

RED LION HOTELS CORP

FORM 10-Q (Quarterly Report)

Filed 8/14/2006 For Period Ending 6/30/2006

| | |
|-------------|--|
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| Industry | Hotels & Motels |
| Sector | Services |
| Fiscal Year | 12/31 |

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: 001-13957

RED LION HOTELS CORPORATION

(Exact name of registrant as specified in its charter)

Washington

(State or other jurisdiction of incorporation or organization)

**201 W. North River Drive, Suite 100,
Spokane, Washington**

(Address of principal executive offices)

91-1032187

(I.R.S. Employer Identification No.)

99201

(Zip Code)

(509)459-6100

(Registrant's telephone number, including area code)

Indicated 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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of August 7, 2006, there were 19,106,161 shares of the registrant's common stock outstanding.

RED LION HOTELS CORPORATION
Form 10-Q
For the Quarter Ended June 30, 2006
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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Red Lion Hotels Corporation
Consolidated Balance Sheets (unaudited)
June 30, 2006 and December 31, 2005

| | June 30, 2006 | December 31, 2005 |
|--|--|------------------------------|
| | <i>(In thousands, except share data)</i> | |
| Assets: | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 58,721 | \$ 28,729 |
| Restricted cash | 5,386 | 8,821 |
| Accounts receivable, net | 9,321 | 8,755 |
| Inventories | 1,707 | 1,712 |
| Prepaid expenses and other | 4,701 | 1,610 |
| Assets held for sale: | | |
| Assets of discontinued operations | 15,040 | 20,217 |
| Other assets held for sale | 715 | 715 |
| Total current assets | <u>95,591</u> | <u>70,559</u> |
| Property and equipment, net | 253,905 | 235,444 |
| Goodwill | 28,042 | 28,042 |
| Intangible assets, net | 12,456 | 12,852 |
| Other assets, net | 7,859 | 8,699 |
| Total assets | <u>\$ 397,853</u> | <u>\$ 355,596</u> |
| Liabilities: | | |
| Current liabilities: | | |
| Accounts payable | \$ 5,331 | \$ 7,057 |
| Accrued payroll and related benefits | 4,916 | 5,520 |
| Accrued interest payable | 641 | 676 |
| Advance deposits | 603 | 198 |
| Other accrued expenses | 13,160 | 9,752 |
| Long-term debt, due within one year | 3,866 | 3,731 |
| Liabilities of discontinued operations | 2,597 | 3,089 |
| Total current liabilities | <u>31,114</u> | <u>30,023</u> |
| Long-term debt, due after one year | 124,643 | 126,633 |
| Deferred income | 7,394 | 7,770 |
| Deferred income taxes | 14,220 | 13,420 |
| Minority interest in partnerships | 7,043 | 9,080 |
| Debentures due Red Lion Hotels Capital Trust | 30,825 | 47,423 |
| Total liabilities | <u>215,239</u> | <u>234,349</u> |
| Stockholders' equity: | | |
| Preferred stock — 5,000,000 shares authorized; \$0.01 par value; no shares issued or outstanding | — | — |
| Common stock — 50,000,000 shares authorized; \$0.01 par value; 19,088,687 and 13,131,282 shares issued and outstanding | 191 | 131 |
| Additional paid-in capital, common stock | 147,032 | 84,832 |
| Retained earnings | 35,391 | 36,284 |
| Total stockholders' equity | <u>182,614</u> | <u>121,247</u> |
| Total liabilities and stockholders' equity | <u>\$ 397,853</u> | <u>\$ 355,596</u> |

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

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Red Lion Hotels Corporation Consolidated Statements of Operations (unaudited) For the Three and Six Months Ended June 30, 2006 and 2005

