JETBLUE AIRWAYS CORP
Form 10-K
February 21, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012
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 000-49728
JETBLUE AIRWAYS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	87-0617894 (I.R.S. Employer Identification No.)

27-01 Queens Plaza North, Long Island City, New York 11101
(Address, including zip code, of registrant's principal executive offices)
(718) 286-7900
Registrant's telephone number, including area code:

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value	The NASDAQ Global Select Market
Participating Preferred Stock Purchase Rights	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý
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 ý No o
Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	Accelerated filer o
Non-accelerated filer o	Smaller reporting company 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 ý

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant as of June 30, 2012 was approximately $1,248,512,000 (based on the last reported sale price on the NASDAQ Global Select Market on that date). The number of shares outstanding of the registrant's common stock as of January 31, 2013 was 280,750,081 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for its 2013 Annual Meeting of Stockholders, which is to be filed subsequent to the date hereof, are incorporated by reference into Part III of this Form 10-K.

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FORWARD-LOOKING INFORMATION

Statements in this Form 10-K (or otherwise made by JetBlue or on JetBlue's behalf) contain various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, which represent our management's beliefs and assumptions concerning future events. When used in this document and in documents incorporated herein by reference, the words "expects," "plans," "anticipates," "indicates," "believes," "forecast," "guidance," " "may," "will," "should," "seeks," "targets" and similar expressions are intended to identify forward-looking statements. Forward-looking statements involve risks, uncertainties and assumptions, and are based on information currently available to us. Actual results may differ materially from those expressed in the forward-looking statements due to many factors, including, without limitation, our extremely competitive industry; increases and volatility in fuel prices, increases in maintenance costs and interest rates; our ability to implement our growth strategy; our significant fixed obligations and substantial indebtedness; our ability to attract and retain qualified personnel and maintain our culture as we grow; our reliance on high daily aircraft utilization; our dependence on the New York metropolitan market and the effect of increased congestion in this market; our reliance on automated systems and technology; our being subject to potential unionization, work stoppages, slowdowns or increased labor costs; our reliance on a limited number of suppliers; our presence in some international emerging markets that may experience political or economic instability or may subject us to legal risk; reputational and business risk from information security breaches; a negative impact on the JetBlue brand; the long term nature of our fleet order book; changes in or additional government rules, regulations or laws; changes in our industry due to other airlines' financial condition; the impact on our growth because of economic difficulties in Europe through a continuance of the economic recessionary conditions in the U.S. or a further economic downturn leading to a continuing or accelerated decrease in demand for domestic and business air travel; and external geopolitical events and conditions. It is routine for our internal projections and expectations to change as the year or each quarter in the year progresses, and therefore it should be clearly understood that the internal projections, beliefs and assumptions upon which we base our expectations may change prior to the end of each quarter or year. Although these expectations may change, we may not inform you if they do.

You should understand that many important factors, in addition to those discussed or incorporated by reference in this report, could cause our results to differ materially from those expressed in the forward-looking statements. Potential factors that could affect our results include, in addition to others not described in this report, those described in Item 1A of this report under "Risks Related to JetBlue" and "Risks Associated with the Airline Industry." In light of these risks and uncertainties, the forward-looking events discussed in this report might not occur.

ITEM 1. BUSINESS

Overview

JetBlue Airways Corporation is a passenger airline known as much for its award-winning customer service and free TV as for its competitive fares. JetBlue believes it offers its customers the best main cabin experience in markets it serves with a strong core product and reasonably priced optional upgrades. JetBlue operates primarily on point-to-point routes with its fleet of 127 Airbus A320 aircraft and 53 EMBRAER 190 aircraft — one of the youngest and most fuel-efficient fleet of any major U.S. airline. As of December 31, 2012, we served 75 destinations in 23 states, Puerto Rico, the U.S. Virgin Islands, Mexico and 12 countries in the Caribbean and Latin America. JetBlue is New York's Hometown Airline. Most of our flights have as an origin or destination one of our six focus cities: New York, Boston, Fort Lauderdale, Los Angeles (Long Beach), Orlando and San Juan, Puerto Rico. By the end of 2012, we operated an average of 750 daily flights. For the year ended December 31, 2012, JetBlue was the sixth largest passenger carrier in the United States based on revenue passenger miles as reported by these passenger airlines. As used in this Form 10-K, the terms "JetBlue", "we", "us", "our" and similar terms refer to JetBlue Airways Corporation and its subsidiaries, unless the context indicates otherwise.

JetBlue was incorporated in Delaware in August 1998 and commenced service February 11, 2000. Our principal executive offices are located at 27-01 Queens Plaza North, Long Island City, New York 11101 and our telephone number is (718) 286-7900.

Where You Can Find Other Information

Our website is www.jetblue.com. Information contained on our website is not part of this report. Information we furnish or file with the SEC, including our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to or exhibits included in these reports are available for download, free of charge, on our website soon after such reports are filed with or furnished to the SEC. Our SEC filings, including exhibits filed therewith, are also available at the SEC's website at www.sec.gov. You may obtain and copy any document we furnish or file with the SEC at the SEC's public reference room at 100 F Street, NE, Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the SEC's public reference facilities by calling the SEC at 1-800-SEC-0330. You may request copies of these documents, upon payment of a duplicating fee, by writing to the SEC at its principal office at 100 F Street, NE, Room 1580, Washington, D.C. 20549.

OUR HISTORY

JetBlue began operations in 2000 as a well-funded start-up, which afforded us the ability to make significant investments in our product offerings, including all new aircraft equipped with leather seats and LiveTV. This product investment combined with superior customer service at low fares led to widespread brand recognition and early success, predominantly with leisure travelers in New York. By the end of 2006, JetBlue employed over 10,000 employees (to whom we refer as Crewmembers), operated 500 daily flights with a fleet of 119 aircraft and generated annual revenues exceeding $2 billion. A heavy debt load taken on to finance this rapid early growth, a wide-spread economic recession and record high energy prices led to annual losses in 2005 and 2006. It became clear to us this rate of growth, as then reflected in our aircraft order book, if not moderated, was unsustainable. Over time, we modified our growth rate through the sale and deferral of aircraft. Additionally, we began to structure our network and invest in offerings targeted to attract a higher mix of business travelers, particularly in Boston. At the same time, we allocated growth to Caribbean routes which typically mature to profitability faster than domestic routes. As we complete our 13^{th} year of operations, we believe our differentiated product and service offering combined with our competitive costs enables us to fiercely compete in high-value geography.

We are the only major U.S. airline which began operations post-deregulation to survive into a second decade of operation on our own. Our continued plans to grow organically and our future success are dependent upon our ability to adapt to an ever-changing environment and enhance shareholder value. We believe we are well-positioned to do so.

Our Industry and Competition

The U.S. passenger airline industry is extremely challenging, competitive and volatile. It is highly sensitive to GDP and economic developments. We operate in one of the most heavily taxed industries, which is extremely capital and energy intensive. U.S. passenger airlines are uniquely susceptible to economic downturns, inclement weather, international events, natural disasters and acts of terrorism. Airline returns are sensitive to even slight changes in fuel costs, average fare levels and passenger demand. The principal competitive factors in the airline industry include fares, capacity, customer service, route networks, flight schedules, aircraft types, safety records, reputations, code-sharing and interline relationships, in-flight entertainment systems and frequent flyer programs.

Since 2001, the majority of traditional network airlines have undergone significant financial restructuring, including bankruptcies, mergers and consolidations. These processes typically result in a lower cost structure through reduction of labor costs, restructuring of commitments (including debt terms, leases and fleet), modification or termination of pension plans, increased workforce flexibility and innovative offerings. They also provide significant opportunities to realign route networks, alliances and frequent flier programs.

Historically, capacity and pricing actions taken by airlines have had a significant influence on industry profitability. Beginning in 2008, most traditional network airlines began to reduce capacity growth in response to weak economic conditions and high fuel costs. This industry wide capacity discipline has continued throughout 2012. We believe it will continue through 2013.

Price competition occurs through price discounting, fare matching, targeted sale promotions, ancillary fee additions and frequent flyer travel initiatives. All of these measures are usually matched by other airlines in order to maintain their competitive position. Our ability to meet this price competition depends on, among other things, our ability to operate at costs equal to or lower than our competitors.

THE JETBLUE EXPERIENCE AND STRATEGY

We strive to offer our customers a distinctive flying experience, referred to as the "JetBlue Experience", by offering what we believe to be the best domestic coach product and providing our customers high value. We believe our success is evidenced by our strong brand preference and the price premium we are able to achieve through product differentiation. We also strive to maintain financial strength and a cost structure that enables profitable growth in the markets we serve. We are focused on delivering solid results for our Crewmembers, our customers and our shareholders.

We believe significant opportunities remain for us to grow profitably and responsibly. Unlike most of our competitors, who have been in business for several decades and who are managing mature networks, we have been flying only since 2000, growing our operations each year. We believe further profitable growth is possible as a result of our high-value network locations, relative low cost structure and differentiated product. Further, the cities we serve include some of the largest high-value travel markets and most densely populated areas in the country, including New York, Boston and Florida.

We believe our business model is unique in the domestic airline industry. We are neither a low-cost airline nor a traditional network airline. Our profitable growth strategy enables us to compete effectively with both types of carriers.

Low-Cost Airlines. Low-cost carriers view their service as a commodity with the belief that their customers will select the airline offering the lowest fare in a given market. We are able to compete well against low-cost airlines because we do not view ourselves as purely a commodity, and neither do our customers. We believe, and our historical experience reflects, our customers prefer a superior level of service and in-flight amenities. Further, they are willing to pay a premium over a low-cost airline's product. Unlike low-cost airlines, we do not try to maintain the lowest costs in the industry. Rather, we strive to achieve sustainable costs to support profitable growth with competitive fares. This approach results in a markedly better product than the low-cost airlines.

Network Airlines. Network carriers rely upon vast global route networks. They generally operate a significant portion of their flights using at least one hub where connections are made for flights over a spoke system. Although we do not have a comparable sized or a hub-and-spoke network, we are able to compete effectively against the network airlines. Our route structure is based on point-to-point flying providing greater customer convenience. We expand our destination offerings via our commercial partnerships. More importantly, our relative costs are lower than those of the large network airlines. This factor allows us to price fares competitively, while offering a differentiated coach product.

High Quality Service and Product

Superior customer service in delivering the JetBlue Experience to our customers through our strong network and award-winning product is core to our mission. We look to attract new customers to our brand and give our current customers reasons to come back to us. A core element of our success in attracting new and retaining current customers is that competitive fares and quality air travel need not be mutually exclusive.

Onboard JetBlue customers enjoy new aircraft with roomy seats and more legroom than other domestic airlines provide in their coach (and on some, premium) service. Our in-flight entertainment systems include 36 channels of free DirecTV®, 100 channels of free SiriusXM satellite radio and premium movie channel offerings from JetBlue Features®, our source of first run films. Our onboard offerings also include an assortment of free and unlimited brand name snacks and beverages. Additionally, customers can purchase premium beverages and food selections and specially-tailored products for overnight flights.

Our aircraft are all equipped with leather seats in a comfortable single class layout. Our Airbus A320 aircraft, with 150 seats, has a wider cabin than both the Boeing 737 and 757 aircraft operated by many of our competitors on their domestic routes. Our EMBRAER 190 aircraft each have 100 seats arranged in a space friendly two-by-two seating configuration and are wider than industry average for this type of aircraft. We offer the most legroom in the main cabin of all U.S. airlines (based on average fleet-wide seat pitch). We plan to introduce the Airbus A321 to our fleet, with 190 seats. We expect to take delivery of our first Airbus A321 during the fourth quarter of 2013. The entry into service date of the A321 will depend on the timing and successful completion of the FAA certification process. We believe the Airbus A321 will allow us to operate our slot portfolio in New York more efficiently, reduce unit costs and enhance the customer experience.

We believe our strong brand and the JetBlue Experience are key elements of our continued success. To that end, we continually seek to enhance and refine our product and service to create value for which people are willing to pay. During 2012, we reconfigured our EMBRAER 190 aircraft to include an additional eight Even More™ Space seats. We also began to offer separately Even More™ Speed which allows customers the option to enjoy an expedited security experience in most domestic JetBlue locations. During 2011, we executed an agreement with ViaSat Inc. to develop and introduce state of the art in-flight broadband connectivity technology called Ka-band. Ka-band offers more speed and flexibility than the existing Ku-band and air-to-ground technologies offered by some of our competitors. During 2012, we began development and testing of this technology; we plan to introduce wi-fi on our aircraft beginning in 2013.

We strive to provide a superior air travel experience, including communicating openly and honestly with customers about delays and service disruptions. We introduced the JetBlue Airways Customer Bill of Rights in 2007. This provides for compensation to customers who experience avoidable inconveniences (as well as some unavoidable circumstances), commits us to perform at high service standards and holds us accountable if we do not. We are the first and currently the only U.S. major airline to provide such a fundamental benefit to customers. In 2012, we completed 99% of our scheduled flights. Unlike most other airlines, we have a policy of not overbooking our flights.

Brand Strength. JetBlue is a widely recognized and respected global brand. We believe our brand differentiates us from our competitors and identifies us as a safe, reliable, high value airline. Our brand has evolved into an important and valuable asset. Similarly, we believe customer awareness of our brand has contributed to the success of our marketing efforts. It enables us to promote ourselves as a preferred marketing partner with companies across many different industries. In 2012, we once again received several prestigious awards, including being voted “Highest in Airline Customer Satisfaction among Low-Cost Carriers” by J.D. Power and Associates for the eighth consecutive year.

Our customers have repeatedly indicated the JetBlue Experience is an important reason why they choose us over other airlines. We believe our high satisfaction rating serves as evidence our customers value what we have to offer. We measure and monitor our customer feedback regularly to achieve a primary goal of continuously improving customer satisfaction. One way we do so is by measuring our net promoter score, or NPS. This metric is used by many industries to gauge customer experience. Our internal measurement shows improvements in our NPS score from 2011 to 2012, and we are focused on being an industry leader in this metric. Many of the leading brands consumers are most familiar with receive high NPS scores and are recognized for great customer service. We believe a higher NPS score leads to higher customer loyalty which results in increased revenue.

Marketing and Distribution

We market our services through advertising and promotions in various media forms including using increasingly popular social media outlets. We engage in large multi-market programs, many local events and sponsorships as well as mobile marketing programs. Our targeted public and community relations efforts reflect our commitment to the communities we serve, as well as promoting brand awareness and complementing our strong reputation.

Our primary and preferred distribution channel is through our website, www.jetblue.com, our lowest cost channel. We re-designed our website in 2012 to ensure our customers continue to have as pleasant an experience booking their travel as they do in the air. Our participation in global distribution systems, or GDSs, supports our profitable growth in the corporate market. We find that business customers are more likely to book through a travel agency or a booking product which rely on a GDS platform. Although the cost of sales through this channel is higher than through our website, the average fare purchased through the GDSs is generally higher and often covers the increased distribution costs. We currently participate in several major GDSs and online travel agents, or OTAs. In 2012, we launched mobile applications for both Apple and Android devices designed to enhance our customers' travel experience. These applications have robust features, including real-time flight information updates. Because the majority of our customers book travel on our website, we maintain relatively low distribution costs despite increases in recent years in our participation in GDS and OTA.

We sell vacation packages through JetBlue Getaways™, a one-stop, value-priced vacation website and service designed to meet customers' demand for self-directed packaged travel planning. JetBlue Getaways™ packages offer competitive fares for air travel on JetBlue, along with a selection of JetBlue-recommended hotels and resorts, car rentals and attractions. We also offer a la carte hotel and car rental reservations through our website which generates ancillary service revenues.

Route Network. We believe knowing our customers and understanding the purpose of their travel helps optimize destinations, strengthen our route schedules and increase unit revenues. Historically, we have been a strong leisure focused airline resulting in high seasonality in our business. In recent years, in order to offset this seasonality, we have increased our relevance to the business customer, particularly in Boston. Additionally, we have continued profitable growth in the Latin America and Caribbean region, with a mix of leisure and visiting friends and relatives, or VFR, travelers. VFR travelers tend to be slightly less seasonal and less susceptible to economic downturns than traditional leisure destination travelers. We have also expanded our portfolio of strategic commercial partnerships, which generate incremental customers throughout our network and help to increase load factor during our off-peak travel periods. We are focused on continuing to grow our network and further reducing our seasonality by targeting new customers in the leisure, business and VFR areas. Our operations primarily consist of transporting passengers on our aircraft. Domestic U.S. operations, including Puerto Rico, accounted for 84% of our capacity in 2012. The historic distribution of our available seat miles, or capacity, by region is:

	Year Ended December 31,					
Capacity Distribution	2012		2011		2010	
East Coast – Western U.S.	32.1	%	32.4	%	34.5	%
Northeast – Florida	30.6		32.2		31.4	
Medium – haul	2.9		3.2		3.3	
Short – haul	7.2		7.5		7.6	
Caribbean, including Puerto Rico	27.2		24.7		23.2	
Total	100.0	%	100.0	%	100.0	%

As of December 31, 2012, we provided service to 75 destinations in 23 states, Puerto Rico, the U.S. Virgin Islands, Mexico, and 12 countries in the Caribbean and Latin America. In 2012, we commenced service to five diverse new destinations, including Dallas/Fort Worth, Texas and Grand Cayman, Cayman Islands. We also reduced service tactically across our system, where the markets were not performing adequately. In 2013, we intend to begin service to the following destinations:

Destination	Service Scheduled to Commence
Charleston, South Carolina	February 2013
Albuquerque, New Mexico	April 2013
Philadelphia, Pennsylvania	May 2013
Medellin, Colombia	June 2013

In considering new markets, we generally focus on either underserved markets or those with high average fares. As a part of this process, we analyze publicly available data from the Department of Transportation, or DOT, showing the historical number of passengers, capacity and average fares over time. Using this data, combined with our knowledge and experience about how comparable markets have reacted in the past to capacity changes, we forecast the expected level of demand that may result from our introduction of service and lower prices. We also consider the anticipated response of existing airlines in the particular market. When deciding upon and entering new markets, we analyze the uniqueness of each market and design our operations to target the customer base which will allow us to compete effectively and grow profitably. For example, in the Caribbean our operations are primarily targeted on the leisure traveler, whereas in Boston, we are focused on both the business traveler and the leisure traveler.

These forecast techniques are designed to portray what we expect the market to produce upon maturity. We measure maturity of a market based upon cash break-even and profitability. We consider, among other things, the level of investment we believe may be required to reach a steady state of performance in a given market. Each route analysis is unique for many reasons including, but not limited to, geography, demographics, competitive dynamics and our existing size in the market. Generally, a business market takes two to three years to fully mature. High leisure Caribbean markets, however, have in some cases, matured in as little as six months. Our key objective is to achieve a sustainable growth rate by offsetting the investment in new markets with the cash and profits generated from mature markets.

Commercial Partnerships. Airlines frequently participate in marketing alliances which, among other things, generally provide for code-sharing, frequent flyer program reciprocity, coordinated flight schedules and other joint marketing activities. Our commercial agreements typically begin as an interline agreement, which allows a customer to book one ticket with itineraries on multiple airlines. As we expand our portfolio of commercial partnerships, we have also deepened the relationship with some of our existing partners from a basic interline agreement to include a code-share element in which one airline places its name and flight number on flights operated by another airline. The benefits of broad networks potentially attract more customers and expand our growing network. We currently participate in several commercial partnerships, primarily interline agreements, and will continue to seek additional strategic opportunities as they arise. We believe our commercial partnerships allow us to leverage our strong network and drive incremental traffic and revenue while improving our off-peak periods.

Our commercial partnerships, of which there are currently 22, are structured with gateways primarily at New York's JFK and Boston's Logan International Airport. These arrangements allow international travelers, whom we do not otherwise serve, to easily access many of our key domestic and Caribbean routes. Our partners include many notable international carriers. We plan on continuing to add commercial partners throughout 2013.

Customer Loyalty Program. TrueBlue is an online program designed to reward and recognize our most loyal customers. The program offers incentives to increase members' travel on JetBlue. TrueBlue members earn points based upon the amount paid for JetBlue flights. Member accounts accumulate points which do not expire as long as new flight points are earned at least once in a 12-month period. Redemption of points for a one-way flight can begin once a member attains as few as 5,000 points. The program has no black-out dates or seat restrictions and any JetBlue destination can be booked if the member has enough points to exchange for the value of an open seat.

There were approximately 753,000 travel segments flown during 2012. TrueBlue award miles flown represent approximately 3% of our total revenue passenger miles.

In 2012, we introduced a new badge of TrueBlue for our most loyal customers called Mosaic. In order to qualify for Mosaic status, TrueBlue members must either (1) fly a minimum of 30 times with JetBlue and acquire at least 12,000 base flight points within a calendar year; or (2) accumulate 15,000 base flight points within a calendar year. Mosaic

customers enjoy benefits including free EvenMore™ Speed, early boarding, access to a dedicated Customer service line available 24 hours a day/7days a week, a free second bag checked and free EvenMore™ Space seat upgrades.
We have an agreement with American Express under which it issues JetBlue co-branded American Express credit cards, allowing cardmembers to earn TrueBlue points. We have a separate agreement with American Express allowing any American Express cardholder to convert their Membership Rewards points into TrueBlue points. Additionally, we have agreements with

other loyalty partners, including hotels and car rental companies, allowing their customers to earn TrueBlue points through participation in the partners’ programs. We intend to develop and pursue other loyalty partnerships in the future.

In 2012, we launched an international co-branded loyalty credit card jointly with Banco Santander Puerto Rico and Mastercard. This new Santander JetBlue Mastercard allows our customers in Puerto Rico - where we are the largest carrier - the ability to take full advantage of our TrueBlue loyalty program.

Our Cost Structure and Operations

Our cost structure has allowed us to price fares lower than many of our larger competitors while offering an award-winning product and service. Our network initiatives and growth plans require a low cost platform. Maintaining a low cost structure relative to our competitors is fundamental to our sustainable growth and profitability. For the year ended December 31, 2012, our cost per available seat mile, excluding fuel, of 6.99 cents is among the lowest reported by all other major U.S. airlines. However, as our fleet and workforce age, it is increasingly difficult to maintain this marginal advantage relative to our competitors. There are several contributing factors to our cost advantage, including high aircraft utilization, new and efficient aircraft, limited fleet types, relatively low distribution costs, and a productive workforce.

We are continually focused on maintaining a cost advantage relative to our competitors while offering a high-quality product and service our customers value. We believe in making investments that will deliver future benefits, preserve our low cost advantage and drive efficiency. Examples of such investments include sharklets for our A320 aircraft to increase fuel efficiency and our construction of an international arrival facility at Terminal 5 in New York to streamline our international operations.

Infrastructure

Unlike many network carriers operating under a hub-and-spoke system, our point-to-point system is the foundation of our operation. The majority of our routes are served by at least one of our six focus cities. This structure allows us to optimize costs and generate a revenue premium in certain markets as we are able to accommodate customers' preference for non-stop itineraries. During 2012 and 2011, approximately 90% of our customers flew on non-stop itineraries.

A vast majority of our operations are centered in and around the northeast corridor of the United States encompassing some of the most populated airspace in the world. Operating in this congested airspace, however, makes us susceptible to certain operational constraints, including the increased susceptibility of prolonged recovery times stemming from weather events. We are continually working on ways to increase our overall operational efficiencies, including investing in technology and more robust operational systems. During 2012, we made several important technological advancements. In particular, we were among the industry leaders in the efforts towards implementing the Next Generation Air Transportation System, or NextGen. By December 31, 2012, through a government funded program, we had equipped 35 of our Airbus A320 aircraft with ADS-B Out. ADS-B Out is a satellite based technology aimed to facilitate the communication between pilots and air traffic controllers thereby improving safety and operational efficiency in this busy airspace. We expect to begin initial testing in 2013. We anticipate that when the technology is in place, average flight times will be reduced. Additionally, in 2012, we became the first FAA certified Airbus A320 carrier in the United States to use satellite-based Special Required Navigation Performance Authorization Required, or RNP AR, approaches at two of JFK's prime and most used runways, 13L and 13R. Given our significant presence in JFK, we believe the unique procedures associated with this technology will provide for shorter flight times and reduced greenhouse emissions.

The highest concentration of our network and infrastructure is in the New York metropolitan area, Boston and the Caribbean & Latin America region.

- New York Metropolitan Area. We are New York's Hometown Airline.™ Since 2000, the majority of our operations have originated in New York City, the nation's largest travel market and the largest U.S. point of entry from international locations. We are the largest domestic airline at New York's John F. Kennedy International Airport, or JFK, as measured by passengers and, by the end of 2012, our domestic operations at JFK accounted for nearly 40% of all domestic passengers at this airport. In addition to JFK, we serve Newark, NJ's Liberty International Airport, New

York's LaGuardia Airport, Newburgh, NY's Stewart International Airport and White Plains, NY's Westchester County Airport. We are the leading carrier in number of flights flown per day between the New York metropolitan area and Florida. JFK is New York's largest airport, with an infrastructure including four runways, large facilities and a direct light-rail connection to the New York City subway system and the Long Island Rail Road. In 2012, we began construction of T5i, an international arrivals facility, which will expand our current Terminal 5, or T5, footprint. We believe the new space will enable us to increase efficiencies, provide savings and streamline our operations and the overall customer experience.

- Boston. We are the largest carrier in terms of flights and seats offered at Boston's Logan International Airport, or Boston. Additionally, we serve twice as many non-stop destinations from Boston than any other airline. By the end of

2012, our domestic operations accounted for more than 20% of all domestic flights at this airport. We continue to capitalize on opportunities in the changing competitive landscape by adding routes and frequencies and increasing our relevance to local travelers, including corporate travelers. These actions have resulted in significant growth for us over the past three years. During 2012, we continued to invest in our Boston infrastructure including opening a new hangar to accommodate our growing operations. We intend to continue to grow to 150 flights per day from approximately 110 flights per day currently.

Caribbean and Latin America. A main driver of the growth of our route network since 2008 has been through the addition of new destinations in the Caribbean and Latin America. These markets have historically matured more quickly in terms of cash break-even and profitability than mainland flights of comparable distances. As of December 31, 2012, approximately 27% of our capacity was in the Caribbean and Latin America. We expect this number to continue to grow as we continue to seize opportunities. VFR traffic strongly complements leisure travel in the Caribbean region allowing for our profitable growth and success in this area of our network. Additionally, competitive landscape changes in San Juan, Puerto Rico have allowed us to increase our presence there. We continue to invest in our Caribbean operations, including introducing new intra-Caribbean service out of Puerto Rico. We are the largest airline in terms of capacity serving all of Puerto Rico. During 2012, we relocated to an all new terminal in San Juan to accommodate our continued growth. We currently serve approximately 35 flights per day in San Juan and plan to continue to grow our operations to 50 flights per day. During 2012, we began offering service to and from our sixth destination in the Dominican Republic, where we are also the largest airline in terms of capacity. While the Caribbean and Latin American region is a growing part of our network, operating in some of these developing countries can present operational challenges, including working with less developed airport authorities, political instability and increased civil disturbances.

Fleet

High aircraft utilization. By scheduling and operating our aircraft efficiently we are able to spread our fixed costs over a greater number of flights and available seat miles. For the year ended December 31, 2012, our aircraft operated an average of 11.8 hours per day which we believe is among the highest of all major U.S. airlines. Our airport operations allow us to schedule our aircraft with minimum ground time. We offer a significant percentage of overnight "red-eye" flights, which due to the limited ground time presents us with maintenance challenges.

Aircraft reliability and efficiency. We currently operate only two aircraft types, the Airbus A320 and the EMBRAER 190. Reliability and durability of our fleet is essential to our operations running smoothly, and is critical to delivering a superior experience for our customers. The average age of our fleet is 6.7 years, which we believe is one of the youngest of any major U.S. airline. Operating a younger fleet and incorporating the latest technologies results in our aircraft being more efficient and dependable than older aircraft. We have the world's largest fleet of Airbus A320 aircraft. Of the large Airbus A320 operators in North America, we have among the best dispatch reliability. We are continually working internally and with our aircraft and engine manufacturers to enhance our reliability and efficiency metrics. Beginning in 2018, we expect to take delivery of 40 A320 new engine option, or A320neo, aircraft, which incorporate a revolutionary engine design expected to increase fuel efficiency by up to 16% compared to the current A320 design. Beginning in 2013, we plan to equip our Airbus aircraft with curved extensions to the wings designed to provide greater and cleaner aerodynamic lift, or sharklets. We expect the sharklets will produce better fuel efficiency for the aircraft, with up to three percent less fuel burn on long-haul flights, providing for fuel savings and range flexibility. We expect to have 12 A320 aircraft equipped with sharklets by the end of 2013.

Labor

Productive workforce. Our Crewmember efficiency results from flexible and productive work rules resulting from the direct relationship between JetBlue and its highly engaged Crewmembers. We firmly believe maintaining the direct relationship with our Crewmembers is core to the JetBlue Culture we have built since we began operations in 2000. We believe our non-union workforce allows us increased flexibility, which in turn allows us to adapt more quickly in a changing environment. Our continued profitable growth is dependent upon this ability to quickly adapt. Our pilots are among the most productive in the U.S. passenger airline industry, ranking second in average annual block hours per pilot. We also effectively use part-time Crewmembers and automate tasks through the use of technology to gain efficiencies. We are cognizant of the competition for productive labor in key industry positions.

Additionally, new government rules requiring higher qualifications are predicted to result in potential labor shortages in the upcoming years. Through ongoing collaboration with peer-elected frontline Crewmembers from our internal major work groups (which we refer to as Values Committees), we ensure we have the input necessary to help us manage and run the business in the most productive and efficient way. We continue to work closely with our Crewmembers and Values Committees to ensure our Crewmembers remain engaged and productive.

Culture

We believe one of our competitive strengths is our service-oriented culture. Our culture places value upon and stresses the importance of providing high quality customer service. We believe our highly productive, engaged workforce allows us to keep our costs low and, ultimately, achieve our financial goals. Our success depends on our people and their capabilities, individually and collectively, delivering the best customer service experience while living our five key values of safety, caring, integrity, passion and fun. We strive to select, train and maintain a flexible and diverse workforce of caring, passionate, fun and friendly people who want to provide our customers with the best experience possible. Further, our historical experience, as confirmed by numerous surveys, reveals customer satisfaction and the likelihood of returning customers is highly correlated with and can be directly linked to experiences with engaged Crewmembers.

Our ability to continue to hire, retain, and develop people who fit within our Culture and are committed to delivering the JetBlue Experience to our customers is a key component to maintaining our valuable brand. Our culture is first introduced to all new Crewmembers through a screening process and an extensive orientation program which emphasizes the importance of customer service, productivity and cost control. We reinforce the importance of this culture by providing continuous training for our Crewmembers, including technical training, a specialized Captain training program unique in the industry, a leadership program, training focused on the safety value and front line training for our customer service teams. Our emphasis on talent development enables us and our Crewmembers to be strategically aligned and has resulted in a high rate of internal growth opportunities for our Crewmembers.

None of our Crewmembers are currently unionized. We believe a direct relationship between JetBlue Crewmembers and its leaders – not third-party representation – is in the best interests of our Crewmembers, customers and shareholders. We enter into individual employment agreements with each of our Federal Aviation Administration, or FAA, licensed Crewmembers, which consist of pilots, dispatchers, technicians and inspectors as well as air traffic controllers. These agreements are intended to drive higher levels of engagement and alignment with the Company’s strategy, culture of customer service and overall financial success. Each employment agreement is for a term of five years and renews for an additional five-year term unless the Crewmember is terminated for cause or the Crewmember elects not to renew. Pursuant to these agreements, these Crewmembers can only be terminated for cause. In the event of a downturn in our business calling for a reduction in flying and related work hours, we are obligated to pay these Crewmembers a guaranteed level of income and to continue their benefits. In addition, we provide what we believe to be industry-leading job protection language in these agreements in the event of a merger or acquisition as well as the establishment of a legal defense fund to use in connection with seniority integration negotiations.

Our leadership team strives to communicate on a regular basis with all JetBlue Crewmembers in order to maintain a direct relationship with and keep all Crewmembers informed about news, results and challenges affecting the airline. Effective and frequent communication throughout the organization is fostered through various means, including email messages from our CEO and other senior leaders at least weekly, employee engagement surveys, a quarterly digital magazine, active leadership participation in new hire orientations and periodic open forum meetings across our network, called “pocket sessions,” which are often videotaped and posted on our intranet. By soliciting feedback for ways to improve our service, teamwork and work environment, our leadership team strives to keep Crewmembers engaged, make our business decisions transparent and find cost and revenue improvements that are best recognized by Crewmembers closest to the activity.

Our full-time equivalent employees at December 31, 2012 consisted of 2,204 pilots, 2,472 flight attendants, 3,550 airport operations personnel, 541 technicians (whom others refer to as mechanics), 945 reservation agents, and 2,741 management and other personnel. At December 31, 2012, we employed 10,573 full-time and 3,774 part-time employees.

Aircraft Fuel

Aircraft fuel is our largest expense representing nearly 40% of our total operating costs in 2012. The price and availability of aircraft fuel are extremely volatile due to global economic and geopolitical factors we can neither control nor accurately predict. We use a third party fuel management service to procure most of our fuel. Our historical fuel consumption and costs for the years ended December 31 were:

	2012		2011		2010	
Gallons consumed (millions)	563		525		486	
Total cost (millions)	$1,806		$1,664		$1,115	
Average price per gallon	$3.21		$3.17		$2.29	
Percent of operating expenses	39.2	%	39.8	%	32.4	%

Total cost and average price per gallon each include related fuel taxes as well as effective fuel hedging gains and losses.

