tax purposes. As a result of limitations imposed on REITs related to operating hotel properties, each of the Company s hotel properties is leased or owned by wholly-owned subsidiaries of the Company that are treated as taxable REIT subsidiaries for federal income tax purposes (collectively, such subsidiaries are referred to as Ashford TRS ). Ashford TRS then engages third-party or affiliated hotel management companies to operate the hotels under management contracts. Remington Lodging & Hospitality, L.P. and Remington Management, L.P. (collectively, Remington Lodging ), both primary property managers for the Company, are beneficially wholly owned by Mr. Archie Bennett, Jr., the Company s Chairman, and Mr. Montgomery J. Bennett, the Company s President and Chief Executive Officer. As of March 31, 2007, Remington Lodging managed 40 of the Company s 79 hotel properties while unaffiliated management companies managed the remaining 39 hotel properties.

As of March 31, 2007, 73,717,915 shares of common stock, 2,300,000 shares of Series A preferred stock, 7,447,865 shares of Series B preferred stock, and 13,512,425 units of limited partnership interest held by entities other than the Company were outstanding and 36,585 shares of common stock were held as treasury stock. During the three months ended March 31, 2007, the Company completed the following transactions:

- On March 27, 2007, the Company issued 838,500 shares of restricted common stock to its executive officers and certain employees.

- During the three months ended March 31, 2007, the Company acquired 57,426 shares of treasury stock, of which 20,841 shares were reissued in connection with the aforementioned restricted common stock grant on March 27, 2007.

- During the three months ended March 31, 2007, 6,000 unvested shares of restricted common stock were forfeited.

As of March 31, 2007, the Company owned 79 hotel properties in 25 states with 15,096 rooms, an office building with nominal operations, and approximately $95.0 million of mezzanine or first-mortgage loans receivable.

**2. Basis of Presentation**

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information and in accordance with the rules and regulations of the Securities and Exchange Commission. Accordingly, these financial statements do not include certain information and disclosures required by GAAP for complete financial statements. However, in the opinion of management, all adjustments, consisting of normal recurring adjustments and accruals, considered necessary for a fair presentation have been included.

In addition, the following items affect the Company s reporting comparability related to its consolidated financial statements:

- The operations of the Company s hotels have historically been seasonal. This seasonality pattern causes fluctuations in the Company s operating results. Consequently, operating results for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

Marriott International, Inc. ( Marriott ) manages 24 of the Company s properties. For these 24 Marriott-managed hotels, the fiscal year reflects twelve weeks of operations for the first three quarters of the year and sixteen weeks for the fourth quarter of the year. Therefore, in any given quarterly period, period-over-period results will have different ending dates. For Marriott-managed hotels, the first quarters of 2007 and 2006 ended March 23$^{rd}$ and March 24$^{th}$, respectively.

Certain previously reported amounts have been reclassified to conform to the current presentation. These consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and footnotes for the year ended December 31, 2006, included in the Company s Form 10-K, as filed with the Securities and Exchange Commission on March 9, 2007. The accounting policies used in preparing these consolidated financial statements are consistent with those described in such Form 10-K.

**3. Significant Accounting Policies Summary**

Principles of Consolidation The Company s consolidated financial statements include the Company and its majority-owned subsidiaries. All significant intercompany accounts and transactions among the consolidated entities have been eliminated in these consolidated financial statements.

Revenue Recognition Hotel revenues include room, food, beverage, and ancillary revenues such as long-distance telephone service, laundry, and space rentals. Interest income from notes receivable represents interest earned on the Company s mezzanine and first-mortgage loans receivable portfolio. Asset management fees relate to asset management services performed on behalf of a related party, including risk management and insurance procurement, assistance with taxes, negotiating franchise agreements and equipment leases, monitoring compliance with loan covenants, preparation of capital and operating budgets, and property litigation management. Revenues are recognized as the related services are delivered.

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

In addition, in connection with the Company s acquisition of Marriott Crystal Gateway hotel in Arlington, Virginia, on July 13, 2006, the Company assumed the existing management agreement, which expires in 2017 with three ten-year renewal options and provides for a base management fee of 3% of the hotel s gross revenues plus certain incentive management fees. Based on the Company s review of this management agreement, the Company concluded that the terms are more favorable to the manager than a typical current market management agreement. As a result, the Company recorded an unfavorable contract liability of approximately $15.8 million related to this management agreement as of the acquisition date based on the present value of expected cash outflows over the initial term of the agreement, which is being amortized as a reduction to incentive management fees on a straight-line basis over the initial term of the agreement.

Investment in Hotel Properties Hotel properties are stated at cost. However, the initial properties contributed upon the Company s formation are stated at the predecessor s historical cost, net of any impairment charges, plus a minority interest partial step-up related to the acquisition of minority interest from unaffiliated parties associated with four of the initial properties. All improvements and additions which extend the useful life of hotel properties are capitalized.