| | <u>Three months ended June 30,</u> <u>2006</u> | <u>2005</u> | <u>Six months ended June 30,</u> <u>2006</u> | <u>2005</u> |
|---|---|-----------------|---|-------------------|
| | <i>(In thousands, except per share data)</i> | | | |
| Revenue: | | | | |
| Hotels | \$ 40,451 | \$ 39,423 | \$ 71,479 | \$ 69,765 |
| Franchise and management | 641 | 607 | 1,217 | 1,418 |
| Entertainment | 2,488 | 2,613 | 5,858 | 5,418 |
| Real estate | 953 | 1,229 | 2,293 | 2,458 |
| Other | <u>235</u> | <u>348</u> | <u>518</u> | <u>633</u> |
| Total revenues | <u>44,768</u> | <u>44,220</u> | <u>81,365</u> | <u>79,692</u> |
| Operating expenses: | | | | |
| Hotels | 30,549 | 30,397 | 58,425 | 58,006 |
| Franchise and management | 187 | 171 | 409 | 272 |
| Entertainment | 2,056 | 2,321 | 4,956 | 4,789 |
| Real estate | 613 | 930 | 1,529 | 1,808 |
| Other | 276 | 240 | 512 | 452 |
| Depreciation and amortization | 3,167 | 2,881 | 6,288 | 5,720 |
| Hotel facility and land lease | 1,716 | 1,745 | 3,411 | 3,485 |
| Gain on asset dispositions, net | (1,155) | (119) | (1,337) | (307) |
| Undistributed corporate expenses | <u>1,234</u> | <u>1,051</u> | <u>2,218</u> | <u>2,003</u> |
| Total expenses | <u>38,643</u> | <u>39,617</u> | <u>76,411</u> | <u>76,228</u> |
| Operating income | 6,125 | 4,603 | 4,954 | 3,464 |
| Other income (expense): | | | | |
| Interest expense | (3,453) | (3,598) | (6,944) | (7,199) |
| Expense of early extinguishment of debt | (805) | — | (805) | — |
| Minority interest in partnerships, net | (211) | (34) | (237) | 15 |
| Other income, net | <u>456</u> | <u>90</u> | <u>816</u> | <u>86</u> |
| Income (loss) from continuing operations before income taxes | 2,112 | 1,061 | (2,216) | (3,634) |
| Income tax expense (benefit) | <u>226</u> | <u>279</u> | <u>(1,373)</u> | <u>(1,416)</u> |
| Net income (loss) from continuing operations | <u>1,886</u> | <u>782</u> | <u>(843)</u> | <u>(2,218)</u> |
| Discontinued operations: | | | | |
| Income (loss) from operations of discontinued business units, net of income tax expense (benefit) of \$107, \$577, (\$44) and \$456 | 195 | 951 | (80) | 828 |
| Net gain on disposal of discontinued business units, net of income tax expense of \$16 | <u>—</u> | <u>—</u> | <u>30</u> | <u>—</u> |
| Income (loss) from discontinued operations | <u>195</u> | <u>951</u> | <u>(50)</u> | <u>828</u> |
| Net income (loss) | <u>\$ 2,081</u> | <u>\$ 1,733</u> | <u>\$ (893)</u> | <u>\$ (1,390)</u> |

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

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Red Lion Hotels Corporation Consolidated Statements of Operations (unaudited) (continued) For the Three and Six Months Ended June 30, 2006 and 2005

| | <u>Three months ended June 30,</u> <u>2006</u> | <u>2005</u> | <u>Six months ended June 30,</u> <u>2006</u> | <u>2005</u> |
|--|---|----------------|---|------------------|
| | <i>(In thousands, except per share data)</i> | | | |
| Earnings per common share — basic: | | | | |
| Net income (loss) from continuing operations | \$ 0.13 | \$ 0.06 | \$ (0.06) | \$ (0.17) |
| Income (loss) from discontinued operations | 0.01 | 0.07 | — | 0.06 |
| Net income (loss) | <u>\$ 0.14</u> | <u>\$ 0.13</u> | <u>\$ (0.06)</u> | <u>\$ (0.11)</u> |
| Earnings per common share — diluted: | | | | |
| Net income (loss) from continuing operations | \$ 0.12 | \$ 0.06 | \$ (0.06) | \$ (0.17) |
| Income (loss) from discontinued operations | 0.01 | 0.07 | — | 0.06 |
| Net income (loss) | <u>\$ 0.13</u> | <u>\$ 0.13</u> | <u>\$ (0.06)</u> | <u>\$ (0.11)</u> |
| Weighted average shares — basic | 15,120 | 13,092 | 14,182 | 13,085 |
| Weighted average shares — diluted | 15,674 | 13,416 | 14,182 | 13,085 |

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

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Red Lion Hotels Corporation Consolidated Statements of Cash Flows (unaudited) For the Six Months Ended June 30, 2006 and 2005

| | Six months ended June 30, | |
|---|---------------------------|----------------|
| | 2006 | 2005 |
| | <i>(In thousands)</i> | |
| Operating activities: | | |
| Net loss | \$ (893) | \$ (1,390) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 6,291 | 5,788 |
| Gain on disposition of property, equipment and other assets, net | (1,337) | (214) |
| Gain on disposition of discontinued operations, net | (46) | — |
| Expense of early extinguishment of debt | 805 | — |
| Write-off of deferred loan fees | — | 5 |
| Deferred income tax provision | 800 | 600 |
| Minority interest in partnerships | 237 | (15) |
| Equity in investments | 40 | 30 |
| Compensation expense related to stock issuance | 307 | 9 |
| Provision for doubtful accounts | 242 | 73 |
| Change in current assets and liabilities: | | |
| Restricted cash | 3,434 | 612 |
| Accounts receivable | (623) | (1,084) |
| Inventories | 35 | 83 |
| Prepaid expenses and other | (3,143) | (2,788) |
| Accounts payable | (1,731) | 1,134 |
| Accrued payroll and related benefits | (979) | 559 |
| Accrued interest payable | (30) | (33) |
| Other accrued expenses and advance deposits | 3,798 | 4,778 |
| Net cash provided by operating activities | <u>7,207</u> | <u>8,147</u> |
| Investing activities: | | |
| Purchases of property and equipment | (24,208) | (8,276) |
| Proceeds from disposition of property and equipment | 22 | 30 |
| Proceeds from disposition of discontinued operations | 5,137 | — |
| Proceeds from (advances to) Red Lion Hotels Capital Trust | 498 | (20) |
| Distributions from equity investee | — | 117 |
| Proceeds from collections under note receivable | — | 480 |
| Other, net | 90 | 92 |
| Net cash used in investing activities | <u>(18,461)</u> | <u>(7,577)</u> |