Our approach to fuel price management seeks to provide a form of insurance to protect against significant and sharp increases in fuel prices. We attempt to do so by entering into a variety of hedging instruments, including swaps and collar contracts with underlyings of jet fuel as well as crude and heating oil. We also use fixed forward price agreements, or FFPs, which allow us to lock in the price of fuel for specified quantities and at specified locations in future periods. At December 31, 2012, of our projected 2013 fuel requirements, we had hedged approximately 5% and managed approximately 6% with FFPs. In January and February 2013, we entered into jet fuel swap and cap agreements covering an additional 6% of our 2013 projected fuel requirements.

Maintenance

Our FAA-approved maintenance program is administered by our technical operations department. Consistent with our core value of safety, we use qualified maintenance personnel, ensure they have comprehensive training and maintain our aircraft and associated maintenance records in accordance with, if not exceeding, FAA regulations.

The maintenance work performed on our fleet is divided into five general categories: modification line, aircraft line maintenance, aircraft heavy maintenance, component repairs and power plant maintenance. The bulk of line maintenance requirements are handled directly by JetBlue technicians and inspectors and consist of daily checks, overnight and weekly checks, “A” checks, diagnostics and routine repairs. All other maintenance activity is sub-contracted to qualified maintenance, repair and overhaul organizations.

Aircraft heavy maintenance checks consist of a series of more complex tasks that take from one to four weeks to accomplish. The typical frequency for these events is once every 15 months. We send our aircraft to FAA-approved Aeroman facilities in El Salvador, Pemco in Tampa, Florida, Timco in Lake City, Florida and Embraer Aircraft Maintenance Services in Nashville, Tennessee. This work is all performed with oversight by JetBlue personnel.

Component and power plant maintenance, repairs and overhauls on equipment such as engines, auxiliary power units, landing gears, pumps and avionic computers are performed by a number of different FAA-approved repair stations. For example, maintenance of our V2500 series engines which power our Airbus A320 aircraft is performed under a 15-year service agreement with MTU Maintenance Hannover GmbH of Germany, or MTU. MTU is also a manufacturer of many of these engines components. Many of our maintenance service agreements are based on a fixed cost per flying hour, which can vary based upon the age and other operating factors impacting the related component. Required maintenance not covered by one of our agreements is performed on a time and materials basis.

LiveTV, LLC

LiveTV, LLC, a wholly-owned subsidiary of JetBlue, provides in-flight entertainment, voice communication and data connectivity services for commercial and general aviation aircraft. LiveTV’s assets include certain tangible equipment and interests in systems installed on its customers’ aircraft, system components and spare parts in inventory, an air-to-ground spectrum license granted by the Federal Communications Commission, a network of approximately 80 ground stations across the continental U.S., and rights to certain patents and intellectual property. LiveTV’s major competitors in the in-flight entertainment systems market include Rockwell Collins, Thales Avionics and Panasonic

Avionics. Only Panasonic is currently providing in-seat live television. In the voice and data communication services market, LiveTV's primary competitors are GoGo, Row 44, Panasonic, OnAir and Aeromobile.

LiveTV has agreements with six other domestic and international commercial airlines for the sale and installation of certain hardware, programming and maintenance of its live in-seat satellite television and certain other products and services. LiveTV also has general aviation customers to which it supplies voice and data communication services. LiveTV continues to pursue additional customers and related product enhancements. In 2011, JetBlue entered into an agreement with ViaSat Inc. for in-flight broadband connectivity. LiveTV is partnering with ViaSat Inc. to develop this in-flight broadband connectivity for JetBlue and will help us to introduce it on our aircraft beginning in 2013. LiveTV is also working with ViaSat Inc. to support in-flight connectivity for other airlines in the future.

Government Regulation

General. We are subject to regulation by the agencies of the federal government, including, but not limited to, the DOT, the FAA, the Transportation Security Administration, or TSA, and other governmental agencies. The DOT primarily regulates economic issues affecting air service such as certification and fitness, insurance, consumer protection and competitive practices. The DOT has the authority to investigate and institute proceedings to enforce its economic regulations and may assess civil penalties, revoke operating authority and seek criminal sanctions. In February 2000, the DOT granted us a certificate of public convenience and necessity authorizing us to engage in air transportation within the United States, its territories and possessions.

The FAA primarily regulates flight operations and, in particular, matters affecting air safety such as airworthiness requirements for aircraft, the licensing of pilots, mechanics and dispatchers, and the certification of flight attendants. The FAA requires each airline to obtain an operating certificate authorizing the airline to operate at specific airports using specified equipment. We have and maintain FAA certificates of airworthiness for all of our aircraft and have the necessary FAA authority to fly to all of the cities we currently serve.

Like all U.S. certified carriers, we cannot fly to new destinations without the prior authorization of the FAA. The FAA has the authority to modify, suspend temporarily or revoke permanently our authority to provide air transportation or that of our licensed personnel, after providing notice and a hearing, for failure to comply with FAA regulations. The FAA can assess civil penalties for such failures or institute proceedings for the imposition and collection of monetary fines for the violation of certain FAA regulations. The FAA can revoke our authority to provide air transportation on an emergency basis, without providing notice and a hearing, where significant safety issues are involved. The FAA monitors our compliance with maintenance, flight operations and safety regulations, maintains onsite representatives and performs frequent spot inspections of our aircraft, employees and records.

The FAA also has the authority to issue airworthiness directives and other mandatory orders relating to, among other things, inspection of aircraft and engines, fire retardant and smoke detection devices, collision and windshear avoidance systems, noise abatement and the mandatory removal and replacement of aircraft parts that have failed or may fail in the future.

The TSA operates under the Department of Homeland Security and is responsible for all civil aviation security, including passenger and baggage screening, cargo security measures, airport security, assessment and distribution of intelligence, and security research and development. The TSA also has law enforcement powers and the authority to issue regulations, including in cases of national emergency, without a notice or comment period.

In December 2009, the DOT issued a rule, which among other things, requires carriers not to permit domestic flights to remain on the tarmac for more than three hours (the “Tarmac Delay regulations”). The rule became effective in April 2010. Violators can be fined up to a maximum of $27,500 per passenger. The new rule also introduced requirements to disclose on-time performance and delay statistics for certain flights. This new rule may have adverse consequences on our business and our results of operations. In October 2011, several airport and navigational system outages combined with a severe winter storm impacted the northeast which resulted in numerous flight diversions, by us and other domestic and international carriers, to Hartford, CT’s Bradley International Airport. Due to weather, field and airport terminal conditions, five of our six diverted flights were held on the tarmac for times which exceeded the DOT’s established tarmac delay limits. As a result, the DOT is formally investigating these incidents and we may be subject to a civil penalty.

As part of an additional set of consumer protection rules issued by the DOT, as of January 2012, the DOT requires any advertised price for airfare or a tour package including airfare (e.g., a hotel/air vacation package) to be the total price to be paid by the customer, including all government taxes and fees. The new policy applies to all U.S. and foreign air carriers and ticket agents that advertise in the U.S. (including via the internet). Under the new rule, carriers and ticket agents are permitted to include a statement informing customers of the base fare versus government taxes and fees, but such a break-down cannot be more prominent than the advertised total price. Failure to comply could result in fines and penalties by the DOT as well as reputational damage, particularly in light of the substantial media coverage on the new rule and the perception that total price advertising is in the best interest of the customer. The DOT is reviewing whether certain practices and advertising programs by JetBlue since January 2012 are in compliance with the new rule and applicable guidance.

We believe we are operating in material compliance with DOT, FAA, TSA and applicable international and foreign regulations and hold all necessary operating and airworthiness authorizations and certificates. Should any of these authorizations or certificates be modified, suspended or revoked, our business could be materially adversely affected. We are also subject to state and local laws and regulations in a number of states in which we operate.

The airline industry is one of the most heavily taxed in the U.S., with taxes and fees accounting for approximately 16% of the total fare charged to a customer. Airlines are obligated to fund all of these taxes and fees regardless of their ability to pass these charges on to the customer. Additionally, if the TSA were to change the way the Aviation Security Infrastructure Fee is assessed, our security costs could be higher.

Airport Access. Historically, JFK, LaGuardia Airport, or LaGuardia, and Ronald Reagan Washington National Airport in Washington D.C., or Reagan National, were slot-controlled airports subject to the FAA's "High Density Rule," which rule limited the air traffic in and out of the airport during specific times. For JFK and LaGuardia, those rules expired in 2007. Following a significant increase in air traffic in and out of these airports, in 2008, the FAA reinstated temporary rules limiting operations for JFK, LaGuardia and Newark, N.J.'s Liberty International Airport, or Newark. These temporary rules continue in effect today. Due to airspace congestion in the northeast, especially in the New York metropolitan region, and during inclement weather, delays at JFK, LaGuardia and Newark remain among the highest in the nation.

At Reagan National where we increased our presence in 2012 and now operate 18 daily departures to five destinations, the High Density Rule remains in place. We operate with slots permanently assigned to us as well as with leased slots.

Westchester County Airport in White Plains, NY is also a slot-controlled airport, although unlike JFK, LaGuardia, Newark and Reagan National, it is governed by local, not federal regulations. We have 26 slots available for use and currently operate 13 weekday round trip flights from White Plains, NY to six destinations.

Long Beach (California) Municipal Airport is a slot-controlled airport as a result of a 1995 court settlement. We have 32 slots available for use and currently operate them to 12 domestic cities from coast to coast.

Environmental. We are subject to various federal, state and local laws relating to the protection of the environment, including the discharge or disposal of materials and chemicals and the regulation of aircraft noise administered by numerous state and federal agencies.

The Airport Noise and Capacity Act of 1990 recognizes the right of airport operators with special noise problems to implement local noise abatement procedures as long as those procedures do not interfere unreasonably with the interstate and foreign commerce of the national air transportation system. Certain airports, including San Diego and Long Beach, California, have established restrictions to limit noise which can include limits on the number of hourly or daily operations and the time of such operations. These limitations serve to protect the local noise-sensitive communities surrounding the airport. Our scheduled flights at Long Beach and San Diego are in compliance with the noise curfew limits but when we experience irregular operations, on occasion, we may violate these curfews. We have agreed to a payment structure with the Long Beach City Prosecutor for any violations which we pay quarterly to the Long Beach Public Library Foundation. The payment is based on the number of infractions in the preceding quarter. This local ordinance has not had, and we believe it will not have, a negative effect on our operations.

We use our “Jetting to Green” program on www.jetblue.com to educate our customers and Crewmembers about environmental issues and to inform the public about our environmental protection initiatives. Our most recent corporate sustainability report for the years 2010-2011 is available on our website and addresses our environmental programs, including those aimed at curbing greenhouse emissions, our conservation efforts and our social responsibility efforts.

Foreign Operations. International air transportation is subject to extensive government regulation. The availability of international routes to U.S. carriers is regulated by treaties and related agreements between the United States and foreign governments. We currently operate international service to the Bahamas, the Dominican Republic, Bermuda, Aruba, the Netherlands Antilles, Mexico, Colombia, Costa Rica, Jamaica, Barbados, Saint Lucia, the Turks and Caicos Islands and the Cayman Islands. To the extent we seek to provide air transportation to additional international markets in the future, we would be required to obtain necessary authority from the DOT and the applicable foreign government.

Foreign Ownership. Under federal law and the DOT regulations, we must be controlled by United States citizens. In this regard, our president and at least two-thirds of our board of directors must be United States citizens and not more than 24.99% of our outstanding common stock may be voted by non-U.S. citizens. We believe we are currently in compliance with these ownership provisions.

Other Regulations. All air carriers are also subject to certain provisions of the Communications Act of 1934 because of their extensive use of radio and other communication facilities, and are required to obtain an aeronautical radio license from the FCC. To the extent we are subject to FCC requirements, we will take all necessary steps to comply with those requirements. Our labor relations are covered under Title II of the Railway Labor Act of 1926 and are subject to the jurisdiction of the

National Mediation Board. In addition, during periods of fuel scarcity, access to aircraft fuel may be subject to federal allocation regulations. We are also subject to state and local laws and regulations at locations where we operate and the regulations of various local authorities operating the airports we serve.

Civil Reserve Air Fleet. We are a participant in the Civil Reserve Air Fleet Program, which permits the United States Department of Defense to utilize our aircraft during national emergencies when the need for military airlift exceeds the capability of military aircraft. By participating in this program, we are eligible to bid on and be awarded peacetime airlift contracts with the military.

Insurance

We carry insurance of types customary in the airline industry and at amounts deemed adequate to protect us and our property and to comply both with federal regulations and certain of our credit and lease agreements. As a result of the terrorist attacks of September 11, 2001 (the Terrorist Attacks), aviation insurers significantly reduced the amount of insurance coverage available to commercial air carriers for liability to persons other than employees or passengers for claims resulting from acts of terrorism, war or similar events (war-risk coverage). At the same time, these insurers significantly increased the premiums for aviation insurance in general. The U.S. government has agreed to provide commercial war-risk insurance for U.S. based airlines, currently through September 30, 2013, covering losses to employees, passengers, third parties and aircraft. We currently have such coverage in addition to our overall hull and liability insurance coverage. If the U.S. government were to cease providing such insurance in whole or in part, it is likely we would be able to obtain comparable coverage in the commercial market, but we would likely incur higher premiums and more restrictive terms.

Iran Sanctions Disclosure

Pursuant to Section 13(r) of the Securities Exchange Act of 1934, or the Exchange Act, if during 2012, JetBlue or any of its affiliates have engaged in certain transactions with Iran or with persons or entities designated under certain executive orders, JetBlue would be required to disclose information regarding such transactions in our Annual Report as required under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012, or ITRA. During 2012, JetBlue did not engage in any transactions with Iran or with persons or entities related to Iran.

Deutsche Lufthansa AG, or Lufthansa, is a stockholder of approximately 17% of JetBlue's outstanding shares of common stock and has two representatives on our Board of Directors. Accordingly, it may be deemed an “affiliate” of JetBlue, as that term is defined in Exchange Act Rule 12b-2. In response to our inquiries, Lufthansa informed us that it does not engage in transactions that would be disclosable under ITRA Section 219. However, Lufthansa informed us that it does provide air transportation services from Frankfurt, Germany to Tehran, Iran pursuant to Air Transport Agreements between the respective governments. Accordingly, Lufthansa may have agreements in place to support such air transportation services with the appropriate agencies or entities, such as landing or overflight fees, handling fees or technical/refueling fees. In addition, there may be additional civil aviation related dealings with Iran Air as part of typical airline to airline interactions. In response to our inquiry, Lufthansa did not specify the total revenue it receives in connection with the foregoing transactions, but confirmed the transactions are not prohibited under any applicable laws.

ITEM 1A. RISK FACTORS

Risks Related to JetBlue

We operate in an extremely competitive industry.

The domestic airline industry is characterized by low profit margins, high fixed costs and significant price competition in an increasingly concentrated competitive field. We currently compete with other airlines on all of our routes. Most of our competitors are larger and have greater financial resources and name recognition than we do. Following our entry into new markets or expansion of existing markets, some of our competitors have chosen to add service or engage in extensive price competition. Unanticipated shortfalls in expected revenues as a result of price competition or in the number of passengers carried would negatively impact our financial results and harm our business. The extremely competitive nature of the airline industry could prevent us from attaining the level of passenger traffic or maintaining the level of fares required to maintain profitable operations in new and existing markets and could impede our profitable growth strategy, which would harm our business. Additionally, if a traditional network airline were to fully develop a low cost structure, or if we were to experience increased competition from low cost carriers, our business could be materially adversely affected.

Our business is highly dependent on the availability of fuel and subject to price volatility.

Our results of operations are heavily impacted by the price and availability of fuel. Fuel costs comprise a substantial portion of our total operating expenses and are our single largest operating expense. Historically, fuel costs have been subject to wide price fluctuations based on geopolitical factors and supply and demand. The availability of fuel is not only dependent on crude oil but also on refining capacity. When even a small amount of the domestic or global oil refining capacity becomes unavailable, supply shortages can result for extended periods of time. The availability of fuel is also affected by demand for home heating oil, gasoline and other petroleum products, as well as crude oil reserves, dependence on foreign imports of crude oil and potential hostilities in oil producing areas of the world. Because of the effects of these factors on the price and availability of fuel, the cost and future availability of fuel cannot be predicted with any degree of certainty.

Our aircraft fuel purchase agreements do not protect us against price increases or guarantee the availability of fuel. Additionally, some of our competitors may have more leverage than we do in obtaining fuel. We have and may continue to enter into a variety of option contracts and swap agreements for crude oil, heating oil, and jet fuel to partially protect against significant increases in fuel prices; however, such contracts and agreements do not completely protect us against price volatility, are limited in volume and duration, and can be less effective during volatile market conditions and may carry counterparty risk. Under the fuel hedge contracts we may enter from time to time, counterparties to those contracts may require us to fund the margin associated with any loss position on the contracts if the price of crude oils falls below specified benchmarks. Meeting our obligations to fund these margin calls could adversely affect our liquidity.

Due to the competitive nature of the domestic airline industry, at times we have not been able to adequately increase our fares to offset the increases in fuel prices nor may we be able to do so in the future. Future fuel price increases, continued high fuel price volatility or fuel supply shortages may result in a curtailment of scheduled services and could have a material adverse effect on our financial condition and results of operations.

We have a significant amount of fixed obligations and we will incur significantly more fixed obligations, which could harm our ability to service our current or satisfy future fixed obligations.

As of December 31, 2012, our debt of $2.85 billion accounted for 60% of our total capitalization. In addition to long-term debt, we have a significant amount of other fixed obligations under leases related to our aircraft, airport terminal space, other airport facilities and office space. As of December 31, 2012, future minimum payments under noncancelable leases and other financing obligations were approximately $1.02 billion for 2013 through 2017 and an aggregate of $1.33 billion for the years thereafter. We have also constructed, and in October 2008 began operating, a new terminal at JFK under a 30-year lease with the Port Authority of New York and New Jersey, or PANYNJ. The minimum payments under this lease are being accounted for as a financing obligation and have been included in the future minimum payment totals above.

As of December 31, 2012, we had commitments of approximately $5.00 billion to purchase 115 additional aircraft and other flight equipment through 2021, including estimated amounts for contractual price escalations. We may incur additional debt and other fixed obligations as we take delivery of new aircraft and other equipment and continue to expand into new markets. In an effort to limit the incurrence of significant additional debt, we may seek to defer some of our scheduled deliveries, sell or lease aircraft to others, or pay cash for new aircraft, to the extent necessary or possible. The amount of our existing debt, and other fixed obligations, and potential increases in the amount of our debt and other fixed obligations could have important consequences to investors and could require a substantial portion of cash flows from operations for debt service payments, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes.

Our high level of debt and other fixed obligations could:

- impact our ability to obtain additional financing to support capital expansion plans and for working capital and other purposes on acceptable terms or at all;
- divert substantial cash flow from our operations and expansion plans in order to service our fixed obligations;
- require us to incur significantly more interest expense than we currently do if rates were to increase, since approximately 40% of our debt has floating interest rates; and
- place us at a possible competitive disadvantage compared to less leveraged competitors and competitors with better access to capital resources or more favorable terms.

Our ability to make scheduled payments on our debt and other fixed obligations will depend on our future operating performance and cash flows, which in turn will depend on prevailing economic and political conditions and financial, competitive, regulatory, business and other factors, many of which are beyond our control. We are principally dependent upon our operating cash flows and access to the capital markets to fund our operations and to make scheduled payments on debt and other fixed obligations. We cannot assure you we will be able to generate sufficient cash flows from our operations or from capital market activities to pay our debt and other fixed obligations as they become due; if we fail to do so our business could be harmed. If we are unable to make payments on our debt and other fixed obligations, we could be forced to renegotiate those obligations or seek to obtain additional equity or other forms of additional financing.

Our substantial indebtedness may limit our ability to incur additional debt to obtain future financing needs.

We typically finance our aircraft through either secured debt or lease financing. The impact on financial institutions from the global credit and liquidity crisis and continuing economic malaise may adversely affect the availability and cost of credit to JetBlue as well as to prospective purchasers of our aircraft we undertake to sell in the future, including financing commitments we have already obtained for purchases of new aircraft. To the extent we finance our activities with additional debt, we may become subject to financial and other covenants that may restrict our ability to pursue our strategy or otherwise constrain our operations.

Our maintenance costs will increase as our fleet ages.

Our maintenance costs will increase as our fleet ages. In the past, we have incurred lower maintenance expenses because most of the parts on our aircraft were under multi-year warranties; these warranties have for the most part expired. If any existing maintenance provider with whom we have a long-term "power by the hour" agreement fails to perform or honor such agreements, we will incur higher interim maintenance costs until we negotiate new agreements. Furthermore, as our fleet ages, we expect our fleet will require various modifications over the next several years to ensure its continued efficiency, modernization, brand consistency and safety. Our plans to equip our A320 aircraft with sharklets, for example, will, in some cases, require significant modification time. These fleet modifications will require significant investment over the several years, including taking aircraft out of service for several weeks at a time.

Our salaries, wages and benefits costs will increase as our workforce ages.

As our employees' tenure with JetBlue matures, our salaries, wages and benefits costs will increase. Our pilot pay structure, for example, is based on an industry derived average and to the extent our competitors continue consolidating and/or begin raising their pilot salaries in the face of a possible pilot shortage, we may have to address increased salary cost pressure to retain our pilots in an environment where our capacity is also forecast to continue to grow. As our work force ages, we expect our medical and related benefits to increase as well, despite an increased corporate focus on crewmember wellness.

If we fail to successfully implement our strategy, our business could be harmed.

We have grown, and expect to continue to grow our business whenever practicable, by modifying the frequency of flights to markets we currently serve, expanding the number of markets we serve and increasing flight connection opportunities. We have modified our rate of growth several times over the past few years due to higher fuel prices, the competitive pricing environment and other cost increases, by deferring some of our scheduled deliveries of new aircraft, selling some used aircraft, terminating our leases for some of our aircraft, and leasing aircraft to other operators. A continuation of the economic downturn may cause us to further reduce our future growth plans from previously announced levels.

To the extent we continue to grow our business, opening new markets requires us to commit a substantial amount of resources even before the new services commence. Expansion is also dependent upon our ability to maintain a safe and secure operation and requires additional personnel, equipment and facilities. An inability to hire and retain personnel, timely secure the required equipment and facilities in a cost-effective manner, efficiently operate our expanded facilities, or obtain the necessary regulatory approvals may adversely affect our ability to achieve our growth strategy, which could harm our business.

In addition, our competitors often add service, reduce their fares and/or offer special promotions following our entry into a new market. We cannot assure you we will be able to profitably expand our existing markets or establish new markets or be able to adequately temper our growth in a cost effective manner through additional deferrals or selling or leasing aircraft; if we fail to do so, our business could be harmed.

There are risks associated with our presence in some of our international emerging markets, including political or economic instability and failure to adequately comply with existing legal requirements.

Expansion to new international emerging markets may have risks due to factors specific to those markets. Emerging markets are countries which have less developed economies and are vulnerable to economic and political problems, such as significant fluctuations in gross domestic product, interest and currency exchange rates, civil disturbances, government instability, nationalization and expropriation of private assets, trafficking and the imposition of taxes or other charges by governments. The occurrence of any of these events in markets served by us and the resulting instability may adversely affect our business.

We have expanded and, if market and other conditions warrant it, may continue to expand our service to countries in the Caribbean and Latin America, some of which have less developed legal systems, financial markets, and business and political environments than the United States, and therefore present greater political, legal, economic and operational risks. We emphasize legal compliance and have implemented and continue to implement and refresh policies, procedures and certain ongoing training of employees with regard to business ethics, anti-corruption policies and many key legal requirements; however, there can be no assurance our employees will adhere to our code of business ethics, anti-corruption policies, other Company policies, or other legal requirements. If we fail to enforce our policies and procedures properly or maintain adequate record-keeping and internal accounting practices to accurately record our transactions, we may be subject to sanctions. In the event we believe or have reason to believe our employees have or may have violated applicable laws or regulations, we may be subject to investigation costs, potential penalties and other related costs which in turn could negatively affect our reputation, and our results of operations and cash flow.

We may be subject to risks through the commitments and business of LiveTV, our wholly-owned subsidiary.

LiveTV has agreements to provide in-flight entertainment products and services with six other airlines. At December 31, 2012, LiveTV services were available on 439 aircraft under these agreements, with firm commitments for 219 additional aircraft through 2015 and with options for 52 additional installations through 2014. Performance under these agreements requires LiveTV to hire, train and retain qualified employees, obtain component parts unique to its systems and services from their suppliers and secure facilities necessary to perform installations and maintenance on those systems. Should LiveTV be unable to satisfy its commitments under these third party contracts, our business could be harmed.

We may be subject to unionization, work stoppages, slowdowns or increased labor costs; recent changes to the labor laws may make unionization easier to achieve.

Our business is labor intensive and, unlike most other airlines, we have a non-union workforce. The unionization of any of our employees could result in demands that may increase our operating expenses and adversely affect our financial condition and results of operations. Any of the different crafts or classes of our employees could unionize at any time, which would require us to negotiate in good faith with the employee group’s certified representative concerning a collective bargaining agreement. In 2010, the National Mediation Board, or NMB, changed its election procedures to permit a majority of those voting to elect to unionize (from a majority of those in the craft or class). These rule changes fundamentally alter the manner in which labor groups have been able to organize in our industry since the inception of the Railway Labor Act. Ultimately, if we and a newly elected representative were unable to reach agreement on the terms of a collective bargaining agreement and all of the dispute resolution processes of the Railway Labor Act were exhausted, we could be subject to work stoppages. In addition, we may be subject to other disruptions by organized labor groups protesting our non-union status. Any of these events would be disruptive to our operations and could harm our business.

Our high aircraft utilization rate helps us keep our costs low, but also makes us vulnerable to delays and cancellations in our operating regions; such delays and cancellations could reduce our profitability.

We maintain a high daily aircraft utilization rate (the amount of time our aircraft spend in the air carrying passengers). High daily aircraft utilization allows us to generate more revenue from our aircraft and is achieved in part by reducing turnaround times at airports so we can fly more hours on average in a day. Aircraft utilization is reduced by delays and cancellations from various factors, many of which are beyond our control, including adverse weather conditions, security requirements, air traffic congestion and unscheduled maintenance. The majority of our operations are concentrated in the Northeast and Florida, which are particularly vulnerable to weather and congestion delays. Reduced aircraft utilization may limit our ability to achieve and maintain profitability as well as lead to customer dissatisfaction.

Our business is highly dependent on the New York metropolitan market and increases in competition or congestion or a reduction in demand for air travel in this market, or governmental reduction of our operating capacity at JFK, would harm our business.

We are highly dependent on the New York metropolitan market where we maintain a large presence with approximately one-half of our daily flights having JFK, LaGuardia, Newark, Westchester County Airport or Newburgh's Stewart International Airport as either their origin or destination. We have experienced an increase in flight delays and cancellations at JFK due to airport congestion which has adversely affected our operating performance and results of operations. Our business could be further harmed by an increase in the amount of direct competition we face in the New York metropolitan market or by continued or increased congestion, delays or cancellations. Our business would also be harmed by any circumstances causing a reduction in demand for air transportation in the New York metropolitan area, such as adverse changes in local economic conditions, negative public perception of New York City, terrorist attacks or significant price increases linked to increases in airport access costs and fees imposed on passengers.

We rely heavily on automated systems to operate our business; any failure of these systems could harm our business.

We are dependent on automated systems and technology to operate our business, enhance customer service and achieve low operating costs. The performance and reliability of our automated systems and data center is critical to our ability to operate our business and compete effectively. These systems include our computerized airline reservation system, flight operations system, telecommunications systems, website, maintenance systems, check-in kiosks, in-flight entertainment systems and our primary and redundant data centers. Our website and reservation system must be able to accommodate a high volume of traffic and deliver important flight information. These systems require upgrades or replacement periodically, which involve implementation and other operational risks. Our business may be harmed if we fail to operate, replace or upgrade our systems or data center infrastructure successfully.

We rely on the third party providers of our current automated systems and data center infrastructure for technical support. If the current provider were to fail to adequately provide technical support for any one of our key existing systems or if new or updated components were not integrated smoothly, we could experience service disruptions, which, if they were to occur, could result in the loss of important data, increase our expenses, decrease our revenues and generally harm our business and reputation. Furthermore, our automated systems cannot be completely protected against events beyond our control, including natural disasters, computer viruses, other security breaches, or telecommunications failures. Substantial or sustained system failures could impact customer service and result in our customers purchasing tickets from other airlines. We have implemented security measures and change control procedures and have disaster recovery plans as well as requiring our third party providers to have disaster recovery plans; however, we cannot assure you these measures are adequate to prevent disruptions, which, if they were to occur, could result in the loss of important data, increase our expenses, decrease our revenues and generally harm our business and reputation.

Our reputation and business may be harmed and we may be subject to legal claims if there is loss, unlawful disclosure or misappropriation of, or unsanctioned access to, our customers', employees', business partners' or our own information or other breaches of our information security.

We make extensive use of online services and centralized data processing, including through third party service providers. The secure maintenance and transmission of customer and employee information is a critical element of our operations. Our information technology and other systems maintain and transmit customer information, or those of service providers or business partners, may be compromised by a malicious third party penetration of our network security, or of a third party service provider or business partner, or impacted by deliberate or inadvertent actions or inactions by our employees, or those of a third party service provider or business partner. As a result, personal information may be lost, disclosed, accessed or taken without consent.

We transmit confidential credit card information by way of secure private retail networks and rely on encryption and authentication technology licensed from third parties to provide the security and authentication necessary to effect secure transmission and storage of confidential information, such as customer credit card information. The Company has made significant efforts to secure its computer network. If any compromise of our security or computer network were to occur, it could have a material adverse effect on the reputation, business, operating results and financial condition of the Company, and could result in a loss of customers. Additionally, any material failure by the Company to achieve or maintain compliance with the Payment Card Industry, or PCI, security requirements or rectify a security issue may result in fines and the imposition of restrictions on the Company's ability to accept credit cards as a form of payment.

Any such loss, disclosure or misappropriation of, or access to, customers', employees' or business partners' information or other breach of our information security can result in legal claims or legal proceedings, including regulatory investigations and actions, may have a negative impact on our reputation and may materially adversely affect our business, operating results and financial condition. Furthermore, the loss, disclosure or misappropriation of our business information may materially adversely affect our business, operating results and financial condition.

Our liquidity could be adversely impacted in the event one or more of our credit card processors were to impose material reserve requirements for payments due to us from credit card transactions.

We currently have agreements with organizations that process credit card transactions arising from purchases of air travel tickets by our customers. Credit card processors have financial risk associated with tickets purchased for travel which can occur several weeks after the purchase. Our credit card processing agreements provide for reserves to be deposited with the processor in certain circumstances. We do not currently have reserves posted for our credit card processors. If circumstances were to occur requiring us to deposit reserves, the negative impact on our liquidity could be significant which could materially adversely affect our business.

If we are unable to attract and retain qualified personnel or fail to maintain our company culture, our business could be harmed.

We compete against the other major U.S. airlines for pilots, mechanics and other skilled labor; some of them offer wage and benefit packages exceeding ours. As more pilots in the industry approach mandatory retirement age, the U.S. airline industry may be affected by a pilot shortage, to some extent. We may be required to increase wages and/or benefits in order to attract and retain qualified personnel or risk considerable employee turnover. If we are unable to hire, train and retain qualified employees, our business could be harmed and we may be unable to implement our growth plans.

In addition, as we hire more people and grow, we believe it may be increasingly challenging to continue to hire people who will maintain our company culture. One of our competitive strengths is our service-oriented company culture that emphasizes friendly, helpful, team-oriented and customer-focused employees. Our company culture is important to providing high quality customer service and having a productive workforce in order to help keep our costs low. As we continue to grow, we may be unable to identify, hire or retain enough people who meet the above criteria, including those in management or other key positions. Our company culture could otherwise be adversely affected by our growing operations and geographic diversity. If we fail to maintain the strength of our company culture, our competitive ability and our business may be harmed.

Our results of operations fluctuate due to seasonality and other factors.

We expect our quarterly operating results to fluctuate due to seasonality including high vacation and leisure demand occurring on the Florida routes between October and April and on our western routes during the summer. Actions of our competitors may also contribute to fluctuations in our results. We are more susceptible to adverse weather conditions, including snow storms and hurricanes, as a result of our operations being concentrated on the East Coast, than some of our competitors. As we enter new markets we could be subject to additional seasonal variations along with any competitive responses to our entry by other airlines. Price changes in aircraft fuel as well as the timing and amount of maintenance and advertising expenditures also impact our operations. As a result of these factors, quarter-to-quarter comparisons of our operating results may not be a good indicator of our future performance. In addition, it is possible in any future period our operating results could be below the expectations of investors and any published reports or analyses regarding JetBlue. In such an event, the price of our common stock could decline, perhaps substantially.

We are subject to the risks of having a limited number of suppliers for our aircraft, engines and a key component of our in-flight entertainment system.

Our current dependence on two types of aircraft and engines for all of our flights makes us vulnerable to significant problems associated with the Airbus A320 aircraft or the IAE International Aero Engines V2527-A5 engine and the EMBRAER 190 aircraft or the General Electric Engines CF-34-10 engine, including design defects, mechanical problems, contractual performance by the manufacturers, or adverse perception by the public would result in customer avoidance or in actions by the FAA resulting in an inability to operate our aircraft. Carriers operating a more diversified fleet are better positioned than we are to manage such events.