Impairment of Investment in Hotel Properties Hotel properties are reviewed for impairment whenever events or changes in circumstances indicate that the carrying values of such hotel properties may not be recoverable. The Company tests for impairment in several situations, including when current or projected cash flows are less than historical cash flows, when it becomes more likely than not that a hotel property will be sold before the end of its previously estimated useful life, and when events or changes in circumstances indicate that a hotel property s net book value may not be recoverable. In evaluating the impairment of hotel properties, the Company makes many assumptions and estimates, including projected cash flows, holding period, expected useful life, future capital expenditures, and fair values, which considers capitalization rates, discount rates, and comparable selling prices. If an asset was deemed to be impaired, the Company would record an impairment charge for the amount that the property s net book value exceeds its fair value. To date, no such impairment charges have been recognized.

Depreciation and Amortization Expense Depreciation expense is based on the estimated useful life of the Company s assets, while amortization expense for leasehold improvements is based on the shorter of the lease term or the estimated useful life of the related assets. Presently, hotel properties are depreciated using the straight-line method over lives which range from 15 to 39 years for buildings and improvements and 3 to 5 years for furniture, fixtures, and equipment. While the Company believes its estimates are reasonable, a change in estimated lives could affect depreciation expense and net income (loss) as well as the gain or loss on the potential sale of any of the Company s hotels.

Restricted Cash Restricted cash includes reserves for debt service, real estate taxes, and insurance, as well as excess cash flow deposits and reserves for furniture, fixtures, and equipment replacements of approximately 4% to 6% of property revenue for certain hotels, as required by certain management or mortgage debt agreement restrictions and provisions.

Assets Held For Sale and Discontinued Operations The Company records assets as held for sale when management has committed to a plan to sell the assets, actively seeks a buyer for the assets, and the consummation of the sale is considered probable and is expected within one year. The related operations of assets held for sale are reported as discontinued if a) such operations and cash flows can be clearly distinguished, both operationally and financially, from the ongoing operations of the Company, b) such operations and cash flows will be eliminated from ongoing operations once the disposal occurs, and c) the Company will not have any significant continuing involvement subsequent to the disposal.

Notes Receivable The Company provides mezzanine and first-mortgage financing in the form of loans. Loans receivable are recorded at cost, adjusted for net origination fees and costs. Premiums, discounts, and net origination fees are amortized or accreted as an adjustment to interest income using the effective interest method. Loans receivable are reviewed for potential impairment at each balance sheet date. A loan receivable is considered impaired when it becomes probable, based on current information, that the Company will be unable to collect all amounts due according to the loan s contractual terms. The amount of impairment, if any, is measured by comparing the recorded amount of the loan to the present value of the expected cash flows or the fair value of the collateral. If a loan was deemed to be impaired, the Company would record a reserve for loan losses through a charge to income for any shortfall. To date, no such impairment charges have been recognized.

In accordance with Financial Accounting Standards Board Interpretation No. 46, Consolidation of Variable Interest Entities, as revised ( FIN No. 46 ), variable interest entities, as defined, are required to be consolidated by their primary beneficiaries if the variable interest entities do not effectively disperse risks among parties involved. The Company s mezzanine and first-mortgage loans receivable are each secured by various hotel properties or partnership interests in hotel properties and are subordinate to primary loans related to the secured hotels. All such loans receivable are considered to be variable interests in the entities that own the related hotels, which are variable interest entities. However, the Company is not considered to be the primary beneficiary of these hotel properties as a result of holding these loans. Therefore, the Company does not consolidate such hotels for which it has provided

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financing. Interests in entities acquired or created in the future will be evaluated based on FIN No. 46 criteria, and such entities will be consolidated, if required. The analysis utilized by the Company in evaluating FIN No. 46 criteria involves considerable management judgment and assumptions.

Due From Third-Party Hotel Managers  Due from third-party hotel managers primarily consists of amounts due from Marriott related to cash reserves held at the Marriott corporate level related to capital, insurance, real estate taxes, and other items.

Derivative Instruments and Hedging Activities  Statement of Financial Accounting Standards No. 133,  Accounting for Derivative Instruments and Hedging Activities,  as amended and interpreted ( SFAS No. 133 ), establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. As required by SFAS No. 133, the Company records all derivatives on the balance sheet at fair value. Accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

For derivatives designated as fair value hedges, changes in the fair value of the derivative and the hedged item related to the hedged risk are recognized in earnings. For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. The Company assesses the effectiveness of each hedging relationship by comparing the changes in fair value or cash flows of the derivative hedging instrument with the changes in fair value or cash flows of the designated hedged item or transaction. For derivatives not designated as hedges, changes in the fair value are recognized in earnings.

The Company s objective in using derivatives is to increase stability related to interest expense and to manage its exposure to interest rate movements or other identified risks. To accomplish this objective, the Company primarily uses interest rate swaps and caps as part of its cash flow hedging strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount. Interest rate caps designated as cash flow hedges provide the Company with interest rate protection above the strike rate on the cap and result in the Company receiving interest payments when rates are above the cap strike.

Income Taxes  As a REIT, the Company generally will not be subject to federal corporate income tax on the portion of its net income (loss)&n