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

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Red Lion Hotels Corporation Consolidated Statements of Cash Flows (unaudited) (continued) For the Six Months Ended June 30, 2006 and 2005

| | Six months ended June 30, | |
|---|---------------------------|-----------------|
| | 2006 | 2005 |
| | <i>(In thousands)</i> | |
| Financing activities: | | |
| Proceeds from note payable to bank | — | 50 |
| Repayment of note payable to bank | — | (50) |
| Proceeds from long-term debt | — | 3,835 |
| Repayment of long-term debt | (2,084) | (6,027) |
| Proceeds from common stock offering | 60,420 | — |
| Repayment of debentures including expense of early extinguishment | (17,403) | — |
| Proceeds from issuance of common stock under employee stock purchase plan | 66 | 67 |
| Proceeds from stock option exercises | 326 | 46 |
| Additions to deferred financing costs | (48) | (279) |
| Net cash provided by (used in) financing activities | <u>41,277</u> | <u>(2,358)</u> |
| Net cash in discontinued operations | <u>(31)</u> | <u>(33)</u> |
| Change in cash and cash equivalents: | | |
| Net increase (decrease) in cash and cash equivalents | 29,992 | (1,821) |
| Cash and cash equivalents at beginning of period | <u>28,729</u> | <u>9,577</u> |
| Cash and cash equivalents at end of period | <u>\$ 58,721</u> | <u>\$ 7,756</u> |
| Supplemental disclosure of cash flow information: | | |
| Cash paid during period for: | | |
| Interest | \$ 7,053 | \$ 7,993 |
| Income taxes | \$ 1,812 | \$ 13 |
| Noncash investing and financing activities: | | |
| Exchange of common stock for minority interest in partnership | \$ 2,273 | \$ — |
| Exchange of common stock for real estate management business | \$ 1,131 | \$ — |
| Sale of equipment under note receivable | \$ — | \$ 37 |

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

**Red Lion Hotels Corporation
Condensed Notes to Consolidated Financial Statements**

1. Organization

Red Lion Hotels Corporation (“Red Lion” or the “Company”) is a NYSE-listed hospitality and leisure company (ticker symbols RLH and RLH-pa) primarily engaged in the ownership, operation, development and franchising of mid-scale and up-scale, full service hotels under its Red Lion brand. As of June 30, 2006, our hotel system contained 60 hotels located in nine states and one Canadian province, with 10,424 rooms and 509,537 square feet of meeting space. Of these 60 hotels, the Company (i) operated 34 hotels, 21 of which were owned and 13 of which were leased, (ii) franchised 25 hotels to various franchisees and (iii) managed one hotel owned by a third party.

The Company is also engaged in entertainment and real estate operations. Through the entertainment division, which includes TicketsWest.com, Inc., the Company engages in event ticket distribution and promotion and presents a variety of entertainment productions. Through its real estate division, the Company owns certain commercial real estate properties. In addition, the real estate division has historically engaged in traditional real estate related services, including developing, managing and acting as a broker for sales and leases of commercial and multi-unit residential properties (collectively referred to as the real estate management business). Effective April 30, 2006 the Company divested the real estate management portion of its real estate division as further discussed in Note 7.

The Company was incorporated in the State of Washington on April 25, 1978. The financial statements encompass the accounts of Red Lion Hotels Corporation and all of its consolidated subsidiaries, including its 100% ownership of Red Lion Hotels Holdings, Inc., and Red Lion Hotels Franchising, Inc. and its approximately 99% ownership of Red Lion Hotels Limited Partnership (“RLHLP”). The Company also consolidates its 50% interest in a retail and hotel complex as both the substance of the ownership and its level of influence over the operations of the assets indicate that consolidation is appropriate for the property.

The financial statements also include an equity method investment in a 19.9% owned real estate venture, and certain cost method investments in various entities included as other assets, over which the Company does not exercise significant influence. Lastly, the Company holds a 3% common interest in Red Lion Hotels Capital Trust (“the Trust”). The Trust is considered a variable interest entity under FIN-46(R) “Consolidation of Variable Interest Entities” (“FIN-46(R)”), however the Company is not the primary beneficiary of the Trust. This entity is treated as an equity method investment.

All significant inter-company and inter-segment transactions and accounts have been eliminated upon consolidation. Certain amounts in the prior period statements have been reclassified to conform to the current period presentation.

2. Basis of Presentation

The unaudited consolidated financial statements included herein have been prepared by Red Lion pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted as permitted by such rules and regulations. The balance sheet as of December 31, 2005 has been compiled from the audited balance sheet as of such date. The Company believes that the disclosures included herein are adequate; however, these consolidated statements should be read in conjunction with the consolidated financial statements and the notes thereto for the year ended December 31, 2005 previously filed with the SEC on Form 10-K.