One of the unique features of our fleet is every seat in each of our aircraft is equipped with free in-flight entertainment including DirecTV®. An integral component of the system is the antenna, which is supplied to us by KVH Industries Inc, or KVH. If KVH were to stop supplying us with its antennas for any reason, we would have to incur significant costs to procure an alternate supplier.

Our reputation and financial results could be harmed in the event of an accident or incident involving our aircraft.

An accident or incident involving one of our aircraft, or an aircraft containing LiveTV equipment, could involve significant potential claims of injured passengers or others in addition to repair or replacement of a damaged aircraft and its consequential temporary or permanent loss from service. We are required by the DOT to carry liability insurance. Although we believe we currently maintain liability insurance in amounts and of the type generally consistent with industry practice, the amount of such coverage may not be adequate and we may be forced to bear substantial losses from an accident. Substantial claims resulting from an accident in excess of our related insurance coverage would harm our business and financial results.

Moreover, any aircraft accident or incident, even if fully insured, could cause a public perception we are less safe or reliable than other airlines which would harm our business.

An ownership change could limit our ability to use our net operation loss carryforwards.

As of December 31, 2012, we had approximately $371 million of federal net operating loss carryforwards for U.S. income tax purposes that begin to expire in 2025. Section 382 of the Internal Revenue Code imposes limitation on a corporation’s ability to use its net operating loss carryforwards if it experiences an “ownership change”. Similar rules and limitations may apply for state income tax purposes. In the event an “ownership change” were to occur in the future, our ability to utilize our net operating losses could be limited.

Our business depends on our strong reputation and the value of the JetBlue brand.

The JetBlue brand name symbolizes high-quality friendly customer service, innovation, fun, and a pleasant travel experience. JetBlue is a widely recognized and respected global brand; the JetBlue brand is one of our most important and valuable assets. The JetBlue brand name and our corporate reputation are powerful sales and marketing tools and we devote significant resources to promoting and protecting them. Adverse publicity (whether or not justified) relating to activities by our employees, contractors or agents could tarnish our reputation and reduce the value of our brand. Damage to our reputation and loss of brand equity could reduce demand for our services and thus have an adverse effect on our financial condition, liquidity and results of operations, as well as require additional resources to rebuild our reputation and restore the value of our brand.

We may be subject to competitive risks due to the long term nature of our fleet order book.

At present, we have existing aircraft commitments through 2021. As technological evolution occurs in our industry, through the use of composites and other innovations, we may be competitively disadvantaged because we have existing extensive fleet commitments that would prohibit us from adopting new technologies on an expedited basis.

Risks Associated with the Airline Industry

The airline industry is particularly sensitive to changes in economic condition.

Fundamental and permanent changes in the domestic airline industry have been ongoing over the past several years as a result of several years of repeated losses, among other reasons. These losses resulted in airlines renegotiating or attempting to renegotiate labor contracts, reconfiguring flight schedules, furloughing or terminating employees, as well as considering other efficiency and cost-cutting measures. Despite these actions, several airlines have reorganized under Chapter 11 of the U.S. Bankruptcy Code to permit them to reduce labor rates, restructure debt, terminate pension plans and generally reduce their cost structure. Since 2005, the U.S. airline industry has experienced significant consolidation and liquidations. The global economic recession and related unfavorable general economic conditions, such as higher unemployment rates, a constrained credit market, housing-related pressures, and increased business operating costs can reduce spending for both leisure and business travel. Unfavorable economic conditions could also impact an airline’s ability to raise fares to counteract increased fuel, labor, and other costs. It is foreseeable that further airline reorganizations, consolidation, bankruptcies or liquidations may occur in the current global recessionary environment, the effects of which we are unable to predict. We cannot assure you the occurrence of these events, or potential changes resulting from these events, will not harm our business or the industry.

A future act of terrorism, the threat of such acts or escalation of U.S. military involvement overseas could adversely affect our industry.

Acts of terrorism, the threat of such acts or escalation of U.S. military involvement overseas could have an adverse effect on the airline industry. In the event of a terrorist attack, whether or not successful, the industry would likely experience increased security requirements and significantly reduced demand. We cannot assure you these actions, or consequences resulting from these actions, will not harm our business or the industry.

Changes in government regulations imposing additional requirements and restrictions on our operations or the U.S. Government ceasing to provide adequate war risk insurance could increase our operating costs and result in service delays and disruptions.

Airlines are subject to extensive regulatory and legal requirements, both domestically and internationally, involving significant compliance costs. In the last several years, Congress has passed laws, and the agencies of the federal government, including, but not limited to, the DOT, FAA, CBP and the TSA have issued regulations relating to the operation of airlines that have required significant expenditures. We expect to continue to incur expenses in connection with complying with government regulations. Additional laws, regulations, taxes and airport rates and charges have been proposed from time to time that could significantly increase the cost of airline operations or reduce the demand for air travel. If adopted or materially amended, these measures could have the effect of raising ticket prices, reducing air travel demand and/or revenue and increasing costs. The FAA has published new regulations relating to crew rest requirements, which we are currently analyzing. Should the final rules require us to make significant changes to our crew rest requirements, our cost structure could be adversely affected. We cannot assure you these and other laws or regulations enacted in the future will not harm our business.

The U.S. Government currently provides insurance coverage for certain claims resulting from acts of terrorism, war or similar events. Should this coverage no longer be offered, the coverage that would be available to us through commercial aviation insurers may have substantially less desirable terms, result in higher costs and not be adequate to protect our risk, any of which could harm our business.

Compliance with future environmental regulations may harm our business.

Many aspects of airlines' operations are subject to increasingly stringent environmental regulations, and growing concerns about climate change may result in the imposition of additional regulation. There is growing consensus some form of federal regulation may be forthcoming with respect to greenhouse gas emissions (including carbon dioxide (CO2)) and/or "cap and trade" legislation, compliance with which could result in the creation of substantial additional costs to us. The U.S. Congress is considering climate change legislation and the Environmental Protection Agency issued a rule which regulates larger emitters of greenhouse gases. Since the domestic airline industry is increasingly price sensitive, we may not be able to recover the cost of compliance with new or more stringent environmental laws and regulations from our passengers, which could adversely affect our business. Although it is not expected the costs of complying with current environmental regulations will have a material adverse effect on our financial position, results of operations or cash flows, no assurance can be made the costs of complying with environmental regulations in the future will not have such an effect. The impact to us and our industry from such actions is likely to be adverse and could be significant, particularly if regulators were to conclude emissions from commercial aircraft cause significant harm to the upper atmosphere or have a greater impact on climate change than other industries.

Compliance with recently adopted DOT passenger protections rules may increase our costs and may ultimately negatively impact our operations.

The DOT's passenger protection rules, which became effective in April 2010, provide, among other things, that airlines return aircraft to the gate for deplaning following tarmac delays in certain circumstances. On October 29, 2011, a severe winter storm and multiple failures of critical navigational equipment in the New York City area, severely impacted air travel in the northeast which resulted in several flight diversions by JetBlue and many other domestic and international carriers to Hartford, CT's Bradley International Airport, or Bradley. JetBlue diverted a total of six flights to Bradley, five of which were held on the tarmac in excess of three hours, thus exceeding the DOT's established tarmac delay limits. As a result, the DOT is investigating these incidents and we may be subject to a monetary penalty. Based on the allowable maximum DOT fine proscribed by the Tarmac Delay regulations, we could be assessed a fine of up to approximately $15 million. We have issued compensation to the impacted customers in accordance with our Customer Bill of Rights, and are complying with the requests of the DOT investigation and believe the final determination from the DOT should be made in the next few months.

We could be adversely affected by an outbreak of a disease or an environmental disaster that significantly affects travel behavior.

In 2009, there was an outbreak of the H1N1 virus which had an adverse impact throughout our network, including on our operations to and from Mexico. Any outbreak of a disease (including a worsening of the outbreak of the H1N1 virus) affecting travel behavior could have a material adverse impact on us. In addition, outbreaks of disease could result in quarantines of our personnel or an inability to access facilities or our aircraft, which could adversely affect our operations. Similarly, if an environmental disaster were to occur and adversely impact any of our destination cities, travel behavior could be affected and in turn, could materially adversely impact our business.

The unknown impact from the Dodd-Frank Act as well as the rules to be promulgated under it could require the implementation of additional policies and require us to incur administrative compliance costs.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, or the Dodd-Frank Act, contains a variety of provisions designed to regulate financial markets. Many aspects of the Dodd-Frank Act remain subject to rulemaking that will take effect over several years, thus making it difficult to assess its impact on us at this time. We expect to successfully implement any new applicable legislative and regulatory requirements and may incur additional costs associated with our compliance with the new regulations and anticipated additional reporting and disclosure obligations; however, at this time we do not expect such costs to be material to us.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES
Aircraft
As of December 31, 2012, we operated a fleet consisting of 127 Airbus A320 aircraft each powered by two IAE International Aero Engines V2527-A5 engines and 53 EMBRAER 190 aircraft each powered by two General Electric Engines CF 34-10 engines:

Aircraft	Seating Capacity	Owned	Capital Leased	Operating Leased	Total	Average Age in Years
Airbus A320	150	93	4	30	127	7.4
EMBRAER 190	100	23	—	30	53	4.8
Totals		116	4	60	180	6.7

Our aircraft leases have an average remaining lease term of approximately 8.8 years at December 31, 2012. The earliest of these terms ends in 2014 and the latest ends in 2026. We have the option to extend most of these leases for additional periods or to purchase the aircraft at the end of the related lease term. All but 11 of our 116 owned aircraft and all but nine of our 38 owned spare engines are subject to secured debt financing.
In July 2012, we amended our EMBRAER purchase agreement accelerating the delivery of one aircraft to 2013, which was previously scheduled for delivery in 2014. Additionally, we extended the date for which we may elect not to further amend our purchase agreement to order a new EMBRAER 190 variant, if developed, to July 31, 2013. If not elected, seven EMBRAER 190 aircraft we previously deferred may either be returned to their previously committed to delivery dates in 2013 and 2014 or canceled and subject to cancellation fees. In December 2012, we further amended our EMBRAER purchase agreement accelerating the delivery of four aircraft from 2018 to 2013.
As of December 31, 2012, we had on order 115 aircraft, which are scheduled for delivery through 2021. Our aircraft delivery schedule is:

Year	Firm Airbus A320	Airbus A321	Airbus A320neo	EMBRAER 190	Total
2013	3	4	—	7	14
2014	—	9	—	1	10
2015	—	10	—	7	17
2016	3	7	—	8	18
2017	8	—	—	5	13
2018	—	—	10	3	13
2019	—	—	10	—	10
2020	—	—	10	—	10
2021	—	—	10	—	10
	14	30	40	31	115

Facilities

We occupy all of our facilities at each of the airports we serve under leases or other occupancy agreements. Our agreements for terminal passenger service facilities, which include ticket counter and gate space, operations support area and baggage service offices, generally have terms ranging from less than one year to five years, and contain provisions for periodic adjustments of rental rates, landing fees and other charges applicable under the type of lease. We also are responsible for maintenance, insurance, utilities and certain other facility-related expenses and services.

We have entered into use arrangements at each of the airports we serve providing for the non-exclusive use of runways, taxiways and other airport facilities. Landing fees under these agreements are typically based on the number of aircraft landings and the weight of the aircraft.

Our focus cities include New York, Boston, Long Beach, Orlando, Fort Lauderdale and San Juan, Puerto Rico.

In November 2005, we executed a lease agreement with the PANYNJ for the construction and operation of Terminal 5 which became our principal base of operations at JFK; we began to operate from it in October 2008. The lease term ends on October 22, 2038, the thirtieth anniversary of the date of our beneficial occupancy of this terminal, and we have a one-time early termination option five years prior to the end of the scheduled lease term. In December 2010, we executed a supplement to this lease agreement for the Terminal 6 property (our original base of operations at JFK) adjacent to our operations at Terminal 5 for a term of five years, which provides certain use and development rights. In 2012, we commenced construction on an expansion to Terminal 5, or T5i, which will be used as an international arrival facility.

Our operations at Boston’s Logan International Airport, or Logan, are based at Terminal C where we operate 17 gates and 42 ticket counter positions. In 2011, Massport completed work connecting two concourses within Terminal C, centralizing the security checkpoint and providing our customers the convenience of 14 contiguous gates.

Our West Coast operations are based at Long Beach Municipal Airport, or Long Beach, which serves the Los Angeles basin. We operate four gates at Long Beach. In 2010, the Long Beach Airport began work on redevelopment efforts, including a new parking structure and new terminal, which opened in December 2012.

In Florida, our primary operations are at Orlando International Airport, or Orlando, and Fort Lauderdale-Hollywood International Airport, or Fort Lauderdale. We operate from Terminal A in Orlando with eight domestic and one international gate. In Fort Lauderdale, we operate from Terminal 3 with seven domestic gates.

Our operations in San Juan, Puerto Rico are based at Luis Muñoz Marin International Airport, or San Juan. In June 2012, we relocated our San Juan operations to a newly renovated Terminal A with preferential use of seven gates.

We lease a 70,000 square foot aircraft maintenance hangar and an adjacent 32,000 square foot office and warehouse facility at JFK to accommodate our technical support operations and passenger provisioning personnel. The ground lease for this site expires in 2030. In addition, we occupy a building at JFK where we store aircraft spare parts and perform ground equipment maintenance. During 2012, we moved to Hangar 8 in Boston, a total of approximately 80,000 square feet of space, which includes an aircraft maintenance hangar and office space. The ground lease for this site expires in 2017.

We also occupy a training center at Orlando International Airport which is equipped with seven full flight simulators, two cabin trainers, a training pool, classrooms and support areas. This facility is being used for the initial and recurrent training of our pilots and in-flight crew, as well as support training for our technical operations and airport crew. In addition, we lease a 70,000 square foot hangar at Orlando International Airport which is used by Live TV for the installation and maintenance of in-flight satellite television systems and aircraft maintenance. The ground leases for our Orlando support facilities expire in 2035.

As of December 31, 2012, our primary corporate offices were located in Long Island City, New York, where we occupy space under a lease that expires in 2023. Our office in Salt Lake City, Utah, where we occupy space under a lease that expires in 2014, contains a core team of employees who are responsible for group sales, customer service, at-home reservation agent supervision, disbursements and certain other finance functions.

At most other locations, our passenger and baggage handling space is leased directly from the airport authority on varying terms dependent on prevailing practice at each airport. We also maintain administrative offices, terminal, and other airport facilities, training facilities, maintenance facilities, and other facilities, in each case as necessary to support our operations in the cities we serve.

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ITEM 3. LEGAL PROCEEDINGS

In the ordinary course of our business, we are party to various legal proceedings and claims which we believe are incidental to the operation of our business. Other than as described under Note 12-Contingencies to our consolidated financial statements included in Part II, Item 8 of this Annual Report on Form 10-K, we believe the ultimate outcome of these proceedings to which we are currently a party will not have a material adverse effect on our business, financial position, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

EXECUTIVE OFFICERS OF THE REGISTRANT

Certain information concerning JetBlue’s executive officers as of the date of this report follows. There are no family relationships between any of our executive officers.

David Barger, age 55, is our President and Chief Executive Officer. He has served in this capacity since May 2007 and as President since June 2009. He is also a member of our Board of Directors. He previously served as our President from August 1998 to September 2007 and Chief Operating Officer from August 1998 to March 2007. From 1992 to 1998, Mr. Barger served in various management positions with Continental Airlines, including Vice President, Newark hub. He held various director level positions at Continental Airlines from 1988 to 1995. From 1982 to 1988, Mr. Barger served in various positions with New York Air, including Director of Stations.

Mark D. Powers, age 59, is our Chief Financial Officer, a position he has held since April 2012. Mr. Powers joined us in July 2006 as Treasurer and Vice President, Corporate Finance. He was promoted to Senior Vice President, Treasurer in 2007. Prior to joining JetBlue, Mr. Powers was an independent advisor to several aviation-related companies and has held a number of positions in both the finance and legal departments of Continental Airlines, Northwest Airlines and General Electric's jet engine unit.

Rob Maruster, age 41, is our Executive Vice President and Chief Operating Officer and has served in this capacity since June 2009. Mr. Maruster joined JetBlue in 2005 as Vice President, Operations Planning, after a 12-year career with Delta Air Lines in a variety of leadership positions with increasing responsibilities in the carrier’s Marketing and Customer Service departments, culminating in being responsible for all operations at Delta’s largest hub as Vice President, Airport Customer Service at Hartsfield-Jackson Atlanta International Airport. In 2006, Mr. Maruster was promoted to Senior Vice President, Airports and Operational Planning and in 2008, Mr. Maruster’s responsibilities expanded to include the Customer Services group which included Airports, Inflight Services, Reservations, and System Operations.

Robin Hayes, age 46, is our Executive Vice President and Chief Commercial Officer. He joined JetBlue in August 2008 after nineteen years at British Airways. In his last role at British Airways, Mr. Hayes served as Executive Vice President for The Americas and before that he served in a number of operational and commercial positions in the UK and Germany.

James Hnat, age 42, is our Executive Vice President Corporate Affairs, General Counsel and Secretary and has served in this capacity since April 2007. He served as our Senior Vice President, General Counsel and Assistant Secretary since March 2006 and as our General Counsel and Assistant Secretary from February 2003 to March 2006. Mr. Hnat is a member of the bar of New York and Massachusetts.

Don Daniels, age 45, is our Vice President and Chief Accounting Officer, a position he has held since May 2009. He served as our Vice President and Corporate Controller since October 2007. He previously served as our Assistant Controller since July 2006 and Director of Financial Reporting since October 2002.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY; RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the NASDAQ Global Select Market under the symbol JBLU. The table below shows the high and low sales prices for our common stock.

	High	Low
2011 Quarter Ended		
March 31	$7.13	$5.44
June 30	6.38	5.35
September 30	6.26	3.86
December 31	5.65	3.40
2012 Quarter Ended		
March 31	$6.32	$4.73
June 30	5.44	4.06
September 30	5.94	4.76
December 31	5.99	4.77

As of January 31, 2013, there were approximately 726 holders of record of our common stock.

We have not paid cash dividends on our common stock and have no current intention of doing so. Any future determination to pay cash dividends will be at the discretion of our Board of Directors, subject to applicable limitations under Delaware law, and will be dependent upon our results of operations, financial condition and other factors deemed relevant by our Board of Directors.

Purchases of Equity Securities by the Issuer and Affiliated Purchases

Period	Total Number of Shares Purchased	Average price paid per share	Total number of shares purchased as part of publicly announced program	Maximum number of shares that may yet to be purchased under the program
October 2012 (1)	—	$—	—	
November 2012 (1)	478,881	$5.11	478,881	
December 2012 (1)	3,598,764	$5.59	3,598,764	
Total	4,077,645	$5.53	4,077,645	20,922,355

(1) In September 2012, our Board of Directors approved a share repurchase program for up to 25 million shares over a five year period. The repurchases may be commenced or suspended from time to time without prior notice. The shares repurchased under our share repurchase program were purchased in open market transactions and are held as treasury stock.

Stock Performance Graph

This performance graph shall not be deemed "filed" with the SEC or subject to Section 18 of the Exchange Act, nor shall it be deemed incorporated by reference in any of our filings under the Securities Act of 1933, as amended.

The following line graph compares the cumulative total stockholder return on our common stock with the cumulative total return of the Standard & Poor's 500 Stock Index and the NYSE Arca Airline Index from December 31, 2007 to December 31, 2012. The comparison assumes the investment of $100 in our common stock and in each of the foregoing indices and reinvestment of all dividends. The stock performance shown represents historical performance and is not representative of future stock performance.

	12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012
JetBlue Airways Corporation	$100	$120	$92	$112	$88	$97
S&P 500 Stock Index	100	63	80	92	94	109
NYSE Arca Airline Index (1)	100	71	99	137	95	129

(1) As of December 31, 2012, the NYSE Arca Airline Index consisted of Alaska Air Group Inc., AMR Corporation, Copa Holdings S.A., Delta Air Lines, Inc., Gol Linhas Aereas Inteligentes S.A., Hawaiian Holdings, JetBlue Airways Corporation, US Airways Group, Inc., LAN Airlines S.A., Southwest Airlines Company, Republic Airways Holding, Inc., Ryanair Holdings Ads., SkyWest, Inc, TAM S.A., and UAL Corporation.

ITEM 6. SELECTED FINANCIAL DATA

The following financial information for the five years ended December 31, 2012 has been derived from our consolidated financial statements. This information should be read in conjunction with the consolidated financial statements and related notes thereto included elsewhere in this report.

	2012	2011	2010	2009	2008
Statements of Operations Data:					
Operating revenues	$4,982	$4,504	$3,779	$3,292	$3,392
Operating expenses:					
Aircraft fuel and related taxes	1,806	1,664	1,115	945	1,397
Salaries, wages and benefits (1)	1,044	947	891	776	694
Landing fees and other rents	277	245	228	213	199
Depreciation and amortization (2)	258	233	220	228	205
Aircraft rent	130	135	126	126	129
Sales and marketing	204	199	179	151	151
Maintenance materials and repairs	338	227	172	149	127
Other operating expenses (3)	549	532	515	419	377
Total operating expenses	4,606	4,182	3,446	3,007	3,279
Operating income	376	322	333	285	113
Other income (expense) (4)	(167)	(177)	(172)	(181)	(202)
Income (loss) before income taxes	209	145	161	104	(89)
Income tax expense (benefit)	81	59	64	43	(5)
Net income (loss)	$128	$86	$97	$61	$(84)
Earnings (loss) per common share:					
Basic	$0.45	$0.31	$0.36	$0.24	$(0.37)
Diluted	$0.40	$0.28	$0.31	$0.21	$(0.37)
Other Financial Data:					
Operating margin	7.5%	7.1%	8.8%	8.6%	3.3%
Pre-tax margin	4.2%	3.2%	4.3%	3.2%	(2.6)%
Ratio of earnings to fixed charges (5)	1.75x	1.52x	1.59x	1.33x	—
Net cash provided by (used in) operating activities	$698	$614	$523	$486	$(17)
Net cash used in investing activities	(867)	(502)	(696)	(457)	(247)
Net cash provided by (used in) financing activities	(322)	96	(258)	306	635

(1) In 2010, we incurred approximately $9 million in one-time implementation expenses related to our new customer service system.

(2) In 2008, we wrote-off $8 million related to our temporary terminal facility at JFK.

(3) In 2012, we sold six spare engines and two aircraft resulting in gains of approximately $10 million. Additionally, in 2012, LiveTV terminated a customer contract resulting in a gain of approximately $8 million. In 2009, 2008 and 2007, we sold two, nine and three aircraft, respectively, which resulted in gains of $1 million, $23 million and $7 million, respectively. In 2010, we recorded an impairment loss of $6 million related to the spectrum license held by our LiveTV subsidiary. In 2010, we also incurred approximately $13 million in one-time implementation expenses related to our new customer service system.

(4) In 2012, we recorded a net of $1 million in losses related to the early extinguishment of $220 million in principal of debt securing nine aircraft. In 2011, we recorded $6 million loss related to the repurchase of $39 million

principal amount of our 6.75% convertible debentures due 2039. In 2008, we recorded $13 million in additional interest expense related to the early conversion of a portion of our 5.5% convertible debentures due 2038 and a $14 million gain on extinguishment of debt. In 2008, we recorded a holding loss of $53 million related to the valuation of our auction rate securities.

(5) Earnings were inadequate to cover fixed charges by $135 million for the year ended December 31, 2008.

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	As of December 31,				
	2012	2011	2010	2009	2008
	(in millions)				
Balance Sheet Data:					
Cash and cash equivalents	$182	$673	$465	$896	$561
Investment securities	685	591	628	246	244
Total assets	7,070	7,071	6,593	6,549	6,018
Total debt	2,851	3,136	3,033	3,304	3,144
Common stockholders’ equity	1,888	1,757	1,654	1,546	1,270
	Year Ended December 31,				
	2012	2011	2010	2009	2008
Operating Statistics (unaudited):					
Revenue passengers (thousands)	28,956	26,370	24,254	22,450	21,920
Revenue passenger miles (millions)	33,563	30,698	28,279	25,955	26,071
Available seat miles (ASMs) (millions)	40,075	37,232	34,744	32,558	32,442
Load factor	83.8 %	82.4 %	81.4 %	79.7 %	80.4 %
Aircraft utilization (hours per day)	11.8	11.7	11.6	11.5	12.1
Average fare	$157.11	$154.74	$140.69	$130.67	$139.56
Yield per passenger mile (cents)	13.55	13.29	12.07	11.30	11.73
Passenger revenue per ASM (cents)	11.35	10.96	9.82	9.01	9.43
Operating revenue per ASM (cents)	12.43	12.10	10.88	10.11	10.45
Operating expense per ASM (cents)	11.49	11.23	9.92	9.24	10.11
Operating expense per ASM, excluding fuel (cents)	6.99	6.76	6.71	6.33	5.80
Operating expense per ASM, excluding fuel & profit sharing (cents)	6.98	6.76	6.71	6.33	5.80
Airline operating expense per ASM (cents) (6)	11.34	11.06	9.71	8.99	9.87
Departures	264,600	243,446	225,501	215,526	205,389
Average stage length (miles)	1,085	1,091	1,100	1,076	1,120
Average number of operating aircraft during period	173.9	164.9	153.5	148.0	139.5
Average fuel cost per gallon, including fuel taxes	$3.21	$3.17	$2.29	$2.08	$3.08
Fuel gallons consumed (millions)	563	525	486	455	453
Full-time equivalent employees at period end (6)	12,070	11,733	11,121	10,704	9,895

(6) Excludes results of operations and employees of LiveTV, LLC, which are unrelated to our airline operations and are immaterial to our consolidated operating results.

The following terms used in this section and elsewhere in this report have the meanings indicated below:
“Revenue passengers” represents the total number of paying passengers flown on all flight segments.
“Revenue passenger miles” represents the number of miles flown by revenue passengers.
“Available seat miles” represents the number of seats available for passengers multiplied by the number of miles the seats are flown.

“Load factor” represents the percentage of aircraft seating capacity actually utilized (revenue passenger miles divided by available seat miles).
“Aircraft utilization” represents the average number of block hours operated per day per aircraft for the total fleet of aircraft.
“Average fare” represents the average one-way fare paid per flight segment by a revenue passenger.

“Yield per passenger mile” represents the average amount one passenger pays to fly one mile.
“Passenger revenue per available seat mile” represents passenger revenue divided by available seat miles.
“Operating revenue per available seat mile” represents operating revenues divided by available seat miles.
“Operating expense per available seat mile” represents operating expenses divided by available seat miles.
“Operating expense per available seat mile, excluding fuel” represents operating expenses, less aircraft fuel, divided by available seat miles.
“Average stage length” represents the average number of miles flown per flight.
“Average fuel cost per gallon” represents total aircraft fuel costs, including fuel taxes and effective portion of fuel hedging, divided by the total number of fuel gallons consumed.

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

In 2012, we executed on our plans for sustainable, profitable growth while continuing to strengthen our balance sheet and improve our operating margin. Every day, we commit to delivering a safe and reliable JetBlue Experience to our customers while maintaining a competitive cost advantage and improving returns for our shareholders.

2012 Highlights and Accomplishments

- We reported our fourth consecutive year of net income and our highest earnings per diluted share, $0.40, since 2003, and generated record revenues of nearly $5 billion.
- We improved our return on invested capital, or ROIC, by approximately one percentage point even as we grew our operations, increasing capacity by 8%.
- We generated $698 million in cash from operations while strengthening our balance sheet with increased lines of credit and reductions to our overall debt balance.
- We expanded our portfolio of commercial airline partnerships, adding eight new airline partnerships during the year, bringing our total to 22 airline partnerships as of December 31, 2012.
- We further solidified our position as New York's hometown airline with the opening of our new headquarters in Long Island City and as we commenced construction of an international arrivals facility at John F. Kennedy International Airport, or JFK.
- We were recognized by J.D. Power and Associates for the eighth consecutive year as the “Highest in Airline Customer Satisfaction among Low-Cost Carriers.”
- We preserved the direct relationship with our Crewmembers, an important driver of our culture and brand.

We continue to deliver a unique JetBlue Experience to our customers with the superior service they have come to expect from us. In addition, our commitment to deliver increased returns for our shareholders remains at the core of our overall business strategy. We believe our continued focus on financial discipline, product innovation and network enhancements, combined with our service excellence, will drive our future success. Some of our major initiatives are described below.

Strengthening of our Balance Sheet

Throughout 2012, we were focused on strengthening our balance sheet. We believe we made significant progress in doing so, and we remain committed to further improving our balance sheet. We ended the year with unrestricted cash, cash equivalents and short-term investments at approximately 15% of trailing twelve months revenue. During 2012, we prudently used cash to invest in our business while maintaining a solid liquidity profile. Throughout the year, we reduced our overall debt balance by $285 million while increasing our total property and equipment by nearly 10%. Our investments also included capital spending for slot acquisitions, our international arrival facility at JFK and aircraft prepayments. We believe spending wisely now will generate future returns, through balance sheet improvements and, ultimately, by helping us maintain the flexibility to be able to take advantage of future growth opportunities. Additionally, in September 2012, our Board of Directors approved a share repurchase program for up to 25 million shares over a five year period. During the fourth quarter of 2012, we repurchased approximately 4.1 million shares of our common stock for $23 million.

Airport Infrastructure Investments

During 2012, we made significant airport infrastructure enhancements in several of our focus cities. In San Juan, we moved into a larger space in the all-new Terminal A at Luis Muñoz Marin International Airport. In Boston, we opened a newly renovated hangar to support our growing operations. In New York, we commenced construction of a new international arrival extension to our existing Terminal 5 at JFK. The creation of a new dedicated site to handle U.S. Customs and Border Protection checks at Terminal 5 will eliminate the need for our international customers to arrive at an often slow Terminal 4. In Long Beach, we moved into our own concourse in the newly modernized terminal facility.

Network Initiatives

We continue to make network adjustments in furtherance of our overall network growth plans. Our network focus over the past several years has primarily been on Boston and the Caribbean and Latin America. We feel there remains opportunity to

grow our revenue in these regions due to our differentiated product offerings. In Boston, for example, with our product and network enhancements, we have been able to better accommodate business customers which has helped us to build revenue momentum from corporate share gains.
Throughout 2012, we continued to improve our relevance to business customers in Boston. We offer non-stop service to more destinations from Boston's Logan International Airport than any other carrier at Boston. East Coast short-haul markets in Boston were the best performing region in our network during 2012, as measured by year over year unit revenue growth, even while we added significant capacity.
Our growth in the Caribbean and Latin America also continued in 2012; we now have approximately 27% of our capacity in this important region. We remain focused on growing our network and further reducing seasonality by targeting new customers, including leisure travelers, business travelers, visiting friends and relatives, or VFR, traffic and international airline partners.

New Service

As part of our ongoing network initiatives and route optimization efforts, we continued to make schedule and frequency adjustments throughout 2012. In Boston, particularly, we did so to better accommodate business customers and increase our relevance. During 2012, we commenced service to five new destinations: Dallas/Fort Worth, Texas, Cartagena, Colombia, Samana, Dominican Republic, Grand Cayman, Cayman Islands and Providence, Rhode Island. Additionally, we have announced plans to begin service to the following destinations in 2013: Charleston, South Carolina, Albuquerque, New Mexico, Philadelphia, Pennsylvania and Medellin, Colombia. Our growth includes adding new routes between existing cities. Our commitment to profitable growth also resulted in the discontinuation of certain routes and reduced service in our network throughout 2012.

Ancillary Revenue Initiatives

Our ancillary revenue initiatives are focused on increasing high margin revenue streams. Our EvenMore™ product continued to be successful throughout 2012. We reconfigured our EMBRAER 190 fleet, converting eight seats per aircraft to EvenMore™ Space seats. Additionally, we began selling EvenMore™ Speed, our expedited security option, on a standalone basis in most of our U.S. domestic locations.
During 2012, we introduced a new badge to our TrueBlue frequent flyer program called Mosaic, which is designed to recognize and reward our most loyal customers. The program's enhancements include early boarding and a free second checked bag, among many others. We also launched a new co-branded credit card exclusively for residents of Puerto Rico, where we are the largest carrier, which will allow residents to enjoy the full benefits of our TrueBlue loyalty program.

Outlook for 2013

As we enter 2013, we believe we are well positioned to build upon our 2012 performance. We aim to deliver improved year over year margins and increased returns for our shareholders. Our 2013 plan aims to achieve these goals and assumes we are able to maintain our competitive cost advantage and build upon our high-value network. We plan to introduce new service as well as expand our portfolio of commercial airline partnerships during 2013. We continuously look to expand our other ancillary revenue opportunities, including our EvenMore™ product offering and improving our TrueBlue loyalty program. We also remain committed to strengthening our balance sheet and prudently investing in infrastructure and product enhancements to enable us to reap future benefits.
For the full year, we estimate our operating capacity to increase approximately 5.5% to 7.5% over 2012 with the net addition of three Airbus A320 aircraft and seven EMBRAER 190 aircraft to our operating fleet. We will also take delivery of our first four Airbus A321 aircraft in the latter part of 2013. The entry into service date of the Airbus A321 will depend on the timing and successful completion of the FAA certification process. Assuming fuel prices of $3.24 per gallon, net of our fuel hedging activity, our cost per available seat mile for 2013 is expected to increase by 1.5% to 3.5% over 2012. This expected increase is primarily a result of continued maintenance cost pressures associated with the aging of our fleet. Additionally, salaries, wages and benefits are expected to increase due to the increasing tenure of our Crewmembers combined with efforts to maintain competitiveness of our compensation packages.