In the opinion of management, these unaudited consolidated financial statements contain all of the adjustments of a normal and recurring nature necessary to present fairly the consolidated financial position of the Company at June 30, 2006, the consolidated results of operations for the three and six months ended June 30, 2006 and 2005, and the consolidated cash flows for the six months ended June 30, 2006 and 2005. The results of operations for the periods presented may not be indicative of those which may be expected for a full year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements, the reported amounts of revenues and expenses during the reporting period and the disclosures of contingent liabilities. Accordingly, ultimate results could differ materially from those estimates.

3. Common Stock Offering

On May 22, 2006 the Company completed a public offering of 5,000,000 shares of its common stock at \$11.00 per share, resulting in gross proceeds of \$55.0 million. Underwriting discount and other offering costs totaled approximately \$3.4 million, resulting in net proceeds of approximately \$51.6 million to the Company. On June 13, 2006, the underwriter of the offering exercised its over-allotment option and an additional 845,302 shares of common stock were issued at \$11.00 per share. This resulted in additional gross proceeds to the Company of approximately \$9.3 million. Net of underwriting discount, proceeds on the over-allotment were approximately \$8.8 million. The net proceeds of the offering will be primarily used to retire existing long-term debt and related defeasance costs and were used to fund the retirement of debentures discussed in Note 5. Any remaining proceeds will be used for general working capital purposes. An additional 635,344 shares were sold in the offering on May 22, 2006 by certain shareholders of Red Lion (“selling shareholders”), however the Company received no proceeds from these shares.

4. Assets Held For Sale and Discontinued Operations

In connection with the November 2004 announcement of the hotel renovation plan to improve comfort, freshen décor and upgrade technology at its hotels, the Company implemented a plan to divest 11 non-strategic owned hotels, one commercial office building and certain other non-core properties including condominium units and three parcels of excess land (collectively these assets are referred to herein as “the divestment properties”). Each of the divestment properties meet the criteria to be classified as an asset held for sale. In addition, the activities of those 11 hotels and the commercial office building are considered discontinued operations under generally accepted accounting principles. Depreciation of these assets, if previously appropriate, was suspended. At the time of the decision to divest from these assets, a net of tax impairment charge of \$5.8 million on four of the hotel properties was recorded. For comparative purposes, all financial information included in the consolidated statements of operations for periods prior to 2004, if presented, has been reclassified to conform to the current presentation.

During the second half of 2005, the Company completed the sale of seven of the hotels, the commercial office building, and certain non-core real estate assets with gross aggregate proceeds of \$52.8 million. The resulting gain on disposition of discontinued operations was \$10.2 million. In addition, during 2005, the Company recorded an additional aggregate impairment of \$4.5 million on certain hotel properties. The net overall impact of these transactions in 2005, after the effect of income taxes, was a net of tax gain of \$3.7 million.

In the first quarter of 2006 the Company completed the sale of one hotel and a portion of a second for gross aggregate proceeds of \$5.3 million. The resulting gain on disposition of discontinued operations was \$46 thousand. During the second quarter of 2006, the Company executed agreements for the sale of two of the remaining hotels and management expects that both transactions will be closed before September 30, 2006. The Company continues to actively pursue disposition of the last hotel and surplus undeveloped land originally identified for sale. A summary of the assets and liabilities of the hotels remaining in discontinued operations is as follows:

| | <u>June 30,</u> <u>2006</u> | <u>December 31,</u> <u>2005</u> |
|--|--------------------------------|------------------------------------|
| | <i>(In thousands)</i> | |
| Cash and cash equivalents | \$ 97 | \$ 66 |
| Accounts receivable, net | 398 | 602 |
| Inventories | 128 | 157 |
| Prepaid expenses and other | 145 | 106 |
| Property and equipment, net | 14,118 | 19,131 |
| Other assets, net | 154 | 155 |
| Assets of discontinued operations | <u>\$15,040</u> | <u>\$ 20,217</u> |
| Accounts payable | 119 | 125 |
| Accrued payroll and related benefits | 141 | 420 |
| Accrued interest payable | 12 | 7 |
| Advanced deposits | 18 | 11 |
| Other accrued expenses | 188 | 177 |
| Long-term debt | 2,119 | 2,349 |
| Liabilities of discontinued operations | <u>\$ 2,597</u> | <u>\$ 3,089</u> |

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A summary of the results of operations for the discontinued operations is as follows (in thousands):

| | Three Months Ended June 30, 2006 | | | Three Months Ended June 30, 2005 | | |
|-----------------------------------|----------------------------------|-----------------|----------|----------------------------------|-----------------|-----------|
| | Hotel Properties | Office Building | Combined | Hotel Properties | Office Building | Combined |
| | <i>(In thousands)</i> | | | | | |
| Revenues | 2,048 | \$— | \$ 2,048 | \$ 6,571 | \$ 810 | \$ 7,381 |
| Operating expenses | (1,712) | — | (1,712) | (5,131) | (345) | (5,476) |
| Gain (loss) on asset dispositions | 5 | — | 5 | (4) | — | (4) |
| Interest expense | (39) | — | (39) | (177) | (196) | (373) |
| Income tax expense | (107) | — | (107) | (475) | (102) | (577) |
| Net income | \$ 195 | \$— | \$ 195 | \$ 784 | \$ 167 | \$ 951 |
| | <hr/> | | | <hr/> | | |
| | Six Months Ended June 30, 2006 | | | Six Months Ended June 30, 2005 | | |
| | Hotel Properties | Office Building | Combined | Hotel Properties | Office Building | Combined |
| | <i>(In thousands)</i> | | | | | |
| Revenues | 1,428 | \$— | \$ 1,428 | \$10,916 | \$1,630 | \$ 12,546 |
| Operating expenses | (1,814) | — | (1,814) | (9,832) | (691) | (10,523) |
| Gain on asset dispositions | 46 | — | 46 | 11 | — | 11 |
| Interest expense | (39) | — | (39) | (357) | (393) | (750) |
| Income tax benefit (expense) | 135 | — | 135 | (262) | (194) | (456) |
| Net income (loss) | \$ (244) | \$— | \$ (244) | \$ 476 | \$ 352 | \$ 828 |

In the above table, the three month and six month periods ended June 30, 2006 include the activities of the three remaining divestment hotels. The results for the three and six month periods ended June 30, 2005 include the activities of all 11 divestment hotels and the office building.

5. Debenture Repayment

As discussed in Note 1, the Company holds a 3% common interest in the Red Lion Hotels Capital Trust, treated as an equity method investment and included with other long-term assets on the consolidated balance sheet. This represents all of the common ownership of the Trust. Together with the Trust, the Company completed a public offering of \$46.0 million of trust preferred securities in the first quarter of 2004. Those securities are listed on the New York Stock Exchange and entitle holders to cumulative cash distributions at a 9.5% annual rate. They mature on February 24, 2044. The proceeds from the 2004 offering, including the \$1.4 million of proceeds from the trust common securities sold to the Company, were borrowed by Red Lion through 9.5% debentures which are included on the Company's consolidated balance sheet as a long-term liability. Both the trust preferred securities and the trust common securities were issued at a price of \$25.00 per share. Red Lion does not consolidate the Trust as it is considered a variable interest entity under FIN-46(R) and Red Lion is not the primary beneficiary of the trust.

The Trust Agreement, entered into at the date of the offering with the trustees for the trust securities, required the mandatory redemption of 35% of the then outstanding trust securities at 105% of issued value if Red Lion completed an offering of common shares with gross proceeds to the Company of greater than \$50 million. In accordance therewith and in connection with the offering of common stock further described in Note 3, on June 23, 2006, Red Lion repaid approximately \$16.6 million of the debentures due the Trust. The Trust then redeemed 35% of the outstanding trust preferred securities and trust common securities at a price of \$26.25 per share, a 5% premium over the issued value of the securities. Of the \$16.6 million, approximately \$498,000 was received back by Red Lion for its trust common securities and is reflected as a reduction of its equity method investment in the Trust. The \$805 thousand premium paid to retire the debentures is separately identified on the consolidated statements of operations as expense of early extinguishment of debt.

6. Notes Payable to Bank

The Company has a revolving credit agreement with Wells Fargo Bank, National Association (“Wells Fargo”). Starting on February 9, 2005, the agreement provided a revolving credit facility with a total of \$20.0 million in borrowing capacity for working capital purposes. This included a \$4.0 million line-of-credit secured by the Company’s personal property and two hotels (“Line A”) and a \$16.0 million line of credit secured by the Company’s personal property and seven hotels that the Company then held for sale (“Line B”). Since the properties that secured Line B were sold in 2005, Line B expired unused.

On March 27, 2006, the Company entered into a revised credit agreement with Wells Fargo, providing for a revolving credit facility with a total of \$10.0 million in borrowing capacity for working capital purposes. This includes a \$6.0 million line-of-credit secured by two hotels (“New Line A”) and a \$4.0 million line of credit secured by the Company’s personal property (“New Line B”). Interest under New Line A is set at 0.5% over the bank’s prime rate and does not require any principal payments until the end of its two year term. Interest under New Line B is set at 1.0% over the bank’s prime rate and does not require any principal payments until the end of its one year term. The revised agreement contains certain restrictions and covenants, the most restrictive of which requires the Company to maintain a minimum tangible net worth of \$120 million, a minimum EBITDA (as defined by the bank) coverage ratio of 1.25:1, and a maximum funded debt to EBITDA ratio of 5.25:1.

At June 30, 2006 and at December 31, 2005, the Company was in compliance with the covenants in effect under the credit agreement. No amounts were outstanding under any portion of the credit agreement at June 30, 2006 or December 31, 2005.

On July 20, 2006, the Company received a commitment for a \$50.0 million credit facility from Calyon New York Branch which will replace the Wells Fargo credit facility. This credit facility will be used for general corporate purposes and to finance future growth.

7. Real Estate Management Business

On April 30, 2006, the Company closed an agreement to divest on a tax-free basis the real estate management portion of its real estate division for \$1.1 million to an existing company executive and a former company executive who is also the brother of two members of the Company’s board of directors. The sale was in exchange for 94,311 shares of unrestricted Red Lion Hotels Corporation common stock, which was subsequently retired. The transaction resulted in a gain on sale of approximately \$1.0 million. The new entity will continue to manage the Company’s office and retail real estate assets through a management agreement. For the full year 2005, the real estate management business contributed \$2.3 million and \$0.1 million to the company’s revenue and operating income, respectively.