RESULTS OF OPERATIONS

Year 2012 Compared to Year 2011

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We reported net income of $128 million in 2012 compared to net income of $86 million in 2011. In 2012, we had operating income of $376 million, an increase of $54 million over 2011, and an operating margin of 7.5%, up 0.4 points from 2011. Diluted earnings per share were $0.40 for 2012 compared to diluted earnings per share of $0.28 for 2011.

During 2012, despite uncertain economic conditions, a severe hurricane hitting the core of our operations and the persistent competitiveness of the airline industry, we managed to produce solid financial results. We generated consistent unit revenue growth throughout the year by continuing to manage the structure and mix of our network. We further complemented our historically leisure focused travel markets with higher yielding business markets. Our efforts to capitalize on key growth regions were primarily focused in Boston and the Caribbean region, which resulted in increased capacity during 2012.

Our on-time performance, defined by the DOT as arrivals within 14 minutes of schedule, was 79.1% in 2012 compared to 73.3% in 2011. While improved in 2012, our on-time performance throughout the year and on a year-over-year basis remained challenged by our concentration of operations in the northeast United States, which contains some of the most congested and delay-prone airports in the U.S.

2012 vs. 2011 Highlights

- During the fourth quarter of 2012, Hurricane Sandy directly and significantly impacted our operations, closing many East Coast airports for several days. We canceled approximately 1,700 flights over a six day period.
- Operating capacity increased approximately 8% to 40.08 billion available seat miles in 2012.
- Average fares for the year increased 2% to $157, which also resulted in an increase of $4 million in associated credit card fees.
- Operating expenses per available seat mile increased 2% to 11.49 cents. Excluding fuel, our cost per available seat mile increased 3% in 2012.
- Invested in four new owned EMBRAER 190 aircraft and seven new owned Airbus A320 aircraft. Eight of these aircraft were debt financed.
- Commenced service to five new cities during 2012. Total departures increased 9%.
- Extended the leases on three aircraft during 2012 at lower rates.
- The average age of our fleet increased to 6.7 years, and as of December 31, 2012, our oldest operating aircraft had an age of 13.1 years.
- Early extinguishment of approximately $220 million in principal of long-term debt resulted in a net of $1 million in losses recorded in interest income and other.

Operating Revenues

(Revenues in millions)			Year-over-Year Change	
	2012	2011	$	%
Passenger Revenue	$4,550	$4,080	$470	11.5
Other Revenue	432	424	8	2.0
Operating Revenues	$4,982	$4,504	$478	10.6
Average Fare	$157.11	$154.74	2.37	1.5
Yield per passenger mile (cents)	13.55	13.29	0.26	2.0
Passenger revenue per ASM (cents)	11.35	10.96	0.39	3.6
Operating revenue per ASM (cents)	12.43	12.10	0.33	2.8
Average stage length (miles)	1,085	1,091	(6)	(0.5)
Revenue passengers (thousands)	28,956	26,370	2,586	9.8
Revenue passenger miles (millions)	33,563	30,698	2,865	9.3
Available Seat Miles (ASMs)	40,075	37,232	2,843	7.6
Load Factor	83.8 %	82.4 %		1.4 pts

We derive our revenue primarily from transporting passengers on our aircraft. Passenger revenue accounted for 91% of our total operating revenues for the year ended December 31, 2012. Revenues generated from international routes, including

Puerto Rico, accounted for 26% of our total passenger revenues in 2012. Revenue is recognized either when transportation is provided or after the ticket or customer credit expires. We measure capacity in terms of available seat miles, which represents the number of seats available for passengers multiplied by the number of miles the seats are flown. Yield, or the average amount one passenger pays to fly one mile, is calculated by dividing passenger revenue by revenue passenger miles. We attempt to increase passenger revenue primarily by increasing our yield per flight which produces higher revenue per available seat mile, or RASM. Our objective is to optimize our fare mix to increase our overall average fare while continuing to provide our customers with competitive fares. Passenger revenue also includes revenue from our EvenMore™ Space ancillary product offering.

In 2012, the increase in passenger revenues was mainly attributable to the increased capacity and increase in yield. Our EvenMore™ Space seats continued to be a significant ancillary product, generating approximately $150 million in revenue, an increase of approximately 19% over 2011 primarily as a result of additional EvenMore™ Space seats on our EMBRAER 190 fleet, increased capacity and revised pricing.

Other revenue consists primarily of fees charged to customers in accordance with our published policies. These include reservation changes and baggage limitations, EvenMore™ Speed expedited security, the marketing component of TrueBlue point sales, concession revenues, revenues associated with transporting mail and cargo, revenues associated with the ground handling of other airlines and rental income. Revenues earned by our subsidiary, LiveTV, LLC, for the sale of, and on-going services provided for, in-flight entertainment systems on other airlines are also included in Other Revenue.

Other revenue increased primarily as a result of an $18 million increase in revenues from certain passenger related fees such as change fees and excess baggage. These increased fees were slightly offset by a $10 million guarantee recorded in 2011 related to our co-branded credit card.

Operating Expenses

(dollars in millions)			Year-over-Year Change		per ASM		
	2012	2011	$	%	2012	2011	% Change
Aircraft fuel and related taxes	$1,806	$1,664	$142	8.6	4.50	4.47	0.9
Salaries, wages and benefits	1,044	947	97	10.3	2.60	2.54	2.4
Landing fees and other rents	277	245	32	12.8	0.69	0.66	4.8
Depreciation and amortization	258	233	25	10.5	0.65	0.63	2.7
Aircraft rent	130	135	(5)	(3.6)	0.33	0.36	(10.4)
Sales and marketing	204	199	5	3.0	0.51	0.53	(4.3)
Maintenance materials and repairs	338	227	111	48.4	0.84	0.61	37.9
Other operating expenses	549	532	17	3.2	1.37	1.43	(4.1)
Total operating expenses	$4,606	$4,182	$424	10.1	11.49	11.23	2.3

Aircraft Fuel and Hedging

The price and availability of aircraft fuel are extremely volatile due to global economic and geopolitical factors we can neither control nor accurately predict. During 2012 fuel prices remained volatile, increasing 1% over average 2011 prices. We maintain a diversified fuel hedge portfolio by entering into a variety of fuel hedge contracts in order to provide some protection against sharp and sudden volatility and further increases in fuel prices. In total, we hedged 30% of our total 2012 fuel consumption. We also use fixed forward price agreements, or FFPs, which allow us to lock in a price for fixed quantities of fuel to be delivered at a specified date in the future, to manage fuel price volatility. As of December 31, 2012, we had outstanding fuel hedge contracts covering approximately 8% of our forecasted consumption for the first quarter of 2013 and 5% for the full year 2013. As of December 31, 2012, we had 6% of our 2013 fuel consumption requirements covered under FFPs. In January and February 2013, we entered into jet fuel swap and cap agreements covering an additional 6% of our 2013 forecasted consumption. We will continue to monitor fuel prices closely and intend to take advantage of reasonable fuel hedging opportunities as they become available.

Aircraft fuel expense represented approximately 40% of our total operating expenses. The increase in year-over-year average fuel cost per gallon resulted in $20 million of higher fuel expense. Additionally, we consumed 38 million more gallons of aircraft fuel, resulting in $122 million of higher fuel expense. Based on our expected fuel volume for 2013, a 10% per gallon increase in the cost of aircraft fuel would increase our annual fuel expense by approximately $190 million.

During 2012, we recorded $10 million in effective fuel hedge gains which offset fuel expense; this compares to $3 million in 2011. Fuel derivatives not qualifying as cash flow hedges in 2012 resulted in approximately $3 million in losses recorded in interest income and other, compared to an insignificant amount in 2011. Accounting ineffectiveness on fuel derivatives classified as cash flow hedges resulted in insignificant losses in 2012 and $2 million in 2011, recorded in interest income and other. We are unable to predict what the amount of ineffectiveness will be related to these instruments, or the potential loss of hedge accounting which is determined on a derivative-by-derivative basis, due to the volatility in the forward markets for these commodities.

Salaries, Wages and Benefits

The increasing tenure of our Crewmembers, rising healthcare costs and efforts to maintain competitiveness in our overall compensation packages are presenting cost pressures. In an attempt to proactively manage future increases in healthcare costs as a result of new healthcare reform legislation and impending tax increases, we comprehensively re-designed our 2013 healthcare plans.

During 2012, the average number of full-time equivalent employees increased by 4% resulting in an increase to salaries, wages and benefits. The average tenure of our Crewmembers increased to 5.6 years as of December 31, 2012 resulting in an increase to average wages and benefits per full-time equivalent employees. As a result of increased wages, our guaranteed 5% retirement contribution, which we refer to as Retirement Plus, to all of our eligible Crewmembers increased by $3 million. Our increased profitability resulted in $3 million of profit sharing expense to be paid to our Crewmembers in March 2013. During 2012, we also introduced a Retirement Advantage program, providing an additional 3% retirement contribution for certain of our FAA-licensed Crewmembers, which resulted in $4 million of increased expense.

Maintenance Materials and Repairs

Maintenance materials and repairs are generally expensed when incurred unless covered by a long-term flight hour services contract. Because the average age of our aircraft of 6.7 years is relatively young, all of our aircraft currently require less maintenance than the fleet of many of our competitors. As our fleet ages, our maintenance costs will increase significantly, both on an absolute basis and as a percentage of our unit costs, as older aircraft require additional, more expensive repairs over time.

In addition to the increase in operating aircraft and the aging of our fleet, several aircraft coming off of warranty contributed to higher maintenance costs in 2012. Additionally, one of our key engine and component repair maintenance providers liquidated during the first quarter of 2012. We believe the overall impact of the liquidation was approximately $10 million in more costly repairs while we found alternative providers. During the third and fourth quarter of 2012, we engaged new maintenance providers to replace the liquidated provider. These new maintenance providers will provide similar services at competitive rates. We are also working on a long-term maintenance agreement for our EMBRAER 190 aircraft components, which are currently not covered under a maintenance agreement. We believe expanding the scope of our maintenance services covered under long-term agreements will help us to better manage and predict maintenance costs over time.

We are continuously exploring opportunities to mitigate and level the increase in maintenance expense, including by improving operational efficiencies. We also continue to work with our various maintenance repair partners and manufacturers; most recently we entered into an agreement to mitigate the risk of cost overruns associated with our EMBRAER 190 heavy maintenance checks. We expect the rate of increase in maintenance expense to lessen in the next few years as the heavy maintenance hurdle from our mid-2000 aircraft deliveries subsides and we benefit from new maintenance agreements for both our A320 and E190 fleets.

Other Operating Expenses

Other operating expenses consist of purchased services (including expenses related to fueling, ground handling, skycap, security and janitorial services), insurance, personnel expenses, cost of goods sold to other airlines by LiveTV, professional fees, passenger refreshments, supplies, bad debts, communication costs and taxes other than payroll and fuel taxes. During 2012, we had several non-recurring items impacting other operating expenses. LiveTV terminated a customer contract resulting in a gain of approximately $8 million. We sold two EMBRAER 190 aircraft and six spare aircraft engines resulting in a gain of approximately $10 million.

Income Taxes

Our effective tax rate was 39% in 2012 compared to 41% in 2011. Our effective tax rate differs from the statutory income tax rate primarily due to state income taxes and the non-deductibility of certain items for tax purposes as well as the relative size of these items to our 2012 pre-tax income of $209 million and our 2011 pre-tax income of $145 million. The rate decrease was attributable to reductions in certain non-deductible items and the relative size of these items to our pre-tax income.

Year 2011 Compared to Year 2010

We reported net income of $86 million in 2011 compared to net income of $97 million in 2010. In 2011, we had operating income of $322 million, a decrease of $11 million over 2010, and an operating margin of 7.1%, down 1.7 points from 2010. Diluted earnings per share were $0.28 for 2011 compared to diluted earnings per share of $0.31 for 2010.

We generated consistent unit revenue growth throughout the year by managing our network and balancing the seasonality created by our highly leisure focused business. We complemented our leisure travel markets with higher yielding business markets and capitalized on key growth regions, primarily Boston and the Caribbean, which resulted in increased capacity.

Our on-time performance, defined by the DOT as arrivals within 14 minutes of schedule, was 73.3% in 2011 compared to 75.7% in 2010. Our on-time performance throughout the year and on a year-over-year basis remained challenged by our significant operations in the northeast United States.

2011 vs 2010 Highlights

- During the first quarter of 2011, the winter storm season was extremely severe. The operational impact of the severe storm season pressured our CASM, excluding fuel, and negatively impacted our completion factor.
- During the third quarter of 2011, Hurricane Irene severely impacted our operations as its path travelled directly through the core of our network. Flights were suspended in New York and Boston, resulting in approximately 1400 cancellations over a three day period.
- Operating capacity increased approximately 7% to 37.23 billion available seat miles in 2011.
- Average fares for the year increased 10% over 2010 to $155, which also resulted in an increase of $14 million in associated credit card fees.
- Operating expenses per available seat mile increased 13% to 11.23 cents. Excluding fuel, our cost per available seat mile increased 0.9% in 2011.
- Invested in five new owned EMBRAER 190 aircraft and four new owned Airbus A320 aircraft, all of which were debt financed.
- Opened seven new cities in 2011. Total departures increased 8%.
- Extended the leases on four aircraft during 2011 at lower rates.
- The average age of our fleet increased to 6.1 years, and as of December 31, 2011, our oldest operating aircraft had an age of 12.1 years.
- In 2010, we had several items impacting other operating expenses which did not recur in 2011.
  We incurred approximately $13 million in one-time implementation expenses related to our new customer service system.
  We recorded a $6 million one-time impairment expense related to the intangible assets and other costs associated with developing an air to ground connectivity capability.
  We paid a $5 million rescheduling fee in connection with the deferral of aircraft.
- Early extinguishment of $39 million par value of our 6.75% Series A convertible debt due 2039 resulted in $6 million in losses recorded in interest income and other.

Operating Revenues

(Revenues in millions)			Year-over-Year Change	
	2011	2010	$	%
Passenger Revenue	4,080	3,412	668	19.6
Other Revenue	424	367	57	15.3
Operating Revenues	4,504	3,779	725	19.2
Average Fare	154.74	140.69	14.05	10.0
Yield per passenger mile (cents)	13.29	12.07	1.22	10.2
Passenger revenue per ASM (cents)	10.96	9.82	1.14	11.6
Operating revenue per ASM (cents)	12.10	10.88	1.22	11.2
Average stage length (miles)	1,091	1,100	(9)	(0.8)
Revenue passengers (thousands)	26,370	24,254	2.116	8.7
Revenue passenger miles (millions)	30,698	28,279	2,419	8.6
Available Seat Miles (ASMs)	37,232	34,744	2,488	7.2
Load Factor	82.4 %	81.4 %		1.0 pts

Passenger revenues increased 20% mainly attributable to the capacity increase along with the increase in yield. Revenue from our Even More Space seats increased $36 million as a result of increased capacity and revised pricing. Other revenue increased 15% as a result of a $17 million increase in marketing related revenues as well as an $18 million increase in revenues from certain passenger related fees such as change fees and excess baggage. LiveTV third party revenues increased approximately $14 million.

Operating Expenses

(dollars in millions)			Year-over-Year Change		per ASM		
	2011	2010	$	%	2011	2010	% Change
Aircraft fuel and related taxes	$1,664	$1,115	$549	49.2	4.47	3.21	39.2
Salaries, wages and benefits	947	891	56	6.2	2.54	2.57	(0.9)
Landing fees and other rents	245	228	17	7.9	0.66	0.65	0.7
Depreciation and amortization	233	220	13	6.3	0.63	0.63	(0.8)
Aircraft rent	135	126	9	7.1	0.36	0.36	—
Sales and marketing	199	179	20	10.9	0.53	0.52	3.5
Maintenance materials and repairs	227	172	55	32.1	0.61	0.50	23.3
Other operating expenses	532	515	17	3.4	1.43	1.48	(3.5)
Total operating expenses	$4,182	$3,446	$736	21.4	11.23	9.92	13.3

Aircraft Fuel and Hedging

Aircraft fuel expense increased 49%, and represented approximately 40% of our total operating expenses. Average fuel cost per gallon increased 38% to $3.17 compared to $2.29 in 2010, resulting in $461 million of higher fuel expense. Additionally, we consumed 39 million more gallons of aircraft fuel, resulting in $88 million of higher fuel expense.

We hedged approximately 43% of our total 2011 fuel consumption. We recorded $3 million in effective fuel hedge gains, which offset fuel expense, versus $3 million in effective fuel hedge losses during 2010, which were an increase to fuel expense. Accounting ineffectiveness on fuel derivatives classified as cash flow hedges resulted in losses of $2 million in each of 2011 and 2010, recorded in interest income and other. We are unable to predict what the amount of ineffectiveness will be related to

these instruments, or the potential loss of hedge accounting which is determined on a derivative-by-derivative basis, due to the volatility in the forward markets for these commodities.

Salaries, Wages and Benefits

The increase in salaries, wages and benefits was primarily due to a 5% increase in the number of average number of full-time equivalent employees needed to support our profitable growth plans. The increasing seniority levels of our Crewmembers combined with pay and benefit increases also contributed to higher expense.

Maintenance Materials and Repairs

Maintenance expense represented a significant cost challenge in 2011, increasing $55 million. In addition to the additional operating aircraft and the aging of our fleet, several aircraft coming off of warranty contributed to higher maintenance costs. Maintenance expense is expected to increase significantly as our fleet ages, as older aircraft need additional, more expensive repairs over time.

Income Taxes

Our effective tax rate was 41% in 2011 compared to 40% in 2010. Our effective tax rate differs from the statutory income tax rate primarily due to state income taxes, the change in valuation allowance and the non-deductibility of certain items for tax purposes and the relative size of these items to our 2011 pre-tax income of $145 million and our 2010 pre-tax income of $161 million. The rate increase was due to a reduction in the valuation allowance attributable to state net operating loss carryforwards in 2010.

Costs per Available Seat Mile (Non-GAAP)

Our costs per available seat mile, or CASM, a common metric used in the airline industry, are summarized in the table below. We have listed separately our fuel costs and profit sharing expense. While these amounts are included in CASM, we believe excluding fuel costs, which are subject to many economic and political factors beyond our control, as well as profit sharing, which is sensitive to volatility in earnings, from this metric is useful to management and investors. We believe this non-GAAP measure is more indicative of our ability to manage our costs and provides a meaningful comparison of our results to the airline industry and our prior year results. Investors should consider this non-GAAP financial measure in addition to, and not as a substitute for, our financial performance measures prepared in accordance with GAAP.

Reconciliation of Operating expense per ASM, excluding fuel and profit sharing
(in millions, except per ASM data in cents)

	2012		2011		Per ASM Year-over-Year Change	
	$	per ASM	$	per ASM	%	
Total operating expenses	$4,606	11.49	$4,182	11.23	2.3	%
Less: Aircraft fuel and related taxes	1,806	4.50	1,664	4.47	0.9	
Operating expenses, excluding fuel	2,800	6.99	2,518	6.76	3.3	
Less: Profit sharing	3	0.01	—	—	—	
Operating expense, excluding fuel & profit sharing	$2,797	6.98	$2,518	6.76	3.2	

Quarterly Results of Operations

The following table sets forth selected financial data and operating statistics for the four quarters ended December 31, 2012. The information for each of these quarters is unaudited and has been prepared on the same basis as the audited consolidated financial statements appearing elsewhere in this Form 10-K.

	Three Months Ended March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
Statements of Operations Data (dollars in millions)				
Operating revenues	$1,203	$1,277	$1,308	$1,194
Operating expenses:				
Aircraft fuel and related taxes	433	450	481	442
Salaries, wages and benefits	255	265	262	262
Landing fees and other rents	66	72	73	66
Depreciation and amortization	61	63	66	68
Aircraft rent	33	33	32	32
Sales and marketing	47	54	51	52
Maintenance materials and repairs	88	85	85	80
Other operating expenses (1)	131	125	145	148
Total operating expenses	1,114	1,147	1,195	1,150
Operating income (2)	89	130	113	44
Other income (expense) (3)	(40)	(44)	(40)	(43)
Income before income taxes	49	86	73	1
Income tax expense	19	34	28	—
Net income	$30	$52	$45	$1
Operating margin	7.4%	10.2%	8.6%	3.7%
Pre-tax margin	4.0%	6.7%	5.6%	0.1%
Operating Statistics:				
Revenue passengers (thousands)	6,853	7,338	7,747	7,018
Revenue passenger miles (millions)	7,908	8,497	9,075	8,083
Available seat miles ASM (millions)	9,536	9,961	10,704	9,874
Load factor	82.9%	85.3%	84.8%	81.9%
Aircraft utilization (hours per day)	11.6	11.8	12.4	11.3
Average fare	$159.93	$159.58	$154.04	$155.17
Yield per passenger mile (cents)	13.86	13.78	13.15	13.47
Passenger revenue per ASM (cents)	11.49	11.76	11.15	11.03
Operating revenue per ASM (cents)	12.62	12.82	12.21	12.09
Operating expense per ASM (cents)	11.69	11.51	11.16	11.65
Operating expense per ASM, excluding fuel (cents)	7.15	6.99	6.67	7.17
Operating expense per ASM, excluding fuel and profit sharing (cents)	7.15	6.92	6.63	7.26
Airline operating expense per ASM (cents) (4)	11.59	11.35	10.99	11.47
Departures	63,546	66,067	69,925	65,062
Average stage length (miles)	1,077	1,081	1,094	1,089
Average number of operating aircraft during period	170.3	172.4	175.0	177.8
Average fuel cost per gallon, including fuel taxes	$3.25	$3.22	$3.17	$3.20
Fuel gallons consumed (millions)	133	140	152	138
Full-time equivalent employees at period end (4)	11,965	12,308	11,797	12,070

(1) During the first quarter of 2012, LiveTV recorded a gain of approximately $8 million related to the termination of a customer contract. During the second quarter of 2012, we recorded net gains of approximately $10 million related to the sale of two EMBRAER 190 aircraft and six spare aircraft engines.

(2)

During the fourth quarter of 2012, operating income was negatively impacted by approximately $30 million as a result of Hurricane Sandy.

(3) During the second and fourth quarters of 2012, we recorded $2 million in gains and $3 million in losses, respectively, related to the early extinguishment of a portion of our long-term debt.

(4) Excludes results of operations and employees of LiveTV, LLC, which are unrelated to our airline operations and are immaterial to our consolidated operating results.

Although we experienced significant revenue growth in 2012, this trend may not continue. We expect our expenses to continue to increase significantly as we acquire additional aircraft, as our fleet ages and as we expand the frequency of flights in existing markets and enter into new markets. Accordingly, the comparison of the financial data for the quarterly periods presented may not be meaningful. In addition, we expect our operating results to fluctuate significantly from quarter-to-quarter in the future as a result of various factors, many of which are outside our control. Consequently, we believe quarter-to-quarter comparisons of our operating results may not necessarily be meaningful and you should not rely on our results for any one quarter as an indication of our future performance.

Network Concentrations and Seasonality

We have historically been a highly leisure-focused airline subject to seasonality in our business. Our focus in recent years has been to increase our mix of business customers, particularly in Boston, to lessen the seasonality impact on our business. Additionally, we believe VFR markets complement our leisure-driven markets from both a seasonal and day of week perspective. The highest levels of traffic and revenue on our routes along the East Coast are generally realized from October through April and on our routes to and from the western United States in the summer. Many of our areas of operations in the Northeast experience poor weather conditions in the winter, causing increased costs associated with de-icing aircraft, cancelled flights and accommodating displaced customers. Many of our Florida and Caribbean routes experience bad weather conditions in the summer and fall due to thunderstorms and hurricanes. As we enter new markets we could be subject to additional seasonal variations along with competitive responses to our entry by other airlines. Given our high proportion of fixed costs, this seasonality may cause our results of operations to vary from quarter to quarter. As such, we remain focused on trying to reduce the seasonal impact of our operations and increase demand and travel during the trough periods.

LIQUIDITY AND CAPITAL RESOURCES

The airline business is capital intensive. Our ability to successfully execute our profitable growth plans is largely dependent on the continued availability of capital on attractive terms. In addition, our ability to successfully operate our business depends on maintaining sufficient liquidity. We believe we have adequate resources from a combination of cash and cash equivalents and investment securities on hand and two available lines of credit. Additionally, as of December 31, 2012, we had 11 unencumbered A320 aircraft and nine unencumbered spare engines which we believe could be an additional source of liquidity, if necessary.

We believe a healthy cash balance is crucial to our ability to weather any part of the economic cycle while continuing to execute on our plans for profitable growth and increased returns. Our goal is to continue to be diligent with our liquidity, maintaining financial flexibility and allowing for prudent capital spending, which in turn we expect to lead to improved returns for our shareholders. As of December 31, 2012 our cash balance declined as compared to a year ago. The current environment of strong industry fundamentals and low interest rates enabled us to adopt a more reasonable cash balance as compared to prior years (as measured by a percentage of trailing twelve months revenue). We believe our current level of cash of approximately 15% of trailing twelve months revenue, combined with our available lines of credit and portfolio of unencumbered assets provides us with a strong liquidity position and the potential for higher returns on cash deployment. We believe we have taken several important actions during 2012 in solidifying our strong balance sheet and overall liquidity position, including:

- Increased our available lines of credit up to $325 million as of December 31, 2012.
- Prepaid approximately $220 million in high cost debt, which will result in an annual interest expense savings of approximately $10 million.
- Increased the number of unencumbered aircraft from one as of December 31, 2011 to 11 as of December 31, 2012.
- Reduced our overall debt balance by $285 million while increasing our total property and equipment by $483 million during 2012.
- Prepaid $200 million for certain 2013 deliveries and deposits on future aircraft deliveries in exchange for favorable pricing terms.

Return on Invested Capital

Return on invested capital, or ROIC, is an important financial metric which we believe provides meaningful information as to how well we generate returns relative to the capital invested in our business. During 2012, we improved our ROIC by nearly one percentage point to 4.8%. We are committed to taking appropriate actions which will allow us to continue to improve ROIC while adding capacity and continuing to grow. We believe this non-GAAP measure provides a meaningful comparison of our results to the airline industry and our prior year results. Investors should consider this non-GAAP financial measure in addition to, and not as a substitute for, our financial performance measures prepared in accordance with GAAP.

Reconciliation of Return on Invested Capital (Non-GAAP)
(in millions, except as otherwise noted)

	Twelve Months Ended December 31,	
	2012	2011
Numerator		
Operating Income	$ 376	$ 322
Add: Interest income and other	1	(3)
Add: Interest component of capitalized aircraft rent (a)	68	71
Subtotal	445	390
Less: Income tax expense impact	172	153
Operating Income After Tax, Adjusted	$ 273	$ 237
Denominator		
Average Stockholders' equity	$ 1,822	$ 1,705
Average total debt	2,994	3,085
Capitalized aircraft rent (a)	913	947
Invested Capital	$ 5,729	$ 5,737
Return on Invested Capital	4.8 %	4.1 %
(a) Capitalized Aircraft Rent		
Aircraft rent, as reported	$ 130	$ 135
Capitalized aircraft rent (7 * Aircraft rent)	913	947
Interest component of capitalized aircraft rent (Imputed interest at 7.5%)	68	71

Analysis of Cash Flows

Operating Activities

At December 31, 2012, we had cash and cash equivalents of $182 million and short-term investments of $549 million, as compared to cash and cash equivalents of $673 million and short-term investments of $553 million at December 31, 2011. We also had $136 million of long-term investments at December 31, 2012 compared to $38 million at December 31, 2011. Cash flows provided by operating activities totaled $698 million in 2012 compared to $614 million in 2011 and $523 million in 2010. The $84 million increase in cash flows from operations in 2012 compared to 2011 was primarily as a result of the 8% increase in capacity and 2% increase in average fares, offset by a 1% higher price of fuel. The $91 million increase in cash flows from operations in 2011 compared to 2010 was primarily as a result of the 10% increase in average fares and 7% increase in capacity, offset by 38% higher price of fuel. As of December 31, 2012, our unrestricted cash, cash equivalents and short-term investments as a percentage of trailing twelve months revenue was approximately 15%. We rely primarily on cash flows from operations to provide working capital for current and future operations.

Investing Activities

During 2012, capital expenditures related to our purchase of flight equipment included (1) $344 million for seven Airbus A320 aircraft, four EMBRAER 190 aircraft and five spare engines, (2) $283 million for flight equipment deposits, which includes a $200 million prepayment in exchange for favorable pricing terms and (3) $32 million for spare part purchases. Capital expenditures for other property and equipment, including ground equipment purchases, facilities improvements and LiveTV inflight-entertainment equipment inventory were $166 million, which includes the final $32 million for the 16 slots we purchased at LaGuardia International Airport and Ronald Reagan International Airport in 2011 and $17 million for T5i, which was paid for using cash from operations. The receipt of $46 million in proceeds from the sale of two EMBRAER 190 aircraft and six spare engines is included in investing

activities. Investing activities also include the net purchase of $104 million in investment securities.
During 2011, capital expenditures related to our purchase of flight equipment included $318 million for four Airbus A320 aircraft, five EMBRAER 190 aircraft and nine spare engines, $44 million for flight equipment deposits and $27 million for

spare part purchases. Capital expenditures for other property and equipment, including ground equipment purchases, facilities improvements and LiveTV inventory, were $135 million, which includes $40 million for the 16 slots we purchased at LaGuardia International Airport and Ronald Reagan International Airport. Investing activities in 2011 also included the net proceeds from the sale and maturities of $24 million in investment securities.

We currently anticipate 2013 capital expenditures for facility improvements, spare parts and ground purchases to be approximately $245 million, including approximately $80 million for our investment at T5i.

Financing Activities

Financing activities during 2012 consisted of (1) scheduled maturities of $198 million of debt and capital lease obligations, (2) the pre-payment of $185 million in high-cost debt secured by seven Airbus A320 aircraft, (3) the repayment of $35 million of debt related to two EMBRAER 190 aircraft which were sold in 2012, (4) proceeds of $215 million in non-public floating rate aircraft-related financing secured by four Airbus A320 aircraft and four EMBRAER 190 aircraft, (5) the net repayment of $88 million under our available lines of credit, (6) the repayment of $12 million in principal related to our construction obligation for Terminal 5 and (7) the acquisition of 4.8 million treasury shares for $26 million primarily related to our share repurchase program and the withholding of taxes upon the vesting of restricted stock units.

Financing activities during 2011 consisted primarily of (1) the early extinguishment of $39 million principal of our 6.75% Series A convertible debentures due 2039 for $45 million, (2) scheduled maturities of $188 million of debt and capital lease obligations, (3) the early payment of $3 million on our spare parts pass-through certificates, (4) proceeds of $121 million in fixed rate and $124 million in non-public floating rate aircraft-related financing secured by four Airbus A320 aircraft and five EMBRAER 190 aircraft, (5) the net borrowings of $88 million under our available line of credit, (6) the repayment of $10 million in principal related to our construction obligation for Terminal 5 and (7) the acquisition of $4 million in treasury shares related to the withholding of taxes, upon the vesting of restricted stock units.

In November 2012, we filed an automatic shelf registration statement with the SEC. Under this universal shelf registration statement, we have the capacity to offer and sell from time to time debt securities, pass-through certificates, common stock, preferred stock and/or other securities. The net proceeds of any securities we sell under this registration statement may be used to fund working capital and capital expenditures, including the purchase of aircraft and construction of facilities on or near airports. Through December 31, 2012, we had not issued any securities under this registration statement. At this time, we have no plans to sell any such securities under this registration statement. We may utilize this universal shelf in the future to raise capital to fund the continued development of our products and services, the commercialization of our products and services or for other general corporate purposes.

None of our lenders or lessors are affiliated with us.

Capital Resources

We have been able to generate sufficient funds from operations to meet our working capital requirements. Approximately 70% of our property and equipment is encumbered, excluding 11 Airbus A320 aircraft and nine spare engines which we own free and clear. We have historically financed our aircraft through either secured debt or lease financing. At December 31, 2012, we operated a fleet of 180 aircraft, of which 60 were financed under operating leases, four were financed under capital leases and all but 11 of the remaining 116 were financed by private and public secured debt. As noted above, we pre-paid some of 2013 aircraft deliveries. We have committed financing for two EMBRAER 190 aircraft scheduled for delivery in 2013. We plan to opportunistically finance the remaining 2013 scheduled deliveries at favorable borrowing terms relative to our weighted average cost of debt. Although we believe debt and/or lease financing should be available for our remaining aircraft deliveries, we cannot give assurance we will be able to secure financing on terms attractive to us, if at all. While these financings may or may not result in an increase in liabilities on our balance sheet, our fixed costs will increase significantly regardless of the financing method ultimately chosen. To the extent we cannot secure financing, we may be required to pay in cash, further modify our aircraft acquisition plans or incur higher than anticipated financing costs.

Working Capital

We had working capital deficit of $508 million at December 31, 2012 compared to working capital of $216 million at December 31, 2011. Working capital deficits can be customary in the airline industry since air traffic liability is classified as a current liability. The significant decrease in our working capital is primarily attributable to approximately $220 million in debt prepayments made during 2012 and the $200 million prepayment for future aircraft deliveries. Our working capital includes the fair value of our short-term fuel hedge derivatives, which was a net liability of $1 million and $4 million at December 31, 2012 and 2011, respectively.

Also contributing to our working capital deficit as of December 31, 2012 is $136 million in marketable investment securities classified as long-term assets, including $57 million related to a deposit made to lower the interest rate on the debt secured by two aircraft. These funds on deposit are readily available to us; however, if we were to draw upon this deposit, the interest rates on the debt would revert to the higher rates in effect prior to the re-financing.