8. Minority Interest and Operating Partnership Units

As discussed in Note 1, the Company is the general partner of RLHLP and through December 31, 2005 held approximately a 98% interest in that entity. Partners who hold operating partnership units (“OP Units”) have the right to put those OP Units to the RLHLP, in which event either (a) RLHLP must redeem the units for cash, or (b) the Company, as general partner, may elect to acquire the OP units for cash or in exchange for a like number of shares of its common stock.

In the first quarter of 2006, the Company elected to issue 143,498 shares of its common stock in exchange for a like number of OP Units that certain then limited partners put to the RLHLP. This resulted in a non-cash adjustment of the minority interest balance of \$2.2 million with a corresponding increase to common stock and additional paid-in capital. At June 30, 2006, the Company held approximately a 99% interest in RLHLP with the remaining 142,663 OP Units held by limited partners. The Company does not expect that the issuance of this common stock will materially affect its per share operating results.

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9. Business Segments

The Company has four primary operating segments: (1) hotels; (2) franchise and management; (3) entertainment; and (4) real estate. Other activities, consisting primarily of miscellaneous revenues and expenses, cash and cash equivalents, certain receivables and certain property and equipment which are not specifically associated with an operating segment are also aggregated for reporting purposes. Management reviews and evaluates the operating segments exclusive of interest expense and inter-segment and inter-company revenues and expenses. Therefore, interest expense is not allocated to the segments and all balances are presented after the elimination of inter-company and inter-segment transactions.

Selected information with respect to the segments is as follows:

Continuing Operations

| | <u>Three months ended June 30,</u> <u>2006</u> | <u>2005</u> | <u>Six months ended June 30,</u> <u>2006</u> | <u>2005</u> |
|---------------------------------|---|------------------|---|------------------|
| | <i>(In thousands)</i> | | | |
| Revenues: | | | | |
| Hotels | \$ 40,451 | \$ 39,423 | \$ 71,479 | \$ 69,765 |
| Franchise and management | 641 | 607 | 1,217 | 1,418 |
| Entertainment | 2,488 | 2,613 | 5,858 | 5,418 |
| Real estate | 953 | 1,229 | 2,293 | 2,458 |
| Other | 235 | 348 | 518 | 633 |
| | <u>\$ 44,768</u> | <u>\$ 44,220</u> | <u>\$ 81,365</u> | <u>\$ 79,692</u> |
| Operating income (loss): | | | | |
| Hotels | 5,897 | 5,169 | 5,087 | 3,915 |
| Franchise and management | 215 | 244 | 332 | 763 |
| Entertainment | 291 | 180 | 621 | 403 |
| Real estate | 1,163 | 263 | 1,420 | 437 |
| Other | (1,441) | (1,254) | (2,506) | (2,053) |
| | <u>\$ 6,125</u> | <u>\$ 4,602</u> | <u>\$ 4,954</u> | <u>\$ 3,465</u> |

Discontinued Operations

| | <u>Three months ended June 30,</u> <u>2006</u> | <u>2005</u> | <u>Six months ended June 30,</u> <u>2006</u> | <u>2005</u> |
|---------------------------------|---|-----------------|---|------------------|
| | <i>(In thousands)</i> | | | |
| Revenues: | | | | |
| Hotels | \$ 2,048 | \$ 6,571 | \$ 3,475 | \$ 10,916 |
| Real estate | — | 810 | — | 1,630 |
| | <u>\$ 2,048</u> | <u>\$ 7,381</u> | <u>\$ 3,475</u> | <u>\$ 12,546</u> |
| Operating income (loss): | | | | |
| Hotels | 342 | 1,436 | 2 | 1,095 |
| Real estate | — | 465 | — | 939 |
| | <u>\$ 342</u> | <u>\$ 1,901</u> | <u>\$ 2</u> | <u>\$ 2,034</u> |

10. Earnings Per Common Share

The following table presents a reconciliation of the numerators and denominators used in the basic and diluted earnings per common share computations for the three and six months ended June 30, 2006 and 2005:

| | <u>Three months ended June 30,</u> <u>2006</u> | <u>2005</u> | <u>Six months ended June 30,</u> <u>2006</u> | <u>2005</u> |
|---|---|----------------|---|------------------|
| <i>(In thousands, except per share amounts)</i> | | | | |
| Numerator: | | | | |
| Basic | | | | |
| Net income (loss) from continuing operations | \$ 1,886 | \$ 782 | \$ (843) | \$ (2,218) |
| Income (loss) on discontinued operations | 195 | 951 | (50) | 828 |
| Net income (loss) — basic | <u>2,081</u> | <u>1,733</u> | <u>(893)</u> | <u>(1,390)</u> |
| Diluted | | | | |
| Effect of OP Units, net of tax | 16 | 22 | — | — |
| Net income (loss) — diluted | <u>2,097</u> | <u>1,755</u> | <u>(893)</u> | <u>(1,390)</u> |
| Denominator: | | | | |
| Weighted average shares — basic | <u>15,120</u> | <u>13,092</u> | <u>14,182</u> | <u>13,085</u> |
| Weighted average shares — diluted | <u>15,674</u> | <u>13,416</u> | <u>14,182</u> | <u>13,085</u> |
| Earnings per common share: | | | | |
| Basic | | | | |
| Net income (loss) from continuing operations | \$ 0.13 | \$ 0.06 | \$ (0.06) | \$ (0.17) |
| Income (loss) on discontinued operations | 0.01 | 0.07 | — | 0.06 |
| Net income (loss) — basic | <u>\$ 0.14</u> | <u>\$ 0.13</u> | <u>\$ (0.06)</u> | <u>\$ (0.11)</u> |
| Diluted | | | | |
| Net income (loss) from continuing operations | \$ 0.12 | \$ 0.06 | \$ (0.06) | \$ (0.17) |
| Income (loss) on discontinued operations | 0.01 | 0.07 | — | 0.06 |
| Net income (loss) — basic | <u>\$ 0.13</u> | <u>\$ 0.13</u> | <u>\$ (0.06)</u> | <u>\$ (0.11)</u> |

For the three months ended June 30, 2006, 411,576 of the 1,132,840 options to purchase common shares outstanding as of that date were considered dilutive. For the three months ended June 30, 2005, 38,644 of the 1,024,019 options to purchase common shares outstanding as of that date were considered dilutive. For those same periods, all of the 142,663 and 286,161 convertible OP units, respectively, were considered dilutive. All convertible debt instruments were considered anti-dilutive.

For the six months ended June 30, 2006 and 2005, all of the 1,132,840 and 1,024,019 outstanding options to purchase common shares were considered anti-dilutive due to the loss for the period. Likewise, for those same periods, all of the 142,663 and 286,161 convertible OP units, respectively, were considered anti-dilutive, as were all convertible debt instruments.

11. Stock Based Compensation

Effective January 1, 2006, the Company adopted the provisions of FASB Statement of Financial Accounting Standards No. 123 Revised (“SFAS No. 123(R)”) for stock based compensation, including options and other awards issued under its stock incentive plans and shares issued under its employee stock purchase plan. Under SFAS No. 123(R), stock based compensation expense reflects the fair value of stock based awards measured at grant date, is recognized over the relevant service period, and is adjusted each period for anticipated forfeitures. The Company has elected to use the modified prospective transition method as permitted by SFAS No. 123(R) and therefore has not restated its financial results for prior periods. Under this transition method, the Company will apply the provisions of SFAS No. 123(R) to new awards and to awards modified, repurchased, or cancelled after January 1, 2006. Additionally, the Company will recognize compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of January 1, 2006, as the remaining service is rendered. The compensation cost we recorded for these awards will be based on their grant-date fair value as required by SFAS No. 123(R).

The 1998 Stock Incentive Plan and the 2006 Stock Incentive Plan (“the Plans”), which are shareholder approved, authorize the grant or issuance of various option or other awards including stock appreciation rights, restricted stock grants, and other stock based compensation. In aggregate, the Plans allow for a maximum number of shares which may be awarded of 2,400,000 shares, subject to adjustments for stock splits, stock dividends and similar events. The Compensation Committee of the Board of Directors administers the Plan and establishes to whom, and the type and the terms and conditions, including the exercise period, of the awards that are granted.

No options have been issued in 2006. All options granted prior to 2003 were designated as nonqualified options, with an exercise price equal to or in excess of fair market value on the date of grant, and for a term of ten years. For substantially all options granted, fifty percent of each recipients’ options will vest on the fourth anniversary of the date of grant and the remaining 50% will vest on the fifth anniversary of the date of grant. For options issued prior to 2004, the vesting schedule will change if, beginning one year after the option grant date, the stock price of the common stock reaches the following target levels (measured as a percentage increase over the exercise price) for 60 consecutive trading days:

| <u>Stock Price Increase</u> | <u>Percent of Option Shares Vested</u> |
|-----------------------------|--|
| 25% | 25% |
| 50% | 50% |
| 75% | 75% |
| 100% | 100% |

For options issued after 2003, the vesting schedule will change if, between the two year anniversary and the four year anniversary of the option grant date, the stock price of the common stock reaches the following target levels (measured as a percentage increase over the exercise price) for 60 consecutive trading days:

| <u>Stock Price Increase</u> | <u>Percent of Option Shares Vested</u> |
|-----------------------------|--|
| 100% | 25% |
| 200% | 50% |

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A summary of the Company's stock option activity during the six months ended June 30, 2006 is as follows:

| | <u>Number of Shares</u> | <u>Weighted-Average Exercise Price</u> | <u>Exercise Price Per Share</u> | <u>Expiration Date</u> | <u>Aggregate Intrinsic Value (in thousands)</u> |
|------------------------------|-----------------------------|--|-------------------------------------|----------------------------|---|
| Outstanding, January 1, 2006 | 1,219,520 | \$ 6.62 | \$ 5.10-15.00 | 2008-2015 | \$ 5,276 |
| Options exercised | (51,705) | \$ 6.13 | \$ 5.26-10.94 | | |
| Options forfeited | (34,975) | \$ 10.45 | \$ 5.10-15.00 | | |
| Outstanding, June 30, 2006 | <u>1,132,840</u> | <u>\$ 6.53</u> | <u>\$ 5.10-15.00</u> | <u>2008-2015</u> | <u>\$ 5,007</u> |
| Exercisable, June 30, 2006 | 310,800 | \$ 8.30 | \$ 5.26-15.00 | 2008-2013 | \$ 823 |