We have a corporate purchasing line with American Express allowing us to borrow up to a maximum of $125 million for the purchase of jet fuel. Borrowings, which are to be paid monthly, are subject to a 6.9% annual interest rate subject to certain limitations. This borrowing facility will terminate no later than January 5, 2015. During 2012, we had borrowed up to $125 million on this corporate purchasing line, all of which was fully repaid, leaving the line undrawn as of December 31, 2012. In July 2012, we entered into a revolving line of credit with Morgan Stanley for up to $100 million, and increased the line of credit for up to $200 million in December 2012. This line of credit is secured by a portion of our investment securities held by Morgan Stanley and the borrowing amount may vary accordingly. This line of credit bears interest at a floating rate of interest based upon LIBOR plus 100 basis points. During 2012, we had borrowed up to the maximum $200 million, all of which was fully repaid, leaving the line undrawn as of December 31, 2012.

We expect to meet our obligations as they become due through available cash, investment securities and internally generated funds, supplemented as necessary by financing activities, as they may be available to us. We expect to generate positive working capital through our operations. However, we cannot predict what the effect on our business might be from the extremely competitive environment we are operating in or from events beyond our control, such as volatile fuel prices, economic conditions, weather-related disruptions, the impact of airline bankruptcies, restructurings or consolidations, U.S. military actions or acts of terrorism. We believe the working capital available to us will be sufficient to meet our cash requirements for at least the next 12 months.

Debt and Capital Leases

Our scheduled debt maturities are expected to increase over the next five years, with a scheduled peak in 2014 of nearly $600 million. Our scheduled debt maturities in 2013 include final mortgage payments on six Airbus A320 aircraft, which will further increase our portfolio of unencumbered assets. As part of our efforts to effectively manage our balance sheet and improve ROIC, we expect to continue to actively manage our debt balances. Our approach to debt management includes managing the mix of fixed vs. floating rate debt, managing the annual maturities of debt, and managing the weighted average cost of debt. Further, we intend to continue to opportunistically pre-purchase outstanding debt when market conditions and terms are favorable. Additionally, our unencumbered assets, including 11 A320 aircraft, allows us some flexibility in managing our cost of debt and capital requirements.

Contractual Obligations

Our noncancelable contractual obligations at December 31, 2012 include (in millions):

	Payments due in Total		2013		2014		2015	2016	2017		Thereafter
Long-term debt and capital lease obligations (1)	$ 3,450		$ 509		$673		$342	$527	$ 236		$ 1,163
Lease commitments	1,492		198		194		191	125	111		673
Flight equipment obligations	5,005		360		525		745	765	8 hotels	December 2015	5.70%
Mortgage loan	5 hotels	February 2016	5.53%	103,362		105,164					
Mortgage loan	5 hotels	February 2016	5.53%	74,251		75,546					
Mortgage loan (2)(6)	5 hotels	February 2016	LIBOR (1) + 4.75%	200,000		200,000					

Mortgage loan (2)	7 hotels	August 2016	LIBOR (1) + 4.35%	301,000	301,000
Mortgage loan (2)	5 hotels	August 2016	LIBOR (1) + 4.38%	62,900	62,900
Mortgage loan (2)	1 hotel	August 2016	LIBOR (1) + 4.20%	37,500	37,500
Mortgage loan (2)	8 hotels	January 2017	LIBOR (1) + 4.95%	376,800	—
Mortgage loan (5)	24 hotels	April 2017	LIBOR (1) + 4.39%	1,070,560	—
Mortgage loan (2)	1 hotel	April 2017	LIBOR (1) + 4.95%	33,300	—
Mortgage loan	5 hotels	April 2017	5.95%	110,707	111,869
Mortgage loan	5 hotels	April 2017	5.95%	99,508	100,552
Mortgage loan	5 hotels	April 2017	5.95%	151,413	153,002
Mortgage loan	7 hotels	April 2017	5.95%	121,113	122,384
Mortgage loan (2)	1 hotel	May 2017	LIBOR (1) + 5.10%	25,100	—
Mortgage loan (2)	1 hotel	June 2017	LIBOR (1) + 5.10%	43,750	—
Mortgage loan (2)	8 hotels	July 2017	LIBOR (1) + 4.09%	144,000	—
Mortgage loan (2)	1 hotel	July 2017	LIBOR (1) + 4.15%	35,200	—
Mortgage loan (2)	1 hotel	July 2017	LIBOR (1) + 5.10%	40,500	—
Mortgage loan	1 hotel	January 2018	4.38%	98,471	—
Mortgage loan	2 hotels	January 2018	4.44%	107,703	—
Mortgage loan (7)	1 hotel	July 2018	LIBOR (1) + 4.50%	21,200	—
Mortgage loan (7)	1 hotel	August 2018	LIBOR (1) + 4.95%	12,000	—
Mortgage loan (3)	1 hotel	July 2019	LIBOR (1) + 3.75%	5,524	5,525
Mortgage loan			6.26%	98,800	99,780

	1 hotel	November 2020			
Mortgage loan	1 hotel	January 2024	5.49%	10,566	10,673
Mortgage loan	1 hotel	January 2024	5.49%	7,240	7,313
Mortgage loan	1 hotel	May 2024	4.99%	6,771	6,845
Mortgage loan	3 hotels	August 2024	5.20%	67,520	67,520
Mortgage loan	2 hotels	August 2024	4.85%	12,500	12,500
Mortgage loan	3 hotels	August 2024	4.90%	24,980	24,980
Mortgage loan	3 hotels	February 2025	4.45%	54,397	—
Mortgage loan	2 hotels	February 2025	4.45%	24,276	—
Mortgage loan	2 hotels	February 2025	4.45%	21,031	—
				3,695,041	1,954,103
Premiums				3,344	—
Total				$3,698,385	$1,954,103

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(1) LIBOR rates were 0.193% and 0.171% at September 30, 2015 and December 31, 2014, respectively.

(2) This mortgage loan has three one-year extension options subject to satisfaction of certain conditions.

(3) This mortgage loan provides for an interest rate of LIBOR + 3.75% with a 0.25% LIBOR floor for the first 18 months and is fixed at 4.0% thereafter.

(4) This mortgage loan had three one-year extension options subject to satisfaction of certain conditions. The first one-year extension period began in November 2014.

(5) This mortgage loan has four one-year extension options subject to satisfaction of certain conditions.

(6) This mortgage loan has a LIBOR floor of 0.20%.

(7) This mortgage loan has two one-year extension options subject to satisfaction of certain conditions.

On January 2, 2015, we refinanced two mortgage loans totaling $356.3 million. The refinance included our $211.0 million mortgage loan due November 2015 and the $145.3 million mortgage loan due July 2015. The new loans initially totaled $477.3

million. The new loans included a $376.8 million mortgage loan due January 2017, a $54.8 million mortgage loan due February 2025, a $24.5 million mortgage loan due February 2025 and a $21.2 million mortgage loan due February 2025. The $376.8 million mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.95%. The stated maturity is January 2017, with three one-year extension options. The three mortgage loans totaling $100.5 million due February 2025 bear interest at a fixed rate of 4.45%. The stated maturity date for each of these loans is February 2025. The new loans continue to be secured by the same 15 hotel properties.

On March 25, 2015, we completed the financing of a $33.3 million mortgage loan, secured by the Memphis Marriott. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.95%. The stated maturity is April 2017, with three one-year extension options.

As previously discussed in Note 1, pursuant to the Agreement, we acquired the remaining approximate 28.26% interest in the PIM Highland JV. The transaction closed on March 6, 2015. Subsequent to the close of the transaction, $907.6 million of assumed mortgage loans due March 2015 were refinanced with a $1.07 billion non-recourse mortgage loan due April 2017. The new loan provides for an interest rate of LIBOR plus 4.39%. Additionally we assumed two mortgage loans which include a $99.3 million mortgage due January 2018 with a fixed interest rate of 4.38% and a $108.6 million mortgage loan due January 2018 with a fixed interest rate of 4.44%.

On April 17, 2015, we completed the financing of a $25.1 million mortgage loan, secured by the Lakeway Resort. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 5.10%. The stated maturity is May 2017, with three one-year extension options.

On June 3, 2015, we completed the financing of a $43.8 million mortgage loan, secured by the Le Pavillon. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 5.10%. The stated maturity is June 2017, with three one-year extension options.

On June 17, 2015, we completed the financing of two mortgage loans totaling $179.2 million, secured by the Rockbridge Portfolio. The financing includes a $144.0 million mortgage loan, secured by eight of the nine hotel properties. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.09%. The stated maturity is July 2017, with three one-year extension options. The financing also includes a $35.2 million mortgage loan, secured by the Sheraton Ann Arbor hotel in Ann Arbor, Michigan. The mortgage loan is interest only and provides for a floating rate of LIBOR + 4.15%. The stated maturity is July 2017, with three one-year extension options.

On June 24, 2015, we completed the financing of a $21.2 million mortgage loan, secured by the Hampton Inn Gainesville. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.50%. The stated maturity is July 2018, with two one-year extension options.

On July 1, 2015, we completed the financing of a $40.5 million mortgage loan, secured by the W Atlanta. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 5.10%. The stated maturity is July 2017, with three one-year extension options.

On August 5, 2015, we completed the financing of a $12.0 million mortgage loan, secured by the Hilton Garden Inn - Wisconsin Dells. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.95%. The stated maturity is August 2018, with two one-year extension options.

During the three and nine months ended September 30, 2015, we recognized premium amortization of $365,000 and $976,000, respectively. The amortization of the premium is computed using a method that approximates the effective interest method, which is included in interest expense and amortization of premiums and loan costs in the consolidated statements of operations.

We are required to maintain certain financial ratios under various debt and related agreements. If we violate covenants in any debt or related agreement, we could be required to repay all or a portion of our indebtedness before maturity at a time when we might be unable to arrange financing for such repayment on attractive terms, if at all. The assets of certain of our subsidiaries are pledged under non-recourse indebtedness and are not available to satisfy the debts and other obligations of Ashford Trust or Ashford Trust OP, our operating partnership, and the liabilities of such subsidiaries do not constitute the obligations of Ashford Trust or Ashford Trust OP. Presently, our existing financial covenants are non-recourse and primarily relate to maintaining minimum debt coverage ratios, maintaining an overall minimum net worth, maintaining a maximum loan to value ratio, and maintaining an overall minimum total assets. As of September 30, 2015, we were in compliance in all material respects with all covenants or other requirements set forth in our debt and related agreements as amended.

ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

8. Income (Loss) Per Share

Basic income (loss) per common share is calculated using the two-class method by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted income (loss) per common share is calculated using the two-class method, or treasury stock method if more dilutive, and reflects the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted into common shares, whereby such exercise or conversion would result in lower income per share.

The following table reconciles the amounts used in calculating basic and diluted income (loss) per share (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Income (loss) allocated to common stockholders:				
Income (loss) from continuing operations attributable to the Company	$(16,321)	$(13,550)	$292,931	$(17,546)
Less: Dividends on preferred stock	(8,490)	(8,490)	(25,471)	(25,471)
Less: Dividends on common stock	(11,281)	(10,661)	(35,216)	(30,930)
Less: Dividends on unvested restricted shares	(176)	(73)	(517)	(231)
Less: Undistributed income from continuing operations allocated to unvested shares	—	—	(2,713)	—
Undistributed income (loss)	(36,268)	(32,774)	229,014	(74,178)
Add back: Dividends on common stock	11,281	10,661	35,216	30,930
Distributed and undistributed income (loss) from continuing operations - basic	$(24,987)	$(22,113)	$264,230	$(43,248)
Add back: Income from continuing operations allocated to operating partnership units	—	—	39,616	—
Distributed and undistributed net income (loss) - diluted	$(24,987)	$(22,113)	$303,846	$(43,248)
Income from discontinued operations allocated to common stockholders:				
Income from discontinued operations attributable to the Company	$—	$55	$—	$77
Weighted average shares outstanding:				
Weighted average common shares outstanding - basic	95,888	90,322	97,061	86,961
Effect of assumed conversion of operating partnership units	—	—	18,499	—
Weighted average shares outstanding - diluted	95,888	90,322	115,560	86,961
Basic income (loss) per share:				
Income (loss) from continuing operations allocated to common stockholders per share	$(0.26)	$(0.24)	$2.72	$(0.50)
Income from discontinued operations allocated to common stockholders per share	—	—	—	—
Net income (loss) allocated to common stockholders per share	$(0.26)	$(0.24)	$2.72	$(0.50)
Diluted income (loss) per share:				
Income (loss) from continuing operations allocated to common stockholders per share	$(0.26)	$(0.24)	$2.63	$(0.50)

Income from discontinued operations allocated to common stockholders per share	—	—	—	—
Net income (loss) allocated to common stockholders per share	$(0.26)	$(0.24)	$2.63	$(0.50)

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Due to the anti-dilutive effect, the computation of diluted income (loss) per share does not reflect adjustments for the following items (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Income (loss) from continuing operations allocated to common stockholders is not adjusted for:				
Income allocated to unvested restricted shares	$176	$73	$3,230	$231
Net loss attributable to noncontrolling interest in operating partnership units	(3,193)	(2,592)	—	(4,245)
Total	$(3,017)	$(2,519)	$3,230	$(4,014)
Weighted average diluted shares are not adjusted for:				
Effect of unvested restricted shares	543	148	440	111
Effect of assumed conversion of operating partnership units	18,581	19,926	—	19,725
Total	19,124	20,074	440	19,836

9. Derivative Instruments and Hedging

Interest Rate Derivatives—We are exposed to risks arising from our business operations, economic conditions and financial markets. To manage these risks, we primarily use interest rate derivatives and interest rate floors to hedge our debt and our cash flows. The interest rate derivatives currently include interest rate caps and interest rate floors. These derivatives are subject to master netting settlement arrangements. As of September 30, 2015, maturities on these instruments range from November 2015 to July 2020. To mitigate the nonperformance risk, we routinely rely on a third party’s analysis of the creditworthiness of the counterparties, which supports our belief that the counterparties’ nonperformance risk is limited. All derivatives are recorded at fair value.

For the nine months ended September 30, 2015, we entered into interest rate caps with notional amounts totaling $1.8 billion and strike rates ranging from 1.50% to 3.00%. These interest rate caps had effective dates from January 2015 to August 2015, and maturity dates from January 2017 to August 2018, for a total cost of $1.8 million. These instruments were not designated as a cash flow hedges. These instruments cap the interest rates on our mortgage loans with principal balances of $1.8 billion and maturity dates from January 2017 to August 2018. We also entered into interest rate floors with notional amounts totaling $6.0 billion and strike rates ranging from (0.25)% to zero percent. These interest rate floors had effective dates from April 2015 to July 2015, and maturity dates from April 2020 to July 2020, for a total cost of $9.4 million.

For the nine months ended September 30, 2014, we entered into interest rate caps with notional amounts totaling $736.1 million and strike rates ranging from 2.00% to 2.59%. These interest rate caps had effective dates from January 2014 to August 2014, and maturity dates from May 2015 to August 2016, for a total cost of $661,000. These instruments were not designated as cash flow hedges. At September 30, 2014, we had instruments capping the interest rates on our mortgage loans with principal balances totaling $601.4 million and maturity dates from February 2016 to August 2016.

Credit Default Swap Derivatives—A credit default swap is a derivative contract that functions like an insurance policy against the credit risk of an entity or obligation. The seller of protection assumes the credit risk of the reference obligation from the buyer (us) of protection in exchange for annual premium payments. If a default or a loss, as defined in the credit default swap agreements, occurs on the underlying bonds, then the buyer of protection is protected against those losses. The only liability for us, the buyer, is the annual premium and any change in value of the underlying CMBX index (if the trade is terminated prior to maturity). For all CMBX trades completed to date, we were the buyer of protection. Credit default swaps are subject to master-netting settlement arrangements and credit support annexes. Assuming the underlying bonds pay off at par over their remaining average life, our total exposure

for these trades was approximately $3.2 million as of September 30, 2015. Cash collateral is posted by us as well as our counterparties. We offset the fair value of the derivative and the obligation/right to return/reclaim cash collateral. The change in market value of credit default swaps is settled net through posting cash collateral or reclaiming cash collateral between us and our counterparties when the change in market value is over $250,000.
In April 2015, February 2015 and August 2011, we entered into credit default swap transactions for notional amounts of $45.0 million, $45.0 million and $100.0 million, respectively, to hedge financial and capital market risk for upfront costs of $1.1 million, $1.6 million and $8.2 million, respectively, that was subsequently returned to us as collateral by our counterparties. The

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net carrying value of these credit default swaps was an asset of $783,000 and liability of $184,000 as of September 30, 2015 and December 31, 2014, respectively, which are included in "derivative assets, net" and "liabilities associated with marketable securities and other," respectively, in the consolidated balance sheets. We recognized an unrealized gain of $992,000 and $797,000 for the three and nine months ended September 30, 2015 and an unrealized gain of $86,000 and an unrealized loss of $331,000 for the three and nine months ended September 30, 2014, respectively, which are included in "unrealized loss on derivatives" in the consolidated statements of operations.

Futures Contracts—In September 2015, we entered into Eurodollar futures for upfront costs, including commissions, of $743,000 and maturity dates ranging from September 2016 to March 2017. The carrying value of these futures contracts was an asset of $625,000 as of September 30, 2015, which are included in "derivative assets, net" in the consolidated balance sheets. No unrealized gain or loss was recognized for the three and nine ended September 30, 2015.

Marketable Securities and Liabilities Associated with Marketable Securities and other—We invested in publicly traded equity securities and put and call options on certain publicly traded equity securities, which were considered derivatives. At September 30, 2015, we had no investments in these derivatives. At December 31, 2014, we had investments in these derivatives totaling $654,000 and liabilities of $997,000.

10. Fair Value Measurements

Fair Value Hierarchy—For disclosure purposes, financial instruments, whether measured at fair value on a recurring or nonrecurring basis or not measured at fair value, are classified in a hierarchy consisting of three levels based on the observability of valuation inputs in the market place as discussed below:

- Level 1: Fair value measurements that are quoted prices (unadjusted) in active markets that we have the ability to access for identical assets or liabilities. Market price data generally is obtained from exchange or dealer markets.
- Level 2: Fair value measurements based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.
- Level 3: Fair value measurements based on valuation techniques that use significant inputs that are unobservable. The circumstances for using these measurements include those in which there is little, if any, market activity for the asset or liability.

Fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts/payments and the discounted expected variable cash payments/receipts. Fair values of interest rate caps, floors, flooridors, and corridors are determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates fell below the strike rates of the floors or rise above the strike rates of the caps. Variable interest rates used in the calculation of projected receipts and payments on the swaps, caps, and floors are based on an expectation of future interest rates derived from observable market interest rate curves (LIBOR forward curves) and volatilities (Level 2 inputs). We also incorporate credit valuation adjustments (Level 3 inputs) to appropriately reflect both our own nonperformance risk and the respective counterparty's nonperformance risk.

Fair values of credit default swaps are obtained from a third party who publishes various information including the index composition and price data (Level 2 inputs). The fair value of credit default swaps does not contain credit-risk-related adjustments as the change in fair value is settled net through posting cash collateral or reclaiming cash collateral between us and our counterparty.

Fair values of interest rate floors are determined by obtaining the last market bid prices from several counterparties for a similar investment as of the measurement date. The bids (the Level 2 inputs) used in the calculation of fair value are reviewed across each counterparty and are accessed individually to determine the relevant fair value of each floor.

Fair values of futures contracts are valued at their last reported settlement price as of the measurement date (Level 1 inputs). The fair value of futures contracts have minimal counterparty risk since futures contracts are exchange-traded and the exchange's clearinghouse, as the counterparty to all exchange-traded futures, guarantees the futures against default.

Fair values of marketable securities and liabilities associated with marketable securities, including public equity securities, equity put and call options, and other investments, are based on their quoted market closing prices (Level 1 inputs).

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When a majority of the inputs used to value our derivatives fall within Level 2 of the fair value hierarchy, the derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy. However, when valuation adjustments associated with our derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by us and our counterparties, which we consider significant (10% or more) to the overall valuation of our derivatives, the derivative valuations in their entirety are classified in Level 3 of the fair value hierarchy. Transfers of inputs between levels are determined at the end of each reporting period. In determining the fair values of our derivatives at September 30, 2015, the LIBOR interest rate forward curve (Level 2 inputs) assumed an uptrend from 0.19% to 1.43% for the remaining term of our derivatives. Credit spreads (Level 3 inputs) used in determining the fair values of hedge and non-hedge designated derivatives assumed an uptrend in nonperformance risk for us and all of our counterparties through the maturity dates.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents our assets and liabilities measured at fair value on a recurring basis aggregated by the level within which measurements fall in the fair value hierarchy (in thousands):

	Quoted Market Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting[4]	Total	
September 30, 2015:						
Assets						
Derivative assets:						
Interest rate derivatives - non-hedge	$—	$4,164	$—	$—	$4,164	(1)
Credit default swaps	—	3,911	—	(3,128)	783	(1)
Futures contracts	625	—	—	—	625	(1)
Total	$625	$8,075	$—	$(3,128)	$5,572	
December 31, 2014:						
Assets						
Derivative assets:						
Interest rate derivatives - non-hedge	$—	$182	$—	$—	$182	(1)
Equity put options	653	—	—	—	653	(2)
Equity call options	1	—	—	—	1	(2)
Non-derivative assets:						
Equity securities	57,941	—	—	—	57,941	(2)
U.S. treasury securities	4,622	—	—	—	4,622	(2)
Total	63,217	182	—	—	63,399	
Liabilities						
Derivative liabilities:						
Credit default swaps	—	379	—	(563)	(184)	(3)
Short equity put options	(216)	—	—	—	(216)	(3)
Short equity call options	(781)	—	—	—	(781)	(3)
Non-derivative liabilities:						
Short equity securities	(17)	—	—	—	(17)	(3)
Margin account balance	(5,003)	—	—	—	(5,003)	(3)
Total	(6,017)	379	—	(563)	(6,201)	

Net	$57,200	$561	$—	$(563)	$57,198

(1) Reported net as “derivative assets, net” in the consolidated balance sheets.
(2) Reported as “marketable securities” in the consolidated balance sheets.
(3) Reported as “liabilities associated with marketable securities and other” in the consolidated balance sheets.
(4) Represents cash collateral posted by our counterparty.

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Effect of Fair-Value-Measured Assets and Liabilities on Consolidated Statements of Operations
The following tables summarize the effect of fair-value-measured assets and liabilities on the consolidated statements of operations for the three and nine months ended September 30, 2015 and 2014 (in thousands):

	Gain (Loss) Recognized in Income		Reclassified from Accumulated OCI into Interest Expense	
	Three Months Ended September 30,		Three Months Ended September 30,	
	2015	2014	2015	2014
Assets				
Derivative assets:				
Interest rate derivatives	$(3,742)	$(156)	$—	$—
Credit default swaps	992 [5]	65	—	—
Equity put options	—	(112)	—	—
Equity call options	—	(3)	—	—
Non-derivative assets:				
Equity	—	(699)	—	—
U.S. Treasury	—	87	—	—
Total	(2,750)	(818)	—	—
Liabilities				
Derivative liabilities:				
Short-equity put options	—	102	—	—
Short-equity call options	—	212	—	—
Total	—	314	—	—
Net	$(2,750)	$(504)	$—	$—
Total combined				
Interest rate derivatives	$(3,742)	$(156)	$—	$—
Credit default swaps	992	86	—	—
Total derivatives	(2,750) [1]	(70) [1]	—	—
Unrealized loss on marketable securities	—	(2,875) [3]	—	—
Realized gain on marketable securities	—	2,441 [2] [4]	—	—
Net	$(2,750)	$(504)	$—	$—

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	Gain (Loss) Recognized in Income		Reclassified from Accumulated OCI into Interest Expense	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Assets				
Derivative assets:				
Interest rate derivatives	$(7,200)	$(349)	$—	$100
Credit default swaps	797 [5]	(394)		
Equity put options	(1,717)	(1,093)	—	—
Equity call options	26	(126)	—	—
Non-derivative assets:				
Equity - American Depositary Receipt	(150)	—	—	—
Equity	1,072	2,145	—	—
U.S. Treasury	314	391	—	—
Total	(6,858)	574	—	100
Liabilities				
Derivative liabilities:				
Short equity put options	1,002	46	—	—
Short equity call options	1,470	235	—	—
Non-derivative liabilities:				
Short equity securities	78	—	—	—
Total	2,550	281	—	—
Net	$(4,308)	$855	$—	$100
Total combined				
Interest rate derivatives	$(7,200)	$(349)	$—	$100
Credit default swaps	797	(331)	—	—
Total derivatives	(6,403) [1]	(680) [1]	—	100
Unrealized gain (loss) on marketable securities	127 [3]	(3,818) [3]	—	—
Realized gain on marketable securities	1,968 [2]	5,353 [2] [4]	—	—
Net	$(4,308)	$855	$—	$100

[1] Reported as “unrealized loss on derivatives” in the consolidated statements of operations.
[2] Included in “other income (expense)” in the consolidated statements of operations.
[3] Reported as “unrealized gain (loss) on marketable securities” in the consolidated statements of operations.
[4] Includes costs of $21 and $63 for the three and nine months ended September 30, 2014, respectively, associated with credit default swaps.
[5] Excludes costs of $130 and $319, included in “other income (expense)” for the three and nine months ended September 30, 2015, respectively, associated with credit default swaps.

There was no change in fair value of our interest rate derivatives that were recognized in other comprehensive loss for the three and nine months ended September 30, 2014.

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11. Summary of Fair Value of Financial Instruments

Determining estimated fair values of our financial instruments such as notes receivable and indebtedness requires considerable judgment to interpret market data. Market assumptions and/or estimation methodologies used may have a material effect on estimated fair value amounts. Accordingly, estimates presented are not necessarily indicative of amounts at which these instruments could be purchased, sold, or settled. Carrying amounts and estimated fair values of financial instruments, for periods indicated, were as follows (in thousands):

	September 30, 2015		December 31, 2014	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets and liabilities measured at fair value:				
Marketable securities	$—	$—	$63,217	$63,217
Derivative assets, net	5,572	5,572	182	182
Liabilities associated with marketable securities and other	—	—	6,201	6,201
Financial assets not measured at fair value:				
Cash and cash equivalents	$185,981	$185,981	$215,063	$215,063
Restricted cash	146,220	146,220	85,830	85,830
Accounts receivable, net	53,037	53,037	22,399	22,399
Note receivable, net	3,695	3,265 to 3,609	3,553	3,049 to 3,370
Due from affiliates	—	—	3,473	3,473
Due from Ashford Prime OP, net	—	—	896	896
Due from third-party hotel managers	37,947	37,947	12,241	12,241
Financial liabilities not measured at fair value:				
Indebtedness	$3,698,385	$3,553,326 to $3,927,365	$1,954,103	$1,905,801 to $2,106,413
Accounts payable and accrued expenses	141,404	141,404	71,118	71,118
Dividends payable	22,679	22,679	21,889	21,889
Due to Ashford Inc., net	9,893	9,893	8,202	8,202
Due to Ashford Prime OP, net	110	110	—	—
Due to related party, net	470	470	1,867	1,867
Due to third-party hotel managers	2,424	2,424	1,640	1,640

Cash, cash equivalents, and restricted cash. These financial assets bear interest at market rates and have maturities of less than 90 days. The carrying value approximates fair value due to their short-term nature. This is considered a Level 1 valuation technique.

Accounts receivable, net, accounts payable and accrued expenses, dividends payable, due to/from Ashford Prime OP, due to/from related party, due from affiliates, due to/from Ashford Inc. and due to/from third-party hotel managers. The carrying values of these financial instruments approximate their fair values due to their short-term nature. This is considered a Level 1 valuation technique.

Note receivable, net. Fair value of notes receivable is determined using similar loans with similar collateral. We relied on our internal analysis of what we believe a willing buyer would pay for this note. We estimated the fair value of the note receivable to be approximately 11.6% to 2.3% lower than the carrying value of $3.7 million at September 30, 2015 and approximately 14.2% to 5.2% lower than the carrying value of $3.6 million at December 31, 2014. This is considered a Level 2 valuation technique.

Marketable securities. Marketable securities consist of U.S. treasury bills, publicly traded equity securities, and put and call options on certain publicly traded equity securities. The fair value of these investments is based on quoted market closing prices at the balance sheet dates. See Notes 2, 9 and 10 for a complete description of the methodology and assumptions utilized in determining fair values.

Indebtedness. Fair value of indebtedness is determined using future cash flows discounted at current replacement rates for these instruments. Cash flows are determined using a forward interest rate yield curve. Current replacement rates are determined by using the U.S. Treasury yield curve or the index to which these financial instruments are tied and adjusted for credit spreads. Credit spreads take into consideration general market conditions, maturity, and collateral. We estimated the fair value of total indebtedness to be approximately 96.1% to 106.2% of the carrying value of $3.7 billion at September 30, 2015 and approximately 97.5% to 107.8% of the carrying value of $2.0 billion at December 31, 2014. This is considered a Level 2 valuation technique.

Derivative assets and liabilities associated with marketable securities and other. Fair value of interest rate derivatives is determined using the net present value of expected cash flows of each derivative based on the market-based interest rate curve and adjusted for credit spreads of us and our counterparties. Fair values of credit default swap derivatives are obtained from a third party who publishes the CMBX index composition and price data. Fair value of interest rate floors is determined by obtaining the last market bid prices from several counterparties for a similar investment as of the measurement date. Fair values of futures contracts are valued at their last reported settlement price as of the measurement date. Liabilities associated with marketable securities and other consists of a margin account balance, short public equity securities and short equity put and call options. Fair value is determined based on quoted market closing prices at the balance sheet dates. See Notes 2, 9 and 10 for a complete description of the methodology and assumptions utilized in determining fair values.

12. Redeemable Noncontrolling Interests in Operating Partnership

Redeemable noncontrolling interests in the operating partnership represents the limited partners’ proportionate share of equity in earnings/losses of the operating partnership, which is an allocation of net income/loss attributable to the common unitholders based on the weighted average ownership percentage of these limited partners’ common units of limited partnership interest in the operating partnership (“common units”) and the units issued under our Long-Term Incentive Plan (the “LTIP units”) that are vested throughout the period plus distributions paid to the limited partners with regard to the Class B common units. Class B common units have a fixed dividend rate of 7.2% and have priority in payment of cash dividends over common units but otherwise have no preference over common units. Aside from the Class B common units, all other outstanding units represent common units. Beginning one year after issuance, each common unit (including each Class B common unit) may be redeemed for either cash or, at our sole discretion, up to one share of our common stock. Beginning in July 2016, each Class B common unit may be converted into a common unit at either party’s discretion. As a result of the Ashford Inc. spin-off, holders of our common stock were distributed one share of Ashford Inc. common stock for every 87 shares of our common stock, while our unitholders received one common unit of the operating limited liability company subsidiary of Ashford Inc. for each common unit of our operating partnership the holder held, and such holder then had the opportunity to exchange up to 99% of those units for shares of Ashford Inc. common stock at the rate of one share of Ashford Inc. common stock for every 55 common units. Following the spin-off, Ashford Hospitality Trust, Inc. continues to hold 598,000 shares of Ashford Inc. common stock for the benefit of its common stockholders, and all of our remaining lodging investments are owned by Ashford Trust OP. Therefore, each common unit and LTIP unit was worth approximately 93% and 94% of one share of our common stock at September 30, 2015 and December 31, 2014, respectively.

LTIP units, which are issued to certain executives and employees of Ashford LLC as compensation, have vesting periods ranging from three to five years. Additionally, certain independent members of the Board of Directors have elected to receive LTIP units as part of their compensation, which are fully vested upon grant. Upon reaching economic parity with common units, each vested LTIP unit can be converted by the holder into one common unit which can then be redeemed for cash or, at our election, settled in our common stock. An LTIP unit will achieve parity with the common units upon the sale or deemed sale of all or substantially all of the assets of the operating partnership at a time when our stock is trading at a level in excess of the price it was trading on the date of the LTIP issuance. More specifically, LTIP units will achieve full economic parity with common units in connection with (i) the actual sale of all or substantially all of the assets of the operating partnership or (ii) the hypothetical sale of such assets, which results from a capital account revaluation, as defined in the partnership agreement, for the operating partnership.

As of September 30, 2015, we have issued a total of 8.7 million LTIP units, all of which, other than approximately 662,000 units and 43,000 units, issued in March 2015 and May 2015, respectively, have reached full economic parity with, and are convertible into, common units. Expense of $174,000 and $1.1 million was recognized for the three and nine months ended September 30, 2015, respectively, all of which was associated with LTIP units issued to Ashford LLC’s employees and is included in “advisory services fee” in our consolidated statements of operations. As the LTIP units are issued to non-employees, the compensation expense was determined based on the share price as of the end of the period. Compensation expense of $4.0 million and $14.6 million associated with the issuance of LTIP units was recognized for the three and nine months ended September 30, 2014, respectively, while we were self-advised. The fair value of the unrecognized cost of LTIP units, which was $3.0 million at September 30, 2015, will be expensed over a period of 2.5 years.

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During the nine months ended September 30, 2015, 152,000 common units with an aggregate fair value of $1.5 million, were redeemed by the holder and, at our election, we issued shares of our common stock to satisfy the redemption price. During the three months ended September 30, 2015, no common units were redeemed. During the three and nine months ended September 30, 2014, 160,000 common units with an aggregate fair value of $1.8 million were redeemed by the holder and, at our election, we issued shares of our common stock to satisfy the redemption price.

Redeemable noncontrolling interests, including vested LTIP units, in our operating partnership as of September 30, 2015 and December 31, 2014 were $114.7 million and $177.1 million, respectively, which represents ownership of our operating partnership of 13.28% and 13.01%, respectively. The carrying value of redeemable noncontrolling interests as of September 30, 2015 and December 31, 2014 included adjustments of $84.8 million and $169.3 million, respectively, to reflect the excess of the redemption value over the accumulated historical costs. Redeemable noncontrolling interests were allocated net loss of $3.2 million and net income of $39.6 million for the three and nine months ended September 30, 2015, respectively, and net loss of $2.6 million and $4.2 million for the three and nine months ended September 30, 2014, respectively. We declared aggregate cash distributions to holders of common units and holders of LTIP units of $2.7 million and $8.2 million for the three and nine months ended September 30, 2015, respectively, and $2.7 million and $8.1 million for each of the three and nine months ended September 30, 2014, respectively. These distributions are recorded as a reduction of redeemable noncontrolling interests in operating partnership.

13. Equity and Equity-Based Compensation

Equity Offering—On January 29, 2015, we commenced a follow-on public offering of 9.5 million shares of common stock. The offering priced on January 30, 2015, at $10.65 per share for gross proceeds of $101.2 million. We granted the underwriters a 30-day option to purchase up to an additional 1.425 million shares of common stock. On February 10, 2015, the underwriters partially exercised their option and purchased an additional 1.029 million shares of our common stock at a price of $10.65 per share less the underwriting discount.

Common Stock Repurchase—On July 31, 2015, we entered into a block trade with an unaffiliated third party, pursuant to a sale arrangement between the Company, Ashford Inc. and Ashford Prime. The block trade included the repurchase and retirement of approximately 5.8 million shares of our common stock at a price of $9.00 per share for a total cost of approximately $51.8 million. The sale arrangement and block trade were evaluated and approved by the independent members of our board of directors. The block trade purchase price and other terms of the sale arrangement were the result of negotiations with the third party. We did not receive any concessions or economic benefits from Ashford Inc. pertaining to our current contractual arrangements with Ashford Inc. in connection with this block trade. The block trade settled on August 4, 2015.

Common Stock Dividends—For each of the 2015 and 2014 quarters, the Board of Directors declared quarterly dividends of $0.12 per outstanding share of common stock with an annualized target of $0.48 per share for 2015.

Equity-Based Compensation—Stock-based compensation expense for the three and nine months ended September 30, 2015, was $402,000 and $1.4 million, respectively, which is associated with restricted shares of our common stock issued to Ashford LLC’s employees, Ashford Trust’s Directors and certain employees of Remington Lodging and are included in “advisory services fee”, “corporate, general and administrative” and “management fees”, respectively, in our consolidated statements of operations. We recognized compensation expense related to restricted shares of our common stock of $766,000 and $2.4 million for the three and nine months ended September 30, 2014, respectively, while we were self-advised. The fair value of the unrecognized cost of restricted shares, which was $5.8 million at September 30, 2015, will be expensed over a period of approximately 2.5 years.

Preferred Dividends—During the three months ended September 30, 2015, the Board of Directors declared quarterly dividends of $0.5344 per share for our 8.55% Series A preferred stock, $0.5281 per share for our 8.45% Series D preferred stock, and $0.5625 per share for our 9.00% Series E preferred stock. During the three months ended September 30, 2014, the Board of Directors declared quarterly dividends of $0.5344 per share for our 8.55% Series A preferred stock, $0.5281 per share for our 8.45% Series D preferred stock and $0.5625 per share for our 9.00% Series E preferred stock.

Noncontrolling Interests in Consolidated Entities—Our noncontrolling entity partner had an ownership interest of 15% in two hotel properties and a total carrying value of $792,000 and $800,000 at September 30, 2015 and December 31, 2014, respectively. Our ownership interest is reported in equity in the consolidated balance sheets. Noncontrolling interests in consolidated entities were allocated income of $3,000 and loss of $8,000 for the three and nine months ended September 30, 2015, respectively, and allocated losses of $124,000 and $146,000 for the three and nine months ended September 30, 2014, respectively.

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ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

14. Commitments and Contingencies
Restricted Cash—Under certain management and debt agreements for our hotel properties existing at September 30, 2015, escrow payments are required for insurance, real estate taxes, and debt service. In addition, for certain properties based on the terms of the underlying debt and management agreements, we escrow 4% to 6% of gross revenues for capital improvements.
Franchise Fees—Under franchise agreements for our hotel properties existing at September 30, 2015, we pay franchisor royalty fees between 2% and 6% of gross room revenue and, in some cases, food and beverage revenues. Additionally, we pay fees for marketing, reservations, and other related activities aggregating between 1% and 6% of gross room revenue and, in some cases, food and beverage revenues. These franchise agreements expire on varying dates between 2017 and 2040. When a franchise term expires, the franchisor has no obligation to renew the franchise. A franchise termination could have a material adverse effect on the operations or the underlying value of the affected hotel due to loss of associated name recognition, marketing support, and centralized reservation systems provided by the franchisor. A franchise termination could also have a material adverse effect on cash available for distribution to stockholders. In addition, if we breach the franchise agreement and the franchisor terminates a franchise prior to its expiration date, we may be liable for up to three times the average annual fees incurred for that property.
Our continuing operations incurred franchise fees of $17.6 million and $46.4 million for the three and nine months ended September 30, 2015, respectively, and $10.0 million and $28.6 million for the three and nine months ended September 30, 2014, respectively.
Management Fees—Under management agreements for our hotel properties existing at September 30, 2015, we pay a) monthly property management fees equal to the greater of $10,000 (CPI adjusted since 2003) or 3% of gross revenues, or in some cases 1.5% to 7% of gross revenues, as well as annual incentive management fees, if applicable, b) market service fees on approved capital improvements, including project management fees of up to 4% of project costs, for certain hotels, and c) other general fees at current market rates as approved by our independent directors, if required. These management agreements expire from 2016 through 2044, with renewal options. If we terminate a management agreement prior to its expiration, we may be liable for estimated management fees through the remaining term and liquidated damages or, in certain circumstances, we may substitute a new management agreement.
Income Taxes—If we sell or transfer the Marriott Crystal Gateway in Arlington, Virginia prior to July 2016, we will be required to indemnify the entity from which we acquired the property if, as a result of such transactions, such entity would recognize a gain for federal tax purposes. In general, tax indemnities equal the federal, state, and local income tax liabilities the contributor or their specified assignee incurs with respect to the gain allocated to the contributor. The contribution agreements' terms generally require us to gross up tax indemnity payments for the amount of income taxes due as a result of such tax indemnities.
Potential Pension Liabilities—Upon our 2006 acquisition of a hotel property, certain employees of such hotel were unionized and covered by a multi-employer defined benefit pension plan. At that time, no unfunded pension liabilities existed. Subsequent to our acquisition, a majority of employees, who are employees of the hotel manager, Remington Lodging, petitioned the employer to withdraw recognition of the union. As a result of the decertification petition, Remington Lodging withdrew recognition of the union. At the time of the withdrawal, the National Retirement Fund, the union's pension fund, indicated unfunded pension liabilities existed. The National Labor Relations Board ("NLRB") filed a complaint against Remington Lodging seeking, among other things, that Remington Lodging's withdrawal of recognition was unlawful. Pending the final determination of the NLRB complaint, including appeals, the pension fund entered into a settlement agreement with Remington Lodging on November 1, 2011, providing that (a) Remington Lodging will continue to make monthly pension fund payments pursuant to the collective bargaining agreement, and (b) if the withdrawal of recognition is ultimately deemed lawful, Remington Lodging will have an unfunded pension liability equal to $1.7 million minus the monthly pension payments made by Remington Lodging since the settlement agreement. To illustrate, if Remington Lodging—as of the date a final determination occurs—has made monthly pension payments equaling $100,000, Remington Lodging's remaining withdrawal liability shall be the

unfunded pension liability of $1.7 million minus $100,000 (or $1.6 million). This remaining unfunded pension liability shall be paid to the pension fund in annual installments of $84,000 (but may be made monthly or quarterly, at Remington Lodging's election), which shall continue for the remainder of the twenty-(20)-year capped period, unless Remington Lodging elects to pay the unfunded pension liability amount earlier. We agreed to indemnify Remington Lodging for the payment of the unfunded pension liability as set forth in the settlement agreement.

Litigation—Palm Beach Florida Hotel and Office Building Limited Partnership, et al. v. Nantucket Enterprises, Inc. This litigation involves a landlord tenant dispute from 2008 in which the landlord, Palm Beach Florida Hotel and Office Building Limited Partnership, a subsidiary of the Company, claimed that the tenant, Nantucket Enterprises, Inc., had violated various lease provisions of the lease agreement and was therefore in default. The tenant counterclaimed and asserted multiple claims including that it had been wrongfully evicted. The litigation was instituted by the plaintiff in November 2008 in the Circuit Court of the

ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Fifteenth Judicial Circuit, in and for Palm Beach County, Florida and proceeded to a jury trial on June 30, 2014. The jury entered its verdict awarding the tenant total claims of $10.8 million and ruling against the landlord on its claim of breach of contract. The landlord is preparing various post trial motions. A final judgment was entered and the landlord has filed a notice of appeal. As a result of the jury verdict, we previously recorded pre-judgment interest of $707,000 and accrued a reasonable estimate of loss related to legal fees of $400,000 during 2014. For the three and nine months ended September 30, 2015, we recorded additional pre-judgment interest of $24,000 and $71,000, respectively. Including the 2014 judgment, pre-judgment interest and estimated loss of legal expenses, total expense recorded was $12.0 million through September 30, 2015. The additional charges related to pre-judgment interest are included in “other expenses” in the consolidated statements of operations for the three and nine months ended September 30, 2015.

We are engaged in other various legal proceedings which have arisen but have not been fully adjudicated. The likelihood of loss from these legal proceedings, based on definitions within contingency accounting literature, ranges from remote to reasonably possible and to probable. Based on estimates of the range of potential losses associated with these matters, management does not believe the ultimate resolution of these proceedings, either individually or in the aggregate, will have a material adverse effect on our consolidated financial position or results of operations. However, the final results of legal proceedings cannot be predicted with certainty and if we fail to prevail in one or more of these legal matters, and the associated realized losses exceed our current estimates of the range of potential losses, our consolidated financial position or results of operations could be materially adversely affected in future periods.

15. Segment Reporting

We operate in one business segment within the hotel lodging industry: direct hotel investments. Direct hotel investments refer to owning hotels through either acquisition or new development. We report operating results of direct hotel investments on an aggregate basis as substantially all of our hotel investments have similar economic characteristics and exhibit similar long-term financial performance. As of September 30, 2015 and December 31, 2014, all of our hotel properties were domestically located.

16. Related Party Transactions

In connection with the previously discussed spin-off of Ashford Inc., we entered into an advisory agreement with Ashford LLC, which was a subsidiary of ours until November 12, 2014, when it spun off and became a subsidiary of Ashford Inc. Ashford LLC acts as our advisor, and as a result, we pay advisory fees to Ashford LLC. The advisory agreement was amended in June 2015. We are required to pay Ashford LLC a quarterly base fee that is a percentage of our total market capitalization on a declining sliding scale, subject to a minimum quarterly base fee, as payment for managing our day-to-day operations in accordance with our investment guidelines. Total market capitalization includes the aggregate principal amount of our consolidated indebtedness (including our proportionate share of debt of any entity that is not consolidated but excluding our joint venture partners’ proportionate share of consolidated debt). The range of base fees on the scale are between 0.70% and 0.50% per annum for total market capitalization that ranges from less than $6.0 billion to greater than $10.0 billion. At September 30, 2015, the quarterly base fee was 0.70% based on our current market capitalization. We are also required to pay Ashford LLC an incentive fee that is based on our total return performance as compared to our peer group as well as to reimburse Ashford LLC for certain reimbursable overhead and internal audit, insurance claims advisory and asset management services, as specified in the advisory agreement. We also record equity-based compensation expense for equity grants of common stock and LTIP units awarded to our officers and employees of Ashford LLC in connection with providing advisory services equal to the fair value of the award in proportion to the requisite service period satisfied during the period.

On June 10, 2015, the independent directors of the Company approved an amended and restated advisory agreement with Ashford LLC, effective as of June 10, 2015. The amendments, among other things: permit the Company to engage an asset manager other than Ashford LLC with respect to any new properties acquired by the Company, if the Company and Ashford LLC determine that such property would be uneconomic to the Company without incentives; shorten the initial term of the advisory agreement to ten years; extend the renewal terms to five years; provide for key money investments by Ashford LLC to facilitate the Company's acquisition of properties under certain conditions, including Ashford LLC becoming the asset manager for the acquired property and receiving related asset management and other fees, as applicable; adjust the base fee payable to Ashford LLC to a declining sliding scale percentage of total market capitalization of the Company above $6.0 billion; clarify the calculation of the termination fee; allow Ashford LLC to terminate the Advisory Agreement upon a Company Change of Control (as defined in the advisory agreement) and require the Company to pay a termination fee to Ashford LLC upon such termination; and grant Ashford LLC repurchase rights with respect to its shares held by the Company upon any termination of the advisory agreement.

On July 31, 2015, we entered into a block trade with an unaffiliated third party, pursuant to a sale arrangement between the Company, Ashford Inc. and Ashford Prime. The block trade included the repurchase and retirement of approximately 5.8 million

shares of our common stock at a price of $9.00 per share for a total cost of approximately $51.8 million. The sale arrangement and block trade were evaluated and approved by the independent members of our board of directors. The block trade purchase price and other terms of the sale arrangement were the result of negotiations with the third party. We did not receive any concessions or economic benefits from Ashford Inc. pertaining to our current contractual arrangements with Ashford Inc. in connection with this block trade.The block trade settled on August 4, 2015.
Beginning November 12, 2014, we incurred advisory services fees to Ashford Inc. The following table summarizes the advisory services fees incurred (in thousands):

	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2015
Advisory services fee		
Base advisory fee	$8,701	$25,217
Reimbursable fees [(1)]	1,619	4,820
Equity-based compensation [(2)]	468	1,790
Incentive management fee	—	—
Total advisory services revenue	$10,788	$31,827

(1) Reimbursable fees include overhead, internal audit and asset management services.
(2) Equity-based compensation is associated with equity grants of Ashford Trust's common stock and LTIP units awarded to officers and employees of Ashford LLC.

At September 30, 2015, we had a payable of $9.9 million, included in due to Ashford Inc., net, associated with the advisory services fee discussed above. At December 31, 2014, we had a payable of $8.2 million, included in due to Ashford Inc., net, associated with reimbursable expenses in connection with the spin-off and the advisory services fee discussed above.

Certain employees of Remington Lodging, who perform work on behalf of Ashford Trust, were granted approximately 147,000 shares of restricted stock under the Ashford Trust Stock Plan on June 30, 2015. These share grants were accounted for under the applicable accounting guidance related to share-based payments granted to non-employees and are recorded as a component of "management fees" in our consolidated statements of operations. Expense of $108,000 was recognized for both the three and nine months ended September 30, 2015. The unamortized fair value of the grants was $769,000 as of September 30, 2015 which will be amortized over a period of 2.5 years.

17. Subsequent Events

As discussed in Note 3, on October 15, 2015, we acquired a 100% interest in the Indigo Atlanta for total consideration of $26.4 million. As part of the transaction, we assumed a mortgage loan of approximately $16.0 million. The assumed debt matures in June 2017 and carries a fixed rate of 5.98%.

The unaudited pro forma results of operations, as if the acquisition had occurred on January 1, 2014, are included in Note 3.

On October 30, 2015, we obtained a new $100.0 million credit facility which matures October 2016. The credit facility provides for a one-year revolving line of credit priced at 200 to 300 basis points over LIBOR or base rate. The credit facility also contains customary financial covenant tests with respect to minimum fixed charge coverage ratio and maximum leverage tests allowable.

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ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

The following discussion should be read in conjunction with the unaudited financial statements and notes thereto appearing elsewhere herein. This report contains forward-looking statements within the meaning of the federal securities laws. Ashford Hospitality Trust, Inc. (the "Company" or "we" or "our" or "us") cautions investors that any forward-looking statements presented herein, or which management may express orally or in writing from time to time, are based on management's beliefs and assumptions at that time.

Throughout this Form 10-Q, we make forward-looking statements that are subject to risks and uncertainties. Forward-looking statements are generally identifiable by use of forward-looking terminology such as "may," "will," "should," "potential," "intend," "expect," "anticipate," "estimate," "approximately," "believe," "could," "project," "predict," o words or expressions. Additionally, statements regarding the following subjects are forward-looking by their nature:

- our business and investment strategy, including our ability to complete proposed business transactions described herein or the expected benefit of any such transactions;
- anticipated or expected purchases or sales of assets;
- our projected operating results;
- completion of any pending transactions;
- our ability to obtain future financing arrangements;
- our understanding of our competition;
- market trends;
- projected capital expenditures; and
- the impact of technology on our operations and business.

Such forward-looking statements are based on our beliefs, assumptions, and expectations of our future performance taking into account all information currently known to us. These beliefs, assumptions, and expectations can change as a result of many potential events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity, results of operations, plans, and other objectives may vary materially from those expressed in our forward-looking statements. Additionally, the following factors could cause actual results to vary from our forward-looking statements:

- factors discussed in our Form 10-K for the year ended December 31, 2014, as filed with the Securities and Exchange Commission on March 2, 2015, including those set forth under the sections titled "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Business," and "Properties," as updated in our subsequent Quarterly Reports on Form 10-Q;
- general and economic business conditions affecting the lodging and travel industry;
- general volatility of the capital markets and the market price of our common and preferred stock;
- changes in our business or investment strategy;
- availability, terms, and deployment of capital;
- availability of qualified personnel to our advisor;
- changes in our industry and the market in which we operate, interest rates, or local economic conditions;
- the degree and nature of our competition;
- actual and potential conflicts of interest with our advisor, Remington Lodging & Hospitality, LLC, our executive officers and our non-independent directors;
- changes in governmental regulations, accounting rules, tax rates and similar matters;
- legislative and regulatory changes, including changes to the Internal Revenue Code of 1986, as amended, and related rules, regulations and interpretations governing the taxation of REITs; and
- limitations imposed on our business and our ability to satisfy complex rules in order for us to qualify as a REIT for federal income tax purposes.

When we use words or phrases such as "will likely result," "may," "anticipate," "estimate," "should," "expect," "believe," "int similar expressions, we intend to identify forward-looking statements. You should not place undue reliance on these forward-looking statements. We are not obligated to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

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Overview

We will continue to seek ways to benefit from the cyclical nature of the hotel industry. We believe that in the prior cycle, hotel values and cash flows, for the most part, peaked in 2007, and the hotel industry recently exceeded these values and cash flows.

Based on our primary business objectives and forecasted operating conditions, our current key priorities and financial strategies include, among other things:

- acquisition of hotel properties that will be accretive to our portfolio;
- disposition of non-core hotel properties;
- pursuing capital market activities to enhance long-term stockholder value;
- preserving capital, enhancing liquidity, and continuing current cost-saving measures;
- implementing selective capital improvements designed to increase profitability;
- implementing effective asset management strategies to minimize operating costs and increase revenues;
- financing or refinancing hotels on competitive terms;
- utilizing hedges and derivatives to mitigate risks; and
- making other investments or divestitures that our Board of Directors deems appropriate.

In June 2015, our Board of Directors modified our investment strategy to focus predominantly on full-service hotels in the upscale and upper-upscale segments in domestic and international markets that have revenue per available room ("RevPAR") generally less than twice the national average. The change in our investment strategy was made in conjunction with our announcement that we plan to sell our select-service hotel portfolio.We believe that as supply, demand, and capital market cycles change, we will be able to shift our investment strategy to take advantage of new lodging-related investment opportunities as they may develop. Our Board of Directors may change our investment strategy at any time without stockholder approval or notice.

Recent Developments

On January 2, 2015, we refinanced two mortgage loans totaling $356.3 million. The refinance included our $211.0 million mortgage loan due November 2015 and our $145.3 million mortgage loan due July 2015. The new loans totaled $477.3 million in four loan pools. The new loans continue to be secured by the same 15 hotel properties.

On January 29, 2015, we commenced a follow-on public offering of 9.5 million shares of common stock. The offering priced on January 30, 2015, at $10.65 per share for gross proceeds of $101.2 million. We granted the underwriters a 30-day option to purchase up to an additional 1.425 million shares of common stock. On February 10, 2015, the underwriters partially exercised their option and purchased an additional 1.029 million shares of our common stock at a price of $10.65 per share less the underwriting discount.

On February 6, 2015, we acquired a 100% interest in the Lakeway Resort & Spa ("Lakeway Resort") in Austin, Texas for total consideration of $33.5 million. The acquisition was funded with cash.

On February 25, 2015, we acquired a 100% interest in the Memphis Marriott East ("Memphis Marriott") hotel in Memphis, Tennessee for total consideration of $43.5 million. The acquisition was funded with cash.

On March 6, 2015, we acquired the remaining approximate 28.26% interest in the PIM Highland JV for $250.1 million in cash. Subsequent to the close of the transaction, $907.6 million of mortgage loans due March 2015 were refinanced with a $1.07 billion non-recourse mortgage loan due April 2017. The new loan provides for an interest rate of LIBOR plus 4.39%. Additionally, we assumed two mortgage loans with initial outstanding balances of $99.3 million due January 2018 with a fixed interest rate of 4.38% and $108.6 million due January 2018 with a fixed interest rate of 4.44%.

On March 11, 2015, we completed the sale of the Hampton Inn in Terre Haute, Indiana for approximately $7.9 million. The sale resulted in a loss of approximately $1.1 million which is included in our continuing operations for the three months ended March 31, 2015.

On March 25, 2015, we completed the financing of a $33.3 million mortgage loan, secured by the Memphis Marriott. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.95%. The stated maturity is April 2017, with three one-year extension options.

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On April 17, 2015, we completed the financing of a $25.1 million mortgage loan, secured by the Lakeway Resort. The new mortgage loan is interest only and provides for a floating interest rate of LIBOR + 5.10%. The stated maturity is May 2017, with three one-year extension options.

On April 29, 2015, we completed the acquisition of the 124-room Hampton Inn & Suites ("Hampton Inn Gainesville") in Gainesville, Florida, for total consideration of $25.2 million in cash.

On June 3, 2015, we acquired a 100% interest in Le Pavillon Hotel ("Le Pavillon") in New Orleans, Louisiana for total cash consideration of $62.5 million. In conjunction with the close of the transaction, we completed the financing of a $43.8 million mortgage loan. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 5.10%. The stated maturity is June 2017, with three one-year extension options.

On June 10, 2015, the independent directors of the Company approved an amended and restated advisory agreement with Ashford LLC, effective as of June 10, 2015. The amendments, among other things: permit the Company to engage an asset manager other than Ashford LLC with respect to any new properties acquired by the Company, if the Company and Ashford LLC determine that such property would be uneconomic to the Company without incentives; shorten the initial term of the advisory agreement to ten years; extend the renewal terms to five years; provide for key money investments by Ashford LLC to facilitate the Company's acquisition of properties under certain conditions, including Ashford LLC becoming the asset manager for the acquired property and receiving related asset management and other fees, as applicable; adjust the base fee payable to Ashford LLC to a declining sliding scale percentage of total market capitalization of the Company above $6.0 billion; clarify the calculation of the termination fee; allow Ashford LLC to terminate the Advisory Agreement upon a Company Change of Control (as defined in the advisory agreement) and require the Company to pay a termination fee to Ashford LLC upon such termination; and grant Ashford LLC repurchase rights with respect to its shares held by the Company upon any termination of the advisory agreement. In connection with the agreement between Ashford Inc. and Remington Holdings to combine, on September 17, 2015, we entered into a letter agreement with Ashford Inc. approved by the independent directors of the Company to clarify that for purposes of determining the termination fee under the advisory agreement, Ashford LLC's earnings shall exclude earnings arising under the master management agreement under which Remington Lodging may manage any of our hotels.

On June 17, 2015, we acquired a 100% interest in a 9-hotel portfolio (the "Rockbridge Portfolio") for total cash consideration of $225.0 million. Subsequent to the close of the transaction, we completed the financing of two mortgage loans totaling $179.2 million, secured by the Rockbridge Portfolio. The financing includes a $144.0 million mortgage loan, secured by eight of the nine hotel properties. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.09%. The stated maturity is July 2017, with three one-year extension options. The financing also includes a $35.2 million mortgage loan secured by the Sheraton Ann Arbor. The mortgage loan is interest only and provides for a floating rate of LIBOR + 4.15%. The stated maturity is July 2017, with three one-year extension options.

On June 24, 2015, we completed the financing of a $21.2 million mortgage loan, secured by the Hampton Inn Gainesville. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.50%. The stated maturity is July 2018, with two one-year extension options.

In June 2015, the Board of Directors modified our investment strategy to focus predominantly on upper upscale, full-service hotels and in conjunction with this modification, on June 26, 2015, we announced that we planned to sell a portfolio of approximately 23 select-service hotels that are mostly brand-managed. The planned sale of the portfolio is consistent with our newly refined strategy, which focuses predominately on full-service hotels in the upscale and upper-upscale segments in domestic and international markets that have RevPAR generally less than twice the national average.

On July 1, 2015, we acquired a 100% interest in the W Atlanta Downtown ("W Atlanta") in Atlanta, Georgia for total consideration of $56.8 million. In conjunction with the close of the transaction, we completed the financing of a $40.5 million mortgage loan. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 5.10%. The stated maturity is July 2017, with three one-year extension options.

On July 13, 2015, we announced that our board of directors had declared the distribution (1) to our stockholders of approximately 4.1 million shares of common stock of Ashford Prime to be received by Ashford Trust upon redemption of Ashford Prime OP common units and (2) to the common unitholders of Ashford Trust OP of our remaining common units of Ashford Prime OP. The distribution occurred on July 27, 2015, to stockholders and common unitholders of record as of the close of business of the New York Stock Exchange on July 20, 2015. As a result of the distribution, we have no ownership interest in Ashford Prime.

On July 23, 2015, we acquired a 100% interest in the Le Meridien Chambers Minneapolis (“Le Meridien Minneapolis”) in Minneapolis, Minnesota for total consideration of $15.0 million. The acquisition was funded with cash.

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On July 31, 2015, we entered into a block trade with an unaffiliated third party, pursuant to a sale arrangement between the Company, Ashford Inc. and Ashford Prime. The block trade included the repurchase and retirement of approximately 5.8 million shares of our common stock at a price of $9.00 per share for a total cost of approximately $51.8 million. The sale arrangement and block trade were evaluated and approved by the independent members of our board of directors. The block trade purchase price and other terms of the sale arrangement were the result of negotiations with the third party. We did not receive any concessions or economic benefits from Ashford Inc. pertaining to our current contractual arrangements with Ashford Inc. in connection with this block trade. The block trade settled on August 4, 2015.

On August 5, 2015, we acquired a 100% interest in the Hilton Garden Inn - Wisconsin Dells in Wisconsin Dells, Wisconsin for total consideration of $15.2 million. In conjunction with the close of the transaction, we completed the financing of a $12.0 million mortgage loan. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.95%. The stated maturity is August 2018, with two one-year extension options.

On October 15, 2015, we acquired a 100% interest in the Hotel Indigo ("Indigo Atlanta") in Atlanta, Georgia for total consideration of $26.4 million. As part of the transaction, we assumed a mortgage loan of approximately $16.0 million. The assumed debt matures in June 2017 and carries a fixed rate of 5.98%.

On October 30, 2015, we obtained a new $100.0 million credit facility which matures October 2016. The credit facility provides for a one-year revolving line of credit priced at 200 to 300 basis points over LIBOR or base rate. The credit facility also contains customary financial covenant tests with respect to minimum fixed charge coverage ratio and maximum leverage tests allowable.

LIQUIDITY AND CAPITAL RESOURCES

Our cash position from operations is affected primarily by macro industry movements in occupancy and rate as well as our ability to control costs. Further, interest rates can greatly affect the cost of our debt service as well as the value of any financial hedges we may put in place. We monitor industry fundamentals and interest rates very closely. Capital expenditures above our reserves will affect cash flow as well.

Certain of our loan agreements contain cash trap provisions that may get triggered if the performance of our hotels decline. When these provisions are triggered, substantially all of the profit generated by our hotels is deposited directly into lockbox accounts and then swept into cash management accounts for the benefit of our various lenders. Cash is distributed to us only after certain items are paid, including deposits into ground leasing and maintenance reserves and the payment of debt service, insurance, taxes, operating expenses, and extraordinary capital expenditures and ground leasing expenses. This could affect our liquidity and our ability to make distributions to our stockholders.

Also, we have entered into certain customary guaranties pursuant to which we guarantee payment of any recourse liabilities of our subsidiaries or unconsolidated entities that may result from non-recourse carve-outs, which include, but are not limited to, fraud, misrepresentation, willful misconduct resulting in waste, misappropriations of rents following an event of default, voluntary bankruptcy filings, unpermitted transfers of collateral, and certain environmental liabilities. Certain of these guarantees represent a guaranty of material amounts, and if we are required to make payments under those guarantees, our liquidity could be adversely affected. In connection with the Ashford Prime spin-off, we are still jointly and severally liable under certain carve-out guarantees and environmental indemnities associated with three loans. Ashford Prime has indemnified us in the case that any of these guarantees are ever called.

In September 2011, we entered into an at-the-market ("ATM") program with an investment banking firm, pursuant to which we may issue up to 700,000 shares of 8.55% Series A Cumulative Preferred Stock and up to 700,000 shares of 8.45% Series D Cumulative Preferred Stock at market prices up to $30.0 million in total proceeds. While the ATM program remains in effect until such time that either party elects to terminate or the share or dollar thresholds are reached, we can not issue shares under the ATM program until such time that a new prospectus is filed with the SEC. Through September 30, 2015, we have issued 169,306 shares of 8.55% Series A Cumulative Preferred Stock for gross proceeds of $4.2 million and 501,909 shares of 8.45% Series D Cumulative Preferred Stock for gross proceeds of $12.3 million. During the nine months ended September 30, 2015, no shares were issued under this ATM program.

On January 2, 2015, we refinanced two mortgage loans totaling $356.3 million. The refinancing included our $211.0 million mortgage loan due November 2015 and our $145.3 million mortgage loan due July 2015. The new loans

totaled $477.3 million in four loan pools. The new loans continue to be secured by the same 15 hotel properties.
On January 29, 2015, we commenced a follow-on public offering of 9.5 million shares of common stock. The offering priced on January 30, 2015, at $10.65 per share for gross proceeds of $101.2 million. We granted the underwriters a 30-day option to purchase up to an additional 1.425 million shares of common stock. On February 10, 2015, the underwriters partially exercised

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their option and purchased an additional 1.029 million shares of our common stock at a price of $10.65 per share, less the underwriting discount.
On March 25, 2015, we completed the financing of a $33.3 million mortgage loan, secured by the Memphis Marriott. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.95%. The stated maturity is April 2017, with three one-year extension options.
On March 6, 2015, we acquired the remaining approximate 28.26% interest in the PIM Highland JV for $250.1 million in cash. Subsequent to the close of the transaction, $907.6 million of mortgage loans due March 2015 were refinanced with a $1.07 billion non-recourse mortgage loan due April 2017. The new loan provides for an interest rate of LIBOR plus 4.39%. Additionally, we assumed two mortgage loans with initial outstanding balances of $99.3 million due January 2018 with a fixed interest rate of 4.38% and $108.6 million due January 2018 with a fixed interest rate of 4.44%.
On April 17, 2015, we completed the financing of a $25.1 million mortgage loan, secured by the Lakeway Resort in Austin, Texas. The new mortgage loan is interest only and provides for a floating interest rate of LIBOR + 5.10%. The stated maturity is May 2017, with three one-year extension options.
In May 2015, we entered into an ATM program with an investment banking firm to offer for sale from time to time up to $150.0 million of our common stock at market prices. No shares have been sold under this ATM program since its inception. The ATM program will remain in effect until such time that either party elects to terminate or the $150.0 million cap is reached.
On June 3, 2015, we completed the financing of a $43.75 million mortgage loan, secured by Le Pavillon. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 5.10%. The stated maturity is June 2017, with three one-year extension options.
On June 17, 2015, we completed the financing of two mortgage loans totaling $179.2 million, secured by the Rockbridge Portfolio. The financing includes a $144.0 million mortgage loan, secured by eight of the nine hotel properties. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.09%. The stated maturity is July 2017, with three one-year extension options. The financing also includes a $35.2 million mortgage loan, secured by the Sheraton Ann Arbor. The mortgage loan is interest only and provides for a floating rate of LIBOR + 4.15%. The stated maturity is July 2017, with three one-year extension options.
On June 24, 2015, we completed the financing of a $21.2 million mortgage loan, secured by Hampton Inn Gainesville. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.50%. The stated maturity is July 2018, with two one-year extension options.
On July 31, 2015, we entered into a block trade with an unaffiliated third party, pursuant to a sale arrangement between the Company, Ashford Inc. and Ashford Prime. The block trade included the repurchase and retirement of approximately 5.8 million shares of our common stock at a price of $9.00 per share for a total cost of approximately $51.8 million. The sale arrangement and block trade were evaluated and approved by the independent members of our board of directors. The block trade purchase price and other terms of the sale arrangement were the result of negotiations with the third party. We did not receive any concessions or economic benefits from Ashford Inc. pertaining to our current contractual arrangements with Ashford Inc. in connection with this block trade.The block trade settled on August 4, 2015.
On August 5, 2015, we completed the financing of a $12.0 million mortgage loan, secured by the Hilton Garden Inn - Wisconsin Dells. The mortgage loan is interest only and provides for a floating interest rate of LIBOR + 4.95%. The stated maturity is August 2018, with two one-year extension options.
On October 15, 2015, we assumed a mortgage loan of approximately $16.0 million, secured by the Indigo Atlanta. The assumed debt matures in June 2017 with a fixed rate of 5.98%.
On October 30, 2015, we obtained a new $100.0 million credit facility which matures October 2016. The credit facility provides for a one-year revolving line of credit priced at 200 to 300 basis points over LIBOR or base rate. The credit facility also contains customary financial covenant tests with respect to minimum fixed charge coverage ratio and maximum leverage tests allowable.
Our principal sources of funds to meet our cash requirements include: cash on hand, positive cash flow from operations, capital market activities, property refinancing proceeds and asset sales. Additionally, our principal uses of

funds are expected to include possible operating shortfalls, owner-funded capital expenditures, new investments, debt interest and principal payments and dividends. Items that impacted our cash flow and liquidity during the periods indicated are summarized as follows:

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Net Cash Flows Provided by Operating Activities. Net cash flows provided by operating activities, pursuant to our consolidated statements of cash flows, which includes changes in balance sheet items, were $133.3 million and $92.9 million for the nine months ended September 30, 2015 and 2014, respectively. Cash flows from operations were impacted by changes in hotel operations, the results of the Pier House Resort, which was sold on March 1, 2014 and is included for the periods from January 1, 2014 through February 28, 2014, the operating results of the Lakeway Resort and the Memphis Marriott, which were acquired on February 6, 2015 and February 25, 2015, respectively, the results of the PIM Highland JV, which the remaining 28.26% ownership was acquired on March 6, 2015, the operating results of the Hampton Inn Gainesville, which was acquired on April 29, 2015, the operating results of Le Pavillon, which was acquired on June 3, 2015, the operating results of the Rockbridge Portfolio, which was acquired on June 17, 2015, the operating results of the W Atlanta Downtown hotel, which we acquired on July 23, 2015, the operating results of the Le Meridien Minneapolis, which we acquired on July 23, 2015, the operating results of the Hilton Garden Inn - Wisconsin Dells, which we acquired on August 5, 2015, the effect of the Ashford Inc. spin-off, that was included in the 2014 results, but not the 2015 results, as well as changes in restricted cash due to the timing of cash deposits for certain loans as well as the timing of collecting receivables from hotel guests, paying vendors, settling with related parties and settling with hotel managers.