The aggregate intrinsic value in the table above is before applicable income taxes and represents the amount optionees would have received if all options had been exercised on the last business day of the period ended June 30, 2006, based upon the Company's closing stock price of \$10.95. As of June 30, 2006, total unrecognized stock-based compensation expense related to non-vested stock options was approximately \$1.5 million before the impact of income taxes and is expected to be recognized over a weighted average period of 39 months.

During the six months ended June 30, 2006 the total intrinsic value of the 51,705 stock options exercised was \$288 thousand. Gross proceeds from those option conversions to the Company were \$317 thousand. During that same period the fair value of options vested was approximately \$10 thousand. The company issues new shares of common stock upon exercise of stock options. As of June 30, 2006 there were 1,116,840 shares of common stock available for issuance pursuant to future stock option grants. Additional information regarding stock options outstanding as of June 30, 2006 is as follows:

| <u>Range of Exercise Prices</u> | <u>Options Outstanding</u> | | | <u>Options Exercisable</u> | |
|---|-------------------------------|--|--|-------------------------------|--|
| | <u>Number Outstanding</u> | <u>Weighted Average Remaining Contractual Life (Years)</u> | <u>Weighted Average Exercise Price</u> | <u>Number Exercisable</u> | <u>Weighted Average Exercise Price</u> |
| 5.10 - 6.07 | 784,313 | 7.60 | \$ 5.33 | 166,423 | \$ 5.53 |
| 7.46 - 8.31 | 254,305 | 8.11 | 7.58 | 54,155 | 8.02 |
| 10.94 | 31,309 | 2.52 | 10.94 | 31,309 | 10.94 |
| 15.00 | 62,913 | 2.08 | 15.00 | 58,913 | 15.00 |
| | <u>1,132,840</u> | <u>7.27</u> | <u>\$ 6.53</u> | <u>310,800</u> | <u>\$ 8.30</u> |

Compensation expense related to options to purchase common stock for the three and six months ended June 30, 2006 was \$117 thousand and \$245 thousand respectively. The Company values stock options issued based upon the Black-Scholes option-pricing model and recognize this value as an expense over the periods in which the options vest. Use of the Black-Scholes option-pricing model requires that the Company make certain assumptions, including expected volatility, risk-free interest rate, expected dividend yield and expected life of the options. The Company utilized assumptions that it believed to be most appropriate at the time of the valuation. Had different assumptions been used in the pricing model the expense recognized for stock options may have been different than the expense recognized in the financial statements. The Company must also apply judgment in developing an expectation of awards of restricted stock and stock options that may be forfeited. If actual experience differs significantly from these estimates, stock based compensation expense and the Company's results of operations could be materially affected.

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The fair value of each option grant is estimated on the grant date. No options have been granted in 2006 through the first two quarters. Options granted in 2005 were valued using the following assumptions:

| | |
|-------------------------|---------|
| Dividend Yield | 0.00% |
| Expected Volatility | 33.00% |
| Risk Free Interest Rate | 4.60% |
| Expected option Life | 4 years |

As permitted by Statement of Financial Accounting Standards No. 123 “Accounting for Stock-Based Compensation” (“SFAS No. 123”), as amended by Statement of Financial Accounting Standards No. 148 “Accounting for Stock-Based Compensation — Transition and Disclosure” (“SFAS No. 148”), through December 31, 2005 the Company has chosen to measure compensation cost for stock-based employee compensation plans using the intrinsic value method of accounting prescribed by Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” and to provide the disclosure only requirements of SFAS No. 123, including frequent and prominent disclosure of stock-based compensation expense.

The Company chose not to record compensation expense for its stock-based employee plans using fair value measurement provisions in the statement of operations in 2005. Had compensation cost for the plans been determined based on the fair value at the grant dates for awards under the plans, reported net income and earnings per share for the three and six months ended June 30, 2005 would have been changed to the pro forma amounts indicated below:

| | Three months ended June 30, 2005 | Six months ended June 30, 2005 |
|---|-------------------------------------|-----------------------------------|
| | <i>(In thousands)</i> | |
| Reported net income (loss) | \$ 1,733 | \$ (1,390) |
| Add back: stock-based employee compensation expense, net of related tax effects | 3 | 6 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (61) | (125) |
| Pro Forma | <u>\$ 1,675</u> | <u>\$ (1,509)</u> |
| Basic and diluted earnings (loss) per share: | | |
| Reported net income (loss) | \$ 0.13 | \$ (0.11) |
| Stock-based employee compensation, fair value | — | — |
| Pro Forma | <u>\$ 0.13</u> | <u>\$ (0.11)</u> |