Net Cash Flows Used in Investing Activities. For the nine months ended September 30, 2015, investing activities used net cash flows of $737.4 million, which consisted of cash outflows of $696.0 million primarily attributable the purchase of the Lakeway Resort, Memphis Marriott, Hampton Inn Gainesville, Le Pavillon, the Rockbridge Portfolio, W Atlanta, Le Meridien Minneapolis, Hilton Garden Inn - Wisconsin Dells and the remaining approximate 28.26% interest in the PIM Highland JV hotel properties, $114.9 million for capital improvements made to various hotel properties and $498,000 for franchise fees. These outflows were partially offset by inflows of $63.5 million of reductions in restricted cash for capital expenditures, $7.5 million attributable to cash proceeds received from the sale of the Hampton Inn in Terre Haute, Indiana, $2.5 million of key money proceeds from a franchisor related to the extension of a certain franchise agreement, $385,000 of proceeds from property insurance and $184,000 of cash payments received on previously impaired mezzanine loans. For the nine months ended September 30, 2014, investing activities used net cash flows of $150.6 million, which primarily consisted of cash outflows of $91.5 million for capital improvements made to various hotel properties, $57.7 million primarily attributable to the purchase of the Ashton and Fremont hotel properties, $39.3 million of net deposits to restricted cash for capital expenditures and $208,000 for franchise fees. These outflows were partially offset by inflows of $22.9 million attributable to cash proceeds received from the sale of the Pier House Resort and three WorldQuest condominium units, $13.6 million of reimbursements from Ashford Prime related to transaction costs from the Ashford Prime spin-off, $1.4 million of proceeds from property insurance and $185,000 of cash payments received on previously impaired mezzanine loans.

Net Cash Flows Provided by Financing Activities. For the nine months ended September 30, 2015, net cash flows provided by financing activities were $575.0 million. Cash inflows consisted primarily of $1.9 billion in borrowings on indebtedness and proceeds of $110.9 million from issuance of treasury stock associated with our equity offering. Cash inflows were partially offset by cash outlays primarily consisting of $1.3 billion for repayments of indebtedness, $38.3 million for payments of loan costs and exit fees, $68.6 million for dividend payments to common and preferred stockholders and unitholders, $1.8 million of payments for derivatives and $52.3 million for repurchase of common shares. For the nine months ended September 30, 2014, net cash flows provided by financing activities were $209.5 million. Cash inflows consisted primarily of $718.8 million in borrowings on indebtedness and $85.8 million in proceeds from issuance of treasury stock associated with our equity offering. Cash inflows were partially offset by cash outlays primarily consisting of $509.2 million for repayments of indebtedness, $63.5 million for dividend payments to common and preferred stockholders and unitholders, $1.2 million for distributions to noncontrolling interests in consolidated entities, $20.2 million for payments of loan costs and exit fees, $458,000 for repurchase of common shares and $661,000 of payments for derivatives.

We are required to maintain certain financial ratios under various debt and related agreements. If we violate covenants in any debt or related agreement, we could be required to repay all or a portion of our indebtedness before maturity at a time when we might be unable to arrange financing for such repayment on attractive terms, if at all. Presently, our existing financial debt covenants primarily relate to maintaining minimum net worth and liquidity. As of

September 30, 2015, we were in compliance in all material respects with all covenants or other requirements set forth in our debt and related agreements as amended.

Mortgage and mezzanine loans are nonrecourse to the borrowers, except for customary exceptions or carve-outs that trigger recourse liability to the borrowers in certain limited instances. Recourse obligations typically include only the payment of costs and liabilities suffered by lenders as a result of the occurrence of certain bad acts on the part of the borrower. However, in certain cases, carve-outs could trigger recourse obligations on the part of the borrower with respect to repayment of all or a portion of the outstanding principal amounts of the loans. We have entered into customary guaranty agreements pursuant to which we guarantee payment of any recourse liabilities of the borrowers that result from non-recourse carve-outs (which include, but are not limited to, fraud, misrepresentation, willful conduct resulting in waste, misappropriations of rents following an event of default, voluntary bankruptcy filings, unpermitted transfers of collateral, and certain environmental liabilities). In the opinion of

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management, none of these guaranty agreements, either individually or in the aggregate, are likely to have a material adverse effect on our business, results of operations, or financial condition.

Based on our current level of operations, management believes that our cash flow from operations and our existing cash balances will be adequate to meet upcoming anticipated requirements for interest and principal payments on debt, working capital, and capital expenditures for the next 12 months. With respect to upcoming maturities, we will proactively address our 2015 and 2016 maturities. No assurances can be given that we will obtain additional financings or, if we do, what the amount and terms will be. Our failure to obtain future financing under favorable terms could adversely impact our ability to execute our business strategy. In addition, we may selectively pursue debt financing on individual properties.

We are committed to an investment strategy where we will opportunistically pursue hotel-related investments as suitable situations arise. Funds for future hotel-related investments are expected to be derived, in whole or in part, from cash on hand, future borrowings under a credit facility or other loans, or proceeds from additional issuances of common stock, preferred stock, or other securities, asset sales, and joint ventures. However, we have no formal commitment or understanding to invest in additional assets, and there can be no assurance that we will successfully make additional investments. We may, when conditions are suitable, consider additional capital raising opportunities.

Our existing hotels are mostly located in developed areas with competing hotel properties. Future occupancy, average daily room rate ("ADR"), and RevPAR of any individual hotel could be materially and adversely affected by an increase in the number or quality of competitive hotel properties in its market area. Competition could also affect the quality and quantity of future investment opportunities.

Dividend Policy. During the nine month periods ended September 30, 2015 and 2014, the Board of Directors declared quarterly dividends of $0.12 per outstanding share of common stock. In December 2014, the Board of Directors approved our 2015 dividend policy which anticipates a quarterly dividend payment of $0.12 per share for the remainder of 2015. However, the adoption of a dividend policy does not commit our Board of Directors to declare future dividends. The Board of Directors will continue to review our dividend policy on a quarterly basis. We may incur indebtedness to meet distribution requirements imposed on REITs under the Internal Revenue Code to the extent that working capital and cash flow from our investments are insufficient to fund required distributions. Alternatively, we may elect to pay dividends on our common stock in cash or a combination of cash and shares of securities as permitted under federal income tax laws governing REIT distribution requirements. We may pay dividends in excess of our cash flow.

RESULTS OF OPERATIONS

RevPAR is a commonly used measure within the hotel industry to evaluate hotel operations. RevPAR is defined as the product of the ADR charged and the average daily occupancy achieved. RevPAR does not include revenues from food and beverage or parking, telephone, or other guest services generated by the property. Although RevPAR does not include these ancillary revenues, it is generally considered the leading indicator of core revenues for many hotels. We also use RevPAR to compare the results of our hotels between periods and to analyze results of our comparable hotels (comparable hotels represent hotels we have owned for the entire period). RevPAR improvements attributable to increases in occupancy are generally accompanied by increases in most categories of variable operating costs. RevPAR improvements attributable to increases in ADR are generally accompanied by increases in limited categories of operating costs, such as management fees and franchise fees.

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The following table summarizes changes in key line items from our consolidated statements of operations (in thousands):

	Three Months Ended September 30,		Favorable/ (Unfavorable)	Nine Months Ended September 30,		Favorable/ (Unfavorable)
	2015	2014	Change	2015	2014	Change
Total revenue	$364,516	$201,457	$ 163,059	$984,089	$604,481	$ 379,608
Total hotel operating expenses	(232,055)	(127,898)	(104,157)	(610,483)	(383,779)	(226,704)
Property taxes, insurance, and other	(17,997)	(10,421)	(7,576)	(47,167)	(28,958)	(18,209)
Depreciation and amortization	(58,741)	(28,338)	(30,403)	(149,221)	(81,022)	(68,199)
Impairment charges	111	105	6	(19,623)	310	(19,933)
Transaction costs	(392)	(533)	141	(5,850)	(616)	(5,234)
Advisory services fee	(10,788)	—	(10,788)	(31,827)	—	(31,827)
Corporate, general, and administrative	(3,772)	(15,104)	11,332	(11,732)	(47,290)	35,558
Operating income	40,882	19,268	21,614	108,186	63,126	45,060
Equity in earnings (loss) of unconsolidated entities	(4,369)	2,831	(7,200)	(9,084)	6,794	(15,878)
Interest income	21	27	(6)	67	45	22
Gain on acquisition of PIM Highland JV	—	—	—	381,835	—	381,835
Other income (expense)	(314)	2,564	(2,878)	1,733	5,841	(4,108)
Interest expense and amortization of premiums and loan costs, net	(51,859)	(29,400)	(22,459)	(133,989)	(85,563)	(48,426)
Write-off of loan costs and exit fees	—	(8,319)	8,319	(4,767)	(10,353)	5,586
Unrealized gain (loss) on marketable securities	—	(2,875)	2,875	127	(3,818)	3,945
Unrealized loss on derivatives	(2,750)	(70)	(2,680)	(6,403)	(680)	(5,723)
Income tax expense	(1,721)	(292)	(1,429)	(4,635)	(820)	(3,815)
Income (loss) from continuing operations	(20,110)	(16,266)	(3,844)	333,070	(25,428)	358,498
Income from discontinued operations	—	62	(62)	—	88	(88)
Gain (loss) on sale of hotel properties, net of tax	599	—	599	(531)	3,491	(4,022)
Net income (loss)	(19,511)	(16,204)	(3,307)	332,539	(21,849)	354,388
Net (income) loss from consolidated entities attributable to noncontrolling interests	(3)	124	(127)	8	146	(138)
Net (income) loss attributable to redeemable noncontrolling interests in operating partnership	3,193	2,585	608	(39,616)	4,234	(43,850)
Net income (loss) attributable to the Company	$(16,321)	$(13,495)	$ (2,826)	$292,931	$(17,469)	$ 310,400

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The following table illustrates key performance indicators for our hotel properties included in continuing operations for the three and nine months ended September 30, 2015 and 2014. The operating results of the Pier House Resort, which was sold on March 1, 2014 are included for the periods from January 1, 2014 through February 28, 2014. The operating results of the Lakeway Resort and the Memphis Marriott, which were acquired on February 6, 2015 and February 25, 2015, respectively, the operating results of the Hampton Inn Gainesville, which was acquired on April 29, 2015, the operating results of the Le Pavillon, which was acquired on June 3, 2015, the operating results of the Rockbridge Portfolio, which was acquired on June 17, 2015, the operating results of the W Atlanta, which we acquired on July 23, 2015, the operating results of the Le Meridien Minneapolis, which we acquired on July 23, 2015, the operating results of the Hilton Garden Inn - Wisconsin Dells, which we acquired on August 5, 2015, are included in continuing operations since their acquisitions. The operating results of the Ashton hotel (“Ashton”) in Fort Worth, Texas and the Fremont Marriott Silicon Valley hotel (“Fremont Marriott”) in Fremont, California, which were acquired on July 18, 2014 and August 6, 2014, respectively, are included in continuing operations for the three and nine months ended September 30, 2015, but are only included for the three and nine months ended September 30, 2014 since their acquisitions. The operating results for the PIM Highland JV for the period from January 1, 2014 through March 5, 2015, are included in equity in loss of unconsolidated entities for our ownership percentage. Beginning March 6, 2015, we consolidated the results of operations of these hotels.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
RevPar (revenue per available room)	$115.84	$104.43	$148.77	$104.68
Occupancy	78.79 %	78.29 %	79.04 %	77.72 %
ADR (average daily rate)	$147.03	$133.38	$148.77	$134.68

The following table illustrates the key performance indicators of the 85 hotels that were included for the full three and nine months ended 2015 and 2014, respectively:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
RevPar (revenue per available room)	$110.41	$104.10	$112.28	$104.57
Occupancy	79.27 %	78.23 %	79.25 %	77.70 %
ADR (average daily rate)	$139.29	$133.07	$141.67	$134.58

Comparison of the Three Months Ended September 30, 2015 and 2014

Net loss attributable to the Company. Net loss attributable to the Company increased $2.8 million, from a net loss of $13.5 million to a net loss of $16.3 million as a result of the factors discussed below.

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Revenue. Rooms revenue from our hotels increased $129.8 million, or 78.7%, to $294.8 million during the three months ended September 30, 2015 (the “2015 quarter”) compared to the three months ended September 30, 2014 (the “2014 quarter”). We experienced an increase in rooms revenue of $93.3 million as a result of the PIM Highland JV acquisition, $27.8 million associated with the Lakeway Resort, Memphis Marriott, Hampton Inn Gainesville, Le Pavillon, Rockbridge Portfolio, W Atlanta, Le Meridien Minneapolis, Hilton Garden Inn - Wisconsin Dells, Ashton and Fremont Marriott (“New Hotel Acquisitions”) that were purchased in February 2015, March 2015, April 2015, June 2015, June 2015, July 2015, July 2015, August 2015, September 2015, July 2014 and August 2014, respectively, and $8.8 million from our remaining hotels and WorldQuest, which experienced an increase of 104 basis points in occupancy and an increase of 4.7% in room rates. Food and beverage revenue experienced an increase of $29.9 million, or 118.5%, to $55.2 million. This increase is a result of $24.4 million from the PIM Highland JV acquisition, $5.4 million associated with the New Hotel Acquisitions and $214,000 from our remaining hotel properties and WorldQuest. Other hotel revenue, which consists mainly of Internet access, parking, and spa, experienced an increase of $7.1 million, or 100.1%, to $14.1 million. This increase is a result of $4.3 million from the PIM Highland JV acquisition, $1.7 million associated with the New Hotel Acquisitions and $993,000 from our remaining hotel properties and WorldQuest. For the 2014 quarter, we recorded advisory services revenue of $3.1 million from an agreement between Ashford LLC and Ashford Prime that was in place prior to the spin-off of Ashford, Inc. The advisory services revenue was comprised of a base advisory fee of $2.2 million and reimbursable expenses of $448,000. We also recorded advisory revenue for equity grants of Ashford Prime common stock and LTIP units awarded to our officers and employees of approximately $431,000 in connection with providing advisory services. Other non-hotel revenue decreased $631,000, or 58.9%, to $441,000. The decrease in other non-hotel revenue is primarily attributable to the acquisition of the PIM Highland JV. Prior to the acquisition, we received expense reimbursements related to our managing the day-to-day operations and providing corporate administrative services such as accounting, insurance, marketing support, asset management, and other services.

Hotel Operating Expenses. Hotel operating expenses increased $104.2 million, or 81.4%, to $232.1 million. Hotel operating expenses consist of direct expenses from departments associated with revenue streams and indirect expenses associated with support departments and management fees. We experienced increases of $51.8 million in direct expenses and $52.3 million in indirect expenses and management fees in the 2015 quarter, which were primarily attributable to increases in direct expenses and indirect expenses and management fees of $38.3 million and $39.3 million, respectively as a result of the PIM Highland JV acquisition, $11.0 million and $11.5 million, respectively as a result of the New Hotel Acquisitions and $2.5 million and $1.5 million, respectively from our remaining hotel properties and WorldQuest. The increases from our remaining hotel properties and WorldQuest are attributable to higher hotel revenues at those properties. Indirect expense included a charge in the 2014 quarter of $10.8 million related to a jury verdict received in a legal proceeding. See Note 13. Direct expenses were 30.7% and 30.4% of total hotel revenue for the 2015 quarter and the 2014 quarter, respectively.

Property Taxes, Insurance, and Other. Property taxes, insurance, and other increased $7.6 million, or 72.7%, to $18.0 million during the 2015 quarter compared to the 2014 quarter. The increase was primarily due to $6.1 million of property taxes, insurance, and other associated with the PIM Highland JV acquisition, $1.8 million associated with the New Hotel Acquisitions, slightly offset by a decrease of $287,000 from our remaining hotel properties and WorldQuest.

Depreciation and Amortization. Depreciation and amortization increased $30.4 million, or 107.3%, to $58.7 million during the 2015 quarter compared to the 2014 quarter. The increase was primarily due to $21.2 million of depreciation and amortization associated with the PIM Highland JV acquisition and $5.9 million associated with the New Hotel Acquisitions. The remaining increase of $3.3 million is attributable to capital expenditures to our remaining hotel properties that have occurred since September 30, 2014.

Impairment Charges. We recorded credits to impairment charges of $111,000 and $105,000 for the 2015 quarter and 2014 quarter, respectively, for cash received and resulting valuation adjustments on a previously impaired mezzanine loan.

Transaction Costs. Transaction costs were $392,000 in the 2015 quarter compared to $533,000 in the 2014 quarter. The 2015 quarter included costs related to the acquisitions of the PIM Highland JV, Rockbridge Portfolio, W Atlanta, Le Meridien Minneapolis and Hilton Garden Inn - Wisconsin Dells. The 2014 quarter included costs related to the acquisitions of the Ashton and Fremont Marriott.

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Advisory Services Fee. Advisory services fees represent fees paid in connection with the advisory agreement between Ashford Inc. and us for the 2015 quarter. For the 2015 quarter, we recorded an advisory services fee of $10.8 million, which was comprised of a base advisory fee of $8.7 million, reimbursable overhead and internal audit, insurance claims advisory and asset management services of $1.6 million and equity-based compensation of $468,000 associated with equity grants of our common stock and LTIP units awarded to the officers and employees of Ashford Inc. For the 2014 quarter, we did not recognize an advisory services fee as we were self-advised.

Corporate, General, and Administrative. Corporate, general, and administrative expenses decreased $11.3 million, or 75.0%, to $3.8 million during the 2015 quarter compared to the 2014 quarter. Other general and administrative expenses decreased $6.6 million and non-cash equity-based compensation decreased $4.7 million for the 2015 quarter. The decrease in other general and administrative expenses was primarily attributable to salaries and benefits of $6.2 million associated with the Ashford Inc. spin-off, as such expenses are no longer recognized with all employees moving to Ashford Inc. Additionally, non-cash equity-based compensation decreased $4.7 million as a result of the Ashford Inc. spin-off. The remaining decreases are primarily attributable to lower office expenses, professional fees and other miscellaneous expenses totaling approximately $389,000.

Equity in Earnings (Loss) of Unconsolidated Entities. We recorded equity in loss of unconsolidated entities of $4.4 million and equity in earnings of $2.8 million for the 2015 quarter and the 2014 quarter, respectively. The 2015 quarter includes equity in loss in the REHE Fund of $3.9 million and in Ashford Prime of $453,000, offset by $16,000 of equity in earnings in Ashford Inc. The 2014 quarter includes equity in earnings in Ashford Prime of $703,000 and $2.1 million in PIM Highland JV.

Interest Income. Interest income was $21,000 and $27,000 for the 2015 quarter and the 2014 quarter, respectively.

Other Income (Expense). Other income (expense) changed by $2.9 million, or 112.2%, from other income of $2.6 million to other expense of $314,000 during the 2015 quarter compared to the 2014 quarter. The change is primarily attributable to the contribution of certain marketable securities to obtain an ownership interest in the REHE Fund. We not longer have realized gain or loss on marketable securities and dividend income for the 2015 quarter compared to a realized gain on marketable securities of $2.4 million and dividend income of $122,000 for the 2014 quarter.

Interest Expense and Amortization of Premiums and Loan Costs, net. Interest expense and amortization of premiums and loan costs, net, increased $22.5 million, or 76.4%, to $51.9 million during the 2015 quarter compared to the 2014 quarter. The increase is primarily due to $16.6 million of interest expense and amortization associated with the PIM Highland JV acquisition and refinance. The remaining increase is associated with higher loan cost amortization and interest expense of $5.2 million as a result of new financings on the majority of the New Hotel Acquisitions and higher loan cost amortization and interest expense as a result of refinances on our remaining hotel properties of $586,000. The average LIBOR rates for the 2015 quarter and the 2014 quarter were 0.20% and 0.15%, respectively.

Write-off of Loan Costs and Exit Fees. Write-off of loan costs and exit fees was $8.3 million for the 2014 quarter. There were no write-off of loan costs and exit fees in the 2015 quarter. In the 2014 quarter, we refinanced three mortgage loans, including our $135.0 million mortgage loan due May 2015, our $102.3 million mortgage loan due December 2014, which had an outstanding balance of $101.1 million, and our $89.3 million mortgage loan due February 2016, which had an outstanding balance of $88.5 million. The new loans total $468.9 million. As a result, we wrote-off the unamortized loan costs of $209,000 and incurred defeasance and exit fees of $8.1 million.

Unrealized Loss on Marketable Securities. Unrealized loss on marketable securities was $2.9 million for the 2014 quarter. There was no gain or loss on marketable securities for the 2015 quarter. Unrealized gain or loss on marketable securities were based on changes in closing market prices during the 2014 quarter.

Unrealized Loss on Derivatives. Unrealized loss on derivatives increased $2.7 million, to $2.8 million during the 2015 quarter compared to the 2014 quarter. The 2015 quarter had losses consisting of $3.3 million and $406,000 related to interest rate floors and interest rate derivatives, respectively, offset by an unrealized gain of $992,000 related to credit default swaps. In the 2014 quarter, we had a loss of $156,000 related to interest rate derivatives and a gain of $86,000 related to credit default swaps, respectively. The fair values of interest rate floors and interest rate derivatives are primarily based on movements in the LIBOR forward curve and the passage of time. The fair value of credit default swaps is based on the change in value of CMBX indices.

Income Tax Expense. Income tax expense increased $1.4 million, or 489.4%, to $1.7 million during the 2015 quarter compared to the 2014 quarter. The increase in income tax expense is primarily due to the acquisition of the approximate 28.26% interest in the PIM Highland JV. Prior to the acquisition, the PIM Highland JV was accounted for under the equity method. After the acquisition, the PIM Highland JV became wholly-owned and income tax expense for its TRS is now included in consolidated income tax expense.

Income from Discontinued Operations. Income from discontinued operations was $62,000 for the 2014 quarter related to the sale of the Homewood Suites Mobile hotel in Mobile, Alabama in November 2014. There were no discontinued operations in the 2015 quarter.
Gain on Sale of Hotel Properties, net of tax. Gain on sale of hotel properties, net of tax, was a gain of $599,000 for the 2015 quarter. We recognized a previously deferred gain of $599,000 on the sale of the Pier House Resort as a result of the distribution of Ashford Prime OP common units to our stockholders and OP unitholders that eliminated our equity investment in Ashford Prime OP. See Note 1.
(Income) Loss from Consolidated Entities Attributable to Noncontrolling Interests. Noncontrolling interest partners in consolidated entities were allocated income of $3,000 and a loss of $124,000 for the 2015 quarter and the 2014 quarter, respectively.
Net Loss Attributable to Redeemable Noncontrolling Interests in Operating Partnership. Redeemable noncontrolling interests in operating partnership were allocated net losses of $3.2 million and $2.6 million in the 2015 quarter and the 2014 quarter, respectively. Redeemable noncontrolling interests represented ownership interests of 13.28% and 13.01% in the operating partnership at September 30, 2015 and 2014, respectively.
Comparison of the Nine Months Ended September 30, 2015 and 2014
Net income (loss) attributable to the Company. Net income (loss) attributable to the Company increased $310.4 million, from a net loss of $17.5 million for the nine months ended September 30, 2014 (the “2014 period”) to net income of $292.9 million for the nine months ended September 30, 2015 (the “2015 period”) as a result of the factors discussed below.
Revenue. Rooms revenue from our hotels increased $298.0 million, or 60.9%, to $787.4 million during the 2015 period compared to the 2014 period. We experienced an increase in rooms revenue of $220.6 million as a result of the PIM Highland JV acquisition, $47.8 million associated with the New Hotel Acquisitions and $33.0 million from our remaining hotels and WorldQuest, which experienced an increase of 155 basis points in occupancy and an increase of 5.3% in room rates. These increases were offset by revenue of $3.4 million from the Pier House Resort that sold in 2014. Food and beverage revenue experienced an increase of $77.0 million, or 93.3%, to $159.5 million during the 2015 period compared to the 2014 period. This increase is a result of $63.4 million from the PIM Highland JV acquisition, $11.0 million associated with the New Hotel Acquisitions and $3.1 million from our remaining hotel properties and WorldQuest, offset by revenue of $597,000 from the Pier House Resort that sold in 2014. Other hotel revenue, which consists mainly of Internet access, parking, and spa, experienced an increase of $15.3 million, or 76.5%, to $35.4 million during the 2015 period compared to the 2014 period. This increase is a result of $9.2 million from the PIM Highland JV acquisition, $3.0 million associated with the New Hotel Acquisitions and $3.4 million from our remaining hotel properties and WorldQuest, offset by revenue of $247,000 from the Pier House Resort that sold in 2014. In the 2014 period, we recorded advisory services revenue of $9.3 million from an agreement between Ashford LLC and Ashford Prime that was in place prior to the spin-off of Ashford, Inc. The advisory services revenue was comprised of a base advisory fee of $6.5 million and reimbursable expenses of $1.3 million. We also recorded advisory revenue for equity grants of Ashford Prime common stock and LTIP units awarded to our officers and employees of approximately $1.5 million in connection with providing advisory services. Other non-hotel revenue decreased $1.5 million, or 46.1%, to $1.7 million during the 2015 period compared to the 2014 period. The decrease in other non-hotel revenue is primarily attributable to the acquisition of the PIM Highland JV. Prior to the acquisition, we received expense reimbursements related to our managing the day-to-day operations and providing corporate administrative services such as accounting, insurance, marketing support, asset management, and other services.
Hotel Operating Expenses. Hotel operating expenses increased $226.7 million, or 59.1%, to $610.5 million during the 2015 period compared to the 2014 period. Hotel operating expenses consist of direct expenses from departments associated with revenue streams and indirect expenses associated with support departments and management fees. We experienced increases of $116.1 million in direct expenses and $110.6 million in indirect expenses and management fees in the 2015 period. The increase in direct expenses was comprised of $89.5 million as a result of the PIM Highland JV acquisition, $19.9 million, as a result of the New Hotel Acquisitions and $6.6 million, from our remaining hotels and WorldQuest. The increase in indirect expenses was comprised of $91.8 million, as a result of the PIM Highland JV acquisition, $20.3 million, as a result of the New Hotel Acquisitions, offset by a decrease of $1.5

million, from our remaining hotels and WorldQuest, which was a result of a charge in the 2014 period of $10.8 million related to a jury verdict received in a legal proceeding. See Note 13. Direct expenses were 29.8% and 29.9% of total hotel revenue for the 2015 period and the 2014 period, respectively.

Property Taxes, Insurance, and Other. Property taxes, insurance, and other increased $18.2 million or 62.9%, to $47.2 million during the 2015 period compared to the 2014 period. The increase was primarily due to $15.0 million of property taxes, insurance, and other associated with the PIM Highland JV acquisition, $3.2 million associated with the New Hotel Acquisitions and $289,000 from our remaining hotel properties and WorldQuest. This increase was partially offset by $297,000 for the Pier House Resort that sold in 2014.

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Depreciation and Amortization. Depreciation and amortization increased $68.2 million or 84.2%, to $149.2 million during the 2015 period compared to the 2014 period. The increase was primarily due to $48.2 million of depreciation and amortization associated with the PIM Highland JV acquisition and $10.0 million associated with the New Hotel Acquisitions. The remaining increase of $10.4 million is attributable to capital expenditures that have occurred since September 30, 2014 and the New Hotel Acquisitions. These increases were offset by lower depreciation of $344,000 as a result of the sale of the Pier House Resort.

Impairment Charges. We recorded impairment charges of $19.6 million and impairment credits of $310,000 for the 2015 period and 2014 period, respectively. The 2015 period amount was comprised of an impairment charge on two hotel properties totaling $19.9 million, offset by a $326,000 impairment credit related to valuation adjustments on a previously impaired mezzanine loan.

Transaction Costs. Transaction costs were $5.9 million in the 2015 period compared to $616,000 in the 2014 period. The increase is primarily attributable to costs related to the acquisitions of the PIM Highland JV, Lakeway Resort, Memphis Marriott, Hampton Inn Gainesville, Le Pavillon, Rockbridge Portfolio, W Atlanta, Le Meridien Minneapolis and Hilton Garden Inn - Wisconsin Dells.

Advisory Services Fee. Advisory services fees represent fees paid in connection with the advisory agreement between Ashford Inc. and us for the 2015 period. For the 2015 period, we recorded an advisory services fee of $31.8 million, which comprised of a base advisory fee of $25.2 million, reimbursable overhead and internal audit, insurance claims advisory and asset management services of $4.8 million and equity-based compensation of $1.8 million associated with equity grants of our common stock and LTIP units awarded to the officers and employees of Ashford Inc. For the 2014 period, we did not recognize an advisory services fee as we were self-advised.

Corporate, General, and Administrative. Corporate, general, and administrative expenses decreased $35.6 million, or 75.2%, to $11.7 million during the 2015 period compared to the 2014 period. Other general and administrative expenses decreased $19.1 million and non-cash equity-based compensation decreased $16.4 million for the 2015 period. The decrease in other general and administrative expenses was primarily attributable to salaries and benefits of $20.1 million associated with the Ashford Inc. spin-off, as such expenses are no longer recognized with all employees moving to Ashford Inc. Additionally, non-cash equity-based compensation decreased $16.4 million as a result of the Ashford Inc. spin-off. The remaining decrease is primarily attributable to lower office expenses, professional fees and other miscellaneous expenses totaling approximately $1.8 million. These decreases were partially offset by $2.6 million of expense associated with the attempted launch of the select-service platform.

Equity in Earnings (Loss) of Unconsolidated Entities. We recorded equity in loss of unconsolidated entities of $9.1 million and equity in earnings of $6.8 million for the 2015 period and the 2014 period, respectively. The 2015 period includes equity in loss in Ashford Inc. of $1.2 million, $4.9 million in the REHE Fund and $3.8 million in PIM Highland JV, offset by equity in earnings in Ashford Prime of $874,000. The 2014 period includes equity in earnings in Ashford Prime of $692,000 and equity in earnings of $6.1 million in PIM Highland JV.

Interest Income. Interest income was $67,000 and $45,000 for the 2015 period and the 2014 period, respectively.

Gain on Acquisition of PIM Highland JV. Gain on acquisition of PIM Highland JV was $381.8 million for the 2015 period. This gain is related to the acquisition of the remaining interest in the PIM Highland JV in March 2015. No gain was recorded in the 2014 period.

Other Income. Other income decreased $4.1 million, or 70.3%, to $1.7 million during the 2015 period compared to the 2014 period. The decrease in other income is primarily attributable to the contribution of certain marketable securities in consideration for an ownership interest in the REHE Fund. As a result, we no longer have realized gain or loss on marketable securities and dividend income. For the period in 2015 prior to our contribution to the REHE Fund, we had a realized gain on marketable securities of $1.9 million and dividend income of $255,000 compared to a realized gain on marketable securities of $5.4 million and dividend income of $485,000 for the 2014 period.

Interest Expense and Amortization of Loan Costs. Interest expense and amortization of loan costs increased $48.4 million or 56.6%, to $134.0 million during the 2015 period compared to the 2014 period. The increase is primarily due to $37.8 million of interest expense and amortization associated with the PIM Highland JV acquisition and refinance. The remaining increase is associated with higher loan cost amortization and interest expense as a result of new financings on the majority of the New Hotel Acquisitions of $7.9 million and higher loan cost amortization and interest expense as a result of refinances on our remaining hotel properties of $3.5 million. These expenses were offset by $718,000 as a result of the sale of the Pier House Resort. The average LIBOR rates for the 2015 period and the 2014 period were 0.18% and 0.15%, respectively.

Write-off of Loan Costs and Exit Fees. Write-off of loan costs and exit fees decreased $5.6 million, or 54.0%, to $4.8 million during the 2015 period compared to the 2014 period. The decrease is primarily attributable to three mortgage loans we refinanced

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and three hotel properties and a portfolio in which we obtained new financing, See Note 7 to the consolidate financial statements. For the 2015 period, we wrote-off the unamortized loan costs of $86,000 and incurred defeasance and other exit fees of $4.7 million. For the 2014 period, we refinanced three mortgage loans, including our $135.0 million mortgage loan due May 2015, our $102.3 million mortgage loan due December 2014, which had an outstanding balance of $101.1 million, and our $89.3 million mortgage loan due February 2016, which had an outstanding balance of $88.5 million. The new loans total $468.9 million. As a result we wrote-off the unamortized loan costs of $209,000 and incurred defeasance and exit fees of $8.1 million. Additionally, we refinanced our $164.4 million loan due March 2014 with a $200.0 million loan due February 2016. As a result, we wrote-off the unamortized loan costs of $251,000 and incurred exit fees of $397,000. We also wrote off loan costs of $1.4 million associated with the Pier House Resort loan that was assumed by Ashford Prime.

Unrealized Gain (Loss) on Marketable Securities. Unrealized gain (loss) on marketable securities was an unrealized gain of $127,000 and an unrealized loss of $3.8 million for the 2015 period and the 2014 period, respectively, and are based on changes in closing market prices during the period.

Unrealized Loss on Derivatives. Unrealized loss on derivatives increased $5.7 million or 841.6%, to $6.4 million during the 2015 period compared to the 2014 period. The 2015 period had losses consisting of $5.4 million and $1.8 million related to interest rate floors and interest rate derivatives, respectively, offset by unrealized gain of $797,000 on credit default swaps. In the 2014 period, we had losses consisting of $349,000 and $331,000 related to interest rate derivatives and credit default swaps, respectively. The fair values of interest rate floors and interest rate derivatives are primarily based on movements in the LIBOR forward curve and the passage of time. The fair value of credit default swaps is based on the change in value of CMBX indices.

Income Tax Expense. Income tax expense increased $3.8 million, or 465.2% to $4.6 million during the 2015 period compared to the 2014 period. The increase in income tax expense is primarily due to the acquisition of the approximate 28.26% interest in the PIM Highland JV. Prior to the acquisition, the PIM Highland JV was accounted for under the equity method. After the acquisition, the PIM Highland JV became wholly-owned and income tax expense for its TRS is now included in consolidated income tax expense.

Income from Discontinued Operations. Income from discontinued operations was $88,000 for the 2014 period related to the sale of the Homewood Suites Mobile hotel in Mobile, Alabama in November 2014. There were no discontinued operations in the 2015 period.

Gain (Loss) on Sale of Hotel Properties, net of tax. Gain (loss) on sale of hotel properties, net of tax, was a loss of $531,000 and a gain of $3.5 million for the 2015 period and the 2014 period, respectively. In the 2015 period, we recognized a loss of $1.1 million on the sale of the Hampton Inn in Terre Haute, Indiana and recognized a previously deferred gain of $599,000 on the sale of the Pier House Resort as a result of the final distribution of Ashford Prime OP common units to our stockholders and OP unitholders that eliminated our equity investment in Ashford Prime OP. See Note 1. In the 2014 period, we recognized a gain of $3.5 million in connection with the sale of the Pier House Resort to Ashford Prime. We deferred a portion of the gain of the Pier House Resort in the amount of $599,000, in accordance with the applicable accounting guidance, as a result of our equity investment in Ashford Prime OP.

Loss from Consolidated Entities Attributable to Noncontrolling Interests. Noncontrolling interest partners in consolidated entities were allocated losses of $8,000 and $146,000 during the 2015 period and the 2014 period, respectively.

Net (Income) Loss Attributable to Redeemable Noncontrolling Interests in Operating Partnership. Noncontrolling interests in operating partnership were allocated net income of $39.6 million and net loss of $4.2 million in the 2015 period and the 2014 period, respectively. Redeemable noncontrolling interests represented ownership interests of 13.28% and 13.01% in the operating partnership at September 30, 2015 and 2014, respectively.

SEASONALITY

Our properties' operations historically have been seasonal as certain properties maintain higher occupancy rates during the summer months and some during the winter months. This seasonality pattern can cause fluctuations in our quarterly lease revenue under our percentage leases. We anticipate that our cash flows from the operations of our properties will be sufficient to enable us to make quarterly distributions to maintain our REIT status. To the extent that cash flows from operations are insufficient during any quarter due to temporary or seasonal fluctuations in lease revenue, we expect to utilize other cash on hand or borrowings to fund required distributions. However, we cannot make any assurances that we will make distributions in the future.

OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of business, we form partnerships or joint ventures that operate certain hotels. We evaluate each partnership and joint venture to determine whether the entity is a VIE. If the entity is determined to be a VIE, we assess whether

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we are the primary beneficiary and need to consolidate the entity. For further discussion of the Company's VIEs, see Notes 2 and 6 to the consolidated financial statements.

CONTRACTUAL OBLIGATIONS

There have been no material changes since December 31, 2014, outside of the ordinary course of business, to contractual obligations specified in the table of contractual obligations included in the section "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our 2014 Form 10-K.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our accounting policies that are critical or most important to understanding our financial condition and results of operations and that require management to make the most difficult judgments are described in our 2014 Form 10-K. There have been no material changes in these critical accounting policies.

NON-GAAP FINANCIAL MEASURES

The following non-GAAP presentations of EBITDA, Adjusted EBITDA, Funds From Operations ("FFO") and Adjusted FFO ("AFFO") are made to assist our investors evaluate our operating performance.

EBITDA is defined as net loss attributable to the Company before interest expense and amortization of premiums and loan costs, net, interest income other than interest income from mezzanine loans, income taxes, depreciation and amortization, and noncontrolling interests in the operating partnership and after adjustments for unconsolidated joint ventures. We adjust EBITDA to exclude certain additional items such as gains on hotel properties, impairment charges, write-off of loan costs and exit fees, other income/expense, transaction, acquisition and management conversion costs, legal judgments, dead deal costs, software implementation costs, and non-cash items such as amortization of unfavorable management contract liabilities, non-cash stock/unit-based compensation, compensation adjustments related to modified employment terms, unrealized gains and losses on marketable securities and derivative instruments, as well as our portion of adjustments to EBITDA of unconsolidated entities. We exclude items from Adjusted EBITDA that are either non-cash or are not part of our core operations in order to provide a period-over-period comparison of our operations. We present EBITDA and Adjusted EBITDA because we believe these measurements a) more accurately reflect the ongoing performance of our hotel assets and other investments, b) provide more useful information to investors as indicators of our ability to meet our future debt payment and working capital requirements, and c) provide an overall evaluation of our financial condition. EBITDA and Adjusted EBITDA as calculated by us may not be comparable to EBITDA and Adjusted EBITDA reported by other companies that do not define EBITDA and Adjusted EBITDA exactly as we define the terms. EBITDA and Adjusted EBITDA do not represent cash generated from operating activities determined in accordance with GAAP and should not be considered as an alternative to a) GAAP net income or loss as an indication of our financial performance or b) GAAP cash flows from operating activities as a measure of our liquidity.

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The following table reconciles net income (loss) to EBITDA and Adjusted EBITDA (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income (loss)	$(19,511)	$(16,204)	$332,539	$(21,849)
Net (income) loss from consolidated entities attributable to noncontrolling interest	(3)	124	8	146
Net (income) loss attributable to redeemable noncontrolling interests in operating partnership	3,193	2,585	(39,616)	4,234
Net income (loss) attributable to the Company	(16,321)	(13,495)	292,931	(17,469)
Interest income	(21)	(27)	(67)	(45)
Interest expense and amortization of premiums and loan costs, net	51,829	29,419	133,900	85,800
Depreciation and amortization	58,682	28,380	149,068	81,144
Income tax expense	1,721	292	4,635	832
Net income (loss) attributable to redeemable noncontrolling interests in operating partnership	(3,193)	(2,585)	39,616	(4,234)
Equity in (earnings) loss of unconsolidated entities	437	(2,831)	4,204	(6,794)
Company's portion of EBITDA of unconsolidated entities (Ashford Inc.)	680	—	(13)	—
Company's portion of EBITDA of unconsolidated entities (Ashford Prime OP)	509	3,524	7,640	9,148
Company's portion of EBITDA of unconsolidated entities (PIM Highland JV)	—	24,240	11,982	73,642
EBITDA available to the Company and OP unitholders	94,323	66,917	643,896	222,024
Amortization of unfavorable management contract liabilities	(493)	(493)	(1,481)	(1,481)
Impairment charges	(111)	(105)	19,623	(310)
Gain on hotel properties	(599)	—	(381,304)	(3,503)
Write-off of loan costs and exit fees	—	8,319	4,767	10,353
Other (income) expense [(1)]	314	(2,564)	(1,733)	(5,841)
Transaction, acquisition and management conversion costs	1,963	1,903	11,552	3,173
Software implementation costs	—	20	—	275
Legal judgment	23	683	71	11,483
Unrealized (gain) loss on marketable securities	—	2,875	(127)	3,818
Unrealized loss on derivatives	2,750	70	6,403	680
Compensation adjustment related to modified employment terms	—	—	—	2,997
Dead deal costs	320	—	567	—
Non-cash stock/unit-based compensation	468	4,734	2,328	14,727
Company's portion of adjustments to EBITDA of unconsolidated entities (REHE Fund)	3,932	—	4,880	—
Company's portion of adjustments to EBITDA of unconsolidated entities (Ashford Inc.)	528	—	3,184	—
Company's portion of adjustments to EBITDA of unconsolidated entities (Ashford Prime OP)	582	64	738	554
Company's portion of adjustments to EBITDA of unconsolidated entities (PIM Highland JV)	—	—	—	(513)
Adjusted EBITDA available to the Company and OP unitholders	$104,000	$82,423	$313,364	$258,436

(1) Other (income) expense, primarily consisting of income/loss from realized gain/loss on marketable securities, is excluded from Adjusted EBITDA.

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We calculate FFO and AFFO in the following table. FFO is calculated on the basis defined by NAREIT, which is net loss attributable to common stockholders, computed in accordance with GAAP, excluding gains or losses on properties, and extraordinary items as defined by GAAP, plus depreciation and amortization of real estate assets, impairment charges on real estate assets, and after adjustments for unconsolidated entities and noncontrolling interests in the operating partnership. Adjustments for unconsolidated entities are calculated to reflect FFO on the same basis. NAREIT developed FFO as a relative measure of performance of an equity REIT to recognize that income-producing real estate historically has not depreciated on the basis determined by GAAP. Our calculation of AFFO excludes write-off of loan costs and exit fees, other impairment charges, other income/expense, transaction, acquisition and management conversion costs, legal judgments, dead deal costs, software implementation costs and non-cash items such as gains and losses on marketable securities and derivative instruments, compensation adjustments related to modified employment terms, as well as our portion of adjustments to FFO related to unconsolidated entities. We exclude items from AFFO that are either non-cash or are not part of our core operations in order to provide a period-over-period comparison of our operating results. We consider FFO and AFFO to be appropriate measures of our ongoing normalized operating performance as a REIT. We compute FFO in accordance with our interpretation of standards established by NAREIT, which may not be comparable to FFO reported by other REITs that either do not define the term in accordance with the current NAREIT definition or interpret the NAREIT definition differently than us. FFO and AFFO do not represent cash generated from operating activities as determined by GAAP and should not be considered as an alternative to a) GAAP net income or loss as an indication of our financial performance or b) GAAP cash flows from operating activities as a measure of our liquidity, nor is it indicative of funds available to satisfy our cash needs, including our ability to make cash distributions. However, to facilitate a clear understanding of our historical operating results, we believe that FFO and AFFO should be considered along with our net income or loss and cash flows reported in the consolidated financial statements.
The following table reconciles net income (loss) to FFO and Adjusted FFO (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income (loss)	$(19,511)	$(16,204)	$332,539	$(21,849)
Net (income) loss from consolidated entities attributable to noncontrolling interest	(3)	124	8	146
Net (income) loss attributable to redeemable noncontrolling interests in operating partnership	3,193	2,585	(39,616)	4,234
Preferred dividends	(8,490)	(8,490)	(25,471)	(25,471)
Net income (loss) attributable to common stockholders	(24,811)	(21,985)	267,460	(42,940)
Depreciation and amortization of real estate	58,682	28,295	149,068	80,882
Gain on hotel properties	(599)	—	(381,304)	(3,503)
Net income (loss) attributable to redeemable noncontrolling interests in operating partnership	(3,193)	(2,585)	39,616	(4,234)
Equity in (earnings) loss of unconsolidated entities	437	(2,831)	4,204	(6,794)
Impairment charges on real estate	—	—	19,949	—
Company's portion of FFO of unconsolidated entities (Ashford Inc.)	372	—	(619)	—
Company's portion of FFO of unconsolidated entities (Ashford Prime OP)	63	2,093	4,371	4,864
Company's portion of FFO of unconsolidated entities (PIM Highland JV)	—	12,966	3,791	39,438
FFO available to the Company and OP unitholders	30,951	15,953	106,536	67,713
Write-off of loan costs and exit fees	—	8,319	4,767	10,353
Other impairment charges	(111)	(105)	(326)	(310)
Transaction, acquisition and management conversion costs	1,963	1,903	11,552	3,173
Other (income) expense [(1)]	314	(2,564)	(1,733)	(5,841)

Legal judgment	23	683	71	11,483
Compensation adjustment related to modified employment terms	—	—	—	2,997
Unrealized (gain) loss on marketable securities	—	2,875	(127)	3,818
Unrealized loss on derivatives	2,750	70	6,403	680
Dead deal costs	320	—	567	—
Software implementation costs	—	20	—	275
Company's portion of adjustments to FFO of unconsolidated entities (REHE Fund)	3,932	—	4,880	—
Company's portion of adjustments to FFO of unconsolidated entities (Ashford Inc.)	(484)	—	(498)	—
Company's portion of adjustments to FFO of unconsolidated entities (Ashford Prime OP)	573	6	593	394
Company's portion of adjustments to FFO of unconsolidated entities (PIM Highland JV)	—	—	—	(513)
Adjusted FFO available to the Company and OP unitholders	$40,231	$27,160	$132,685	$94,222

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[1] Other (income) expense, primarily consisting of net realized gain/loss on marketable securities, is excluded from Adjusted FFO.

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HOTEL PORTFOLIO

The following table presents certain information related to our hotel properties as of September 30, 2015:

Hotel Property	Location	Service Type	Total Rooms	% Owned	Owned Rooms
Fee Simple Properties					
Embassy Suites	Austin, TX	Full service	150	100 %	150
Embassy Suites	Dallas, TX	Full service	150	100	150
Embassy Suites	Herndon, VA	Full service	150	100	150
Embassy Suites	Las Vegas, NV	Full service	220	100	220
Embassy Suites	Syracuse, NY	Full service	215	100	215
Embassy Suites	Flagstaff, AZ	Full service	119	100	119
Embassy Suites	Houston, TX	Full service	150	100	150
Embassy Suites	West Palm Beach, FL	Full service	160	100	160
Embassy Suites	Philadelphia, PA	Full service	263	100	263
Embassy Suites	Walnut Creek, CA	Full service	249	100	249
Embassy Suites	Arlington, VA	Full service	267	100	267
Embassy Suites	Portland, OR	Full service	276	100	276
Embassy Suites	Santa Clara, CA	Full service	257	100	257
Embassy Suites	Orlando, FL	Full service	174	100	174
Hilton Garden Inn	Jacksonville, FL	Select service	119	100	119
Hilton Garden Inn	Austin, TX	Select service	254	100	254
Hilton Garden Inn	Baltimore, MD	Select service	158	100	158
Hilton Garden Inn	Virginia Beach, VA	Select service	176	100	176
Hilton Garden Inn	Wisconsin Dells, WI	Select service	128	100	128
Hilton	Houston, TX	Full service	242	100	242
Hilton	St. Petersburg, FL	Full service	333	100	333
Hilton	Santa Fe, NM	Full service	158	100	158
Hilton	Bloomington, MN	Full service	300	100	300
Hilton	Costa Mesa, CA	Full service	486	100	486
Hilton	Boston, MA	Full service	390	100	390
Hilton	Parssippany, NJ	Full service	353	100	353
Hilton	Tampa, FL	Full service	238	100	238
Hampton Inn	Lawrenceville, GA	Select service	85	100	85
Hampton Inn	Evansville, IN	Select service	140	100	140
Hampton Inn	Parssippany, NJ	Select service	152	100	152
Hampton Inn	Buford, GA	Select service	92	100	92
Hampton Inn	Phoenix, AZ	Select service	106	100	106
Hampton Inn - Waterfront	Pittsburgh, PA	Select service	113	100	113
Hampton Inn - Washington	Pittsburgh, PA	Select service	103	100	103
Hampton Inn	Columbus, OH	Select service	145	100	145
Hampton Inn	Gainesville, FL	Select service	124	100	124
Marriott	Beverly Hills, CA	Full service	260	100	260
Marriott	Durham, NC	Full service	225	100	225
Marriott	Arlington, VA	Full service	697	100	697
Marriott	Bridgewater, NJ	Full service	347	100	347
Marriott	Dallas, TX	Full service	265	100	265
Marriott	Fremont, CA	Full service	357	100	357
Marriott	Memphis, TN	Full service	232	100	232

Marriott	Irving, TX	Full service	491	100	491

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Hotel Property	Location	Service Type	Total Rooms	% Owned	Owned Rooms
Marriott	Omaha, NE	Full service	300	100	300
Marriott	San Antonio, TX	Full service	251	100	251
SpringHill Suites by Marriott	Jacksonville, FL	Select service	102	100	102
SpringHill Suites by Marriott	Baltimore, MD	Select service	133	100	133
SpringHill Suites by Marriott	Kennesaw, GA	Select service	90	100	90
SpringHill Suites by Marriott	Buford, GA	Select service	97	100	97
SpringHill Suites by Marriott	Gaithersburg, MD	Select service	162	100	162
SpringHill Suites by Marriott	Centreville, VA	Select service	136	100	136
SpringHill Suites by Marriott	Charlotte, NC	Select service	136	100	136
SpringHill Suites by Marriott	Durham, NC	Select service	120	100	120
SpringHill Suites by Marriott	Orlando, FL	Select service	400	100	400
SpringHill Suites by Marriott	Manhattan Beach, CA	Select service	164	100	164
SpringHill Suites by Marriott	Plymouth Meeting, PA	Select service	199	100	199
SpringHill Suites by Marriott	Glen Allen, VA	Select service	136	100	136
Fairfield Inn by Marriott	Kennesaw, GA	Select service	86	100	86
Fairfield Inn by Marriott	Orlando, FL	Select service	388	100	388
Courtyard by Marriott	Bloomington, IN	Select service	117	100	117
Courtyard by Marriott - Tremont	Boston, MA	Select service	315	100	315
Courtyard by Marriott	Columbus, IN	Select service	90	100	90
Courtyard by Marriott	Denver, CO	Select service	202	100	202
Courtyard by Marriott	Louisville, KY	Select service	150	100	150
Courtyard by Marriott	Gaithersburg, MD	Select service	210	100	210
Courtyard by Marriott	Crystal City, VA	Select service	272	100	272
Courtyard by Marriott	Ft. Lauderdale, FL	Select service	174	100	174
Courtyard by Marriott	Overland Park, KS	Select service	168	100	168
Courtyard by Marriott	Palm Desert, CA	Select service	151	100	151
Courtyard by Marriott	Savannah, GA	Select service	156	100	156
Courtyard by Marriott	Foothill Ranch, CA	Select service	156	100	156
Courtyard by Marriott	Alpharetta, GA	Select service	154	100	154
Courtyard by Marriott	Orlando, FL	Select service	312	100	312
Courtyard by Marriott	Oakland, CA	Select service	156	100	156
Courtyard by Marriott	Scottsdale, AZ	Select service	180	100	180
Courtyard by Marriott	Plano, TX	Select service	153	100	153
Courtyard by Marriott	Edison, NJ	Select service	146	100	146
Courtyard by Marriott	Newark, CA	Select service	181	100	181
Courtyard by Marriott	Manchester, CT	Select service	90	85	77
Courtyard by Marriott	Basking Ridge, NJ	Select service	235	100	235
Courtyard by Marriott	Wichita, KS	Select service	128	100	128
Courtyard by Marriott - Billerica	Boston, MA	Select service	210	100	210
Homewood Suites	Pittsburgh, PA	Select service	148	100	148
Marriott Residence Inn	Lake Buena Vista, FL	Select service	210	100	210
Marriott Residence Inn	Evansville, IN	Select service	78	100	78
Marriott Residence Inn	Orlando, FL	Select service	350	100	350
Marriott Residence Inn	Falls Church, VA	Select service	159	100	159

Marriott Residence Inn	San Diego, CA	Select service	150	100	150
Marriott Residence Inn	Salt Lake City, UT	Select service	144	100	144
Marriott Residence Inn	Palm Desert, CA	Select service	130	100	130
Marriott Residence Inn	Las Vegas, NV	Select service	256	100	256

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Hotel Property	Location	Service Type	Total Rooms	% Owned		Owned Rooms
Marriott Residence Inn	Phoenix, AZ	Select service	200	100		200
Marriott Residence Inn	Plano, TX	Select service	126	100		126
Marriott Residence Inn	Newark, CA	Select service	168	100		168
Marriott Residence Inn	Manchester, CT	Select service	96	85		82
Marriott Residence Inn	Atlanta, GA	Select service	150	100		150
Marriott Residence Inn	Jacksonville, FL	Select service	120	100		120
Marriott Residence Inn	Stillwater, OK	Select service	101	100		101
Marriott Residence Inn	Tampa, FL	Select service	109	100		109
TownePlace Suites by Marriott	Manhattan Beach, CA	Select service	144	100		144
Ritz-Carlton	Atlanta, GA	Full service	444	100		444
One Ocean	Atlantic Beach, FL	Full service	193	100		193
Sheraton Hotel	Ann Arbor, MI	Full service	197	100		197
Sheraton Hotel	Langhorne, PA	Full service	186	100		186
Sheraton Hotel	Minneapolis, MN	Full service	220	100		220
Sheraton Hotel	Indianapolis, IN	Full service	378	100		378
Sheraton Hotel	Anchorage, AK	Full service	370	100		370
Sheraton Hotel	San Diego, CA	Full service	260	100		260
Hyatt Regency	Coral Gables, FL	Full service	253	100		253
Hyatt Regency	Hauppauge, NY	Full service	358	100		358
Hyatt Regency	Savannah, GA	Full service	351	100		351
Crowne Plaza	Atlanta, GA	Full service	495	100		495
Annapolis Historic Inn	Annapolis, MD	Full service	124	100		124
Lakeway Resort & Spa	Austin, TX	Full service	168	100		168
Silversmith	Chicago, IL	Full service	144	100		144
The Churchill	Washington, DC	Full service	173	100		173
The Melrose	Washington, DC	Full service	240	100		240
Le Pavillon	New Orleans, LA	Full service	226	100		226
The Ashton	Ft. Worth, TX	Select service	39	100		39
Westin	Princeton, NJ	Full service	296	100		296
W	Atlanta, GA	Full service	237	100		237
Le Meridien	Minneapolis, MN	Full service	60	100		60
Ground Lease Properties						
Crown Plaza	Key West, FL	Full service	160	100	%	160
Crown Plaza	Annapolis, MD	Full service	196	100		196
Hilton	Ft. Worth, TX	Full service	294	100		294
Marriott	Sugarland, TX	Full service	300	100		300
Renaissance	Nashville, TN	Full service	673	100		673
Renaissance	Palm Springs, CA	Full service	410	100		410
Renaissance	Portsmouth, VA	Full service	249	100		249
Total			27,608			27,581

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Our primary market risk exposure consists of changes in interest rates on borrowings under our debt instruments and our derivatives portfolio that bear interest at variable rates that fluctuate with market interest rates. The analysis below presents the sensitivity of the market value of our financial instruments to selected changes in market interest rates. We acquired the remaining approximate 28.26% interest in the 28 hotels of the PIM Highland JV, which had a material impact to the analysis below since December 31, 2014.

At September 30, 2015, our total indebtedness of $3.7 billion included $2.4 billion of variable-rate debt. The impact on our results of operations of a 25-basis point change in interest rate on the outstanding balance of variable-rate debt at September 30, 2015 would be approximately $6.0 million annually. Interest rate changes have no impact on the remaining $1.3 billion of fixed-rate debt. At December 31, 2014, the total consolidated indebtedness of $2.0 billion included $817.9 million of variable-rate debt. The impact on the results of operations of a 25-basis point change in interest rate on the outstanding balance of variable-rate debt at December 31, 2014 would be approximately $2.0 million per year. Interest rate changes will have no impact on the remaining $1.2 billion of fixed rate debt.

The above amounts were determined based on the impact of hypothetical interest rates on our borrowings and assume no changes in our capital structure. As the information presented above includes only those exposures that existed at September 30, 2015 and December 31, 2014, respectively, it does not consider exposures or positions that could arise after that date. Accordingly, the information presented herein has limited predictive value. As a result, the ultimate realized gain or loss with respect to interest rate fluctuations will depend on exposures that arise during the period, the hedging strategies at the time, and the related interest rates.

We also entered into interest rate floors with notional amounts totaling $6.0 billion and strike rates ranging from (0.25)% to zero percent. Our total exposure is capped at our initial upfront costs totaling $9.4 million.

In April 2015, February 2015 and August 2011, we entered into credit default swap transactions for notional amounts of $45.0 million, $45.0 million and $100.0 million, respectively, to hedge financial and capital market risk for upfront costs of $1.1 million, $1.6 million and $8.2 million, respectively, which amounts were subsequently returned to us as collateral by our counterparty. A credit default swap is a derivative contract that functions like an insurance policy against the credit risk of an entity or obligation. The seller of protection assumes the credit risk of the reference obligation from the buyer (us) of protection in exchange for annual premium payments. If a default or a loss, as defined in the credit default swap agreements, occurs on the underlying bonds, then the buyer of protection is protected against those losses. The only liability for us, the buyer, is the annual premium and any change in value of the underlying CMBX index (if the trade is terminated prior to maturity). For all CMBX trades completed to date, we were the buyer of protection. Credit default swaps are subject to master-netting settlement arrangements and credit support annexes. Assuming the underlying bonds pay off at par over their remaining average life, our total exposure for these trades was approximately $3.2 million at September 30, 2015.

In September 2015, we entered into Eurodollar futures to hedge our cash flow risk for upfront costs, including commissions, of $743,000. Eurodollar futures prices reflect market expectations for interest rates on three month Eurodollar deposits for specific dates in the future, and the final settlement price is determined by three-month LIBOR on the last trading day. Options on Eurodollar futures provide the ability to limit losses while maintaining the possibility of profiting from favorable changes in the futures prices. As the purchaser, our maximum potential loss is limited to the initial premium paid for the Eurodollar option contracts, while our potential gain has no limit. These exchange-traded options are centrally cleared, and a clearinghouse stands in between all trades to ensure that the obligations involved in the trades are made good.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, our management has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”)) as of September 30, 2015 (“Evaluation Date”). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective (i) to ensure that information required to be disclosed in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms; and (ii) to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

There have been no changes in our internal controls over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Litigation—Palm Beach Florida Hotel and Office Building Limited Partnership, et al. v. Nantucket Enterprises, Inc. This litigation involves a landlord tenant dispute from 2008 in which the landlord, Palm Beach Florida Hotel and Office Building Limited Partnership, a subsidiary of the Company, claimed that the tenant, Nantucket Enterprises, Inc., had violated various lease provisions of the lease agreement and was therefore in default. The tenant counterclaimed and asserted multiple claims including that it had been wrongfully evicted. The litigation was instituted by the plaintiff in November 2008 in the Circuit Court of the Fifteenth Judicial Circuit, in and for Palm Beach County, Florida and proceeded to a jury trial on June 30, 2014. The jury entered its verdict awarding the tenant total claims of $10.8 million and ruling against the landlord on its claim of breach of contract. The landlord is preparing various post trial motions. A final judgment was entered and the landlord has filed a notice of appeal. As a result of the jury verdict, we previously recorded pre-judgment interest of $707,000 and accrued a reasonable estimate of loss related to legal fees of $400,000 during 2014. As of the three and nine months ended September 30, 2015, we recorded additional pre-judgment interest of $24,000 and $71,000, respectively. Including the 2014 judgment, pre-judgment interest and estimated loss of legal expenses, total expense recorded was $12.0 million through September 30, 2015. The additional charges related to pre-judgment interest are included in “other expenses” in the consolidated statements of operations for the three and nine months ended September 30, 2015.

We are engaged in other various legal proceedings which have arisen but have not been fully adjudicated. The likelihood of loss from these legal proceedings, based on definitions within contingency accounting literature, ranges from remote to reasonably possible and to probable. Based on estimates of the range of potential losses associated with these matters, management does not believe the ultimate resolution of these proceedings, either individually or in the aggregate, will have a material adverse effect on our consolidated financial position or results of operations. However, the final results of legal proceedings cannot be predicted with certainty and if we fail to prevail in one or more of these legal matters, and the associated realized losses exceed our current estimates of the range of potential losses, our consolidated financial position or results of operations could be materially adversely affected in future periods.

ITEM 1A. RISK FACTORS

The discussion of our business and operations should be read together with the risk factors contained in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014, filed with the Securities and Exchange Commission, which describe various risks and uncertainties to which we are or may become subject. These risks and uncertainties have the potential to affect our business, financial condition, results of operations, cash flows, strategies, or prospects in a material and adverse manner. At September 30, 2015, there have been no material changes to the risk factors set forth in our Annual Report on Form 10-K for the year ended December 31,2014.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Purchases of Equity Securities by the Issuer

The following table provides the information with respect to purchases of shares of our common stock during each of the months in the third quarter of 2015:

Period	Total Number of Shares Purchased	Average Price Paid Per Share		Total Number of Shares Purchased as Part of Publicly Announced Plan [3]	Maximum Dollar Value of Shares That May Yet Be Purchased Under the Plan
Common stock:					
July 1 to July 31 [1] [2]	5,750,984	$9.00		—	$ 200,000,000
August 1 to August 31 [1]	984	2.84	[4]	—	200,000,000
September 1 to September 30 [1]	1,450	2.65	[4]	—	200,000,000
Total	5,753,418	$9.00		—	

(1) Includes shares that were repurchased when former employees of Ashford LLC, who held restricted shares of our common stock, forfeited the shares upon termination of employment.

(2) Includes 5,750,000 shares that were purchased and retired.

(3) In September 2011, our Board of Directors announced the reinstatement of our 2007 share repurchase program and authorized an increase in repurchase plan authorization from the remaining $58.4 million to $200.0 million. The plan provides for: (i) the repurchase of shares of our common stock, Series A preferred stock, Series D preferred stock and Series E preferred stock, and /or (ii) discounted purchases of outstanding debt obligations, including debt secured by hotel assets. No shares of common or preferred stock have been repurchased under this program since September 2011and none are authorized for purchase without further authorization from our Board of Directors.

(4) Represents the treasury stock cost associated with the original restricted share grant.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit	Description
3.1	Articles of Amendment and Restatement, as amended by Amendment Number One to Articles of Amendment and Restatement (incorporated by reference to Exhibit 4.6 to Registration Statement on Form S-3 filed May 15, 2015) (File No. 333-204235)
3.2	Second Amended and Restated Bylaws, as amended by Amendment No. 1 on October 26, 2014 and by Amendment No. 2 on October 19, 2015 (incorporated by reference to Exhibit 3.1 to the Registrant's Form 8-K, filed on October 22, 2015)
10.1	Letter Agreement, dated September 17, 2015, by and between Ashford Hospitality Trust, Inc., and Ashford Inc.(incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on September 18, 2015)
12*	Statement Regarding Computation of Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends
31.1*	Certifications of Chief Executive Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
31.2*	Certifications of Chief Financial Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The following materials from the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2015 are formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Operations; (iii) Consolidated Statements Comprehensive Income (Loss); (iii) Consolidated Statement of of Equity; (iv) Consolidated Statements of Cash Flows; and (v) Notes to the Consolidated Financial Statements. In accordance with Rule 402 of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 (the "Exchange Act"), or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act of 1933 or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

101.INS	XBRL Instance Document	Submitted electronically with this report.
101.SCH	XBRL Taxonomy Extension Schema Document	Submitted electronically with this report.
101.CAL	XBRL Taxonomy Calculation Linkbase Document	Submitted electronically with this report.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Submitted electronically with this report.
101.LAB	XBRL Taxonomy Label Linkbase Document.	Submitted electronically with this report.
101.PRE	XBRL Taxonomy Presentation Linkbase Document.	Submitted electronically with this report.

* Filed herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ASHFORD HOSPITALITY TRUST, INC.

Date: November 9, 2015	By: /s/ MONTY J. BENNETT Monty J. Bennett Chief Executive Officer
Date: November 9, 2015	By: /s/ DERIC S. EUBANKS Deric S. Eubanks Chief Financial Officer

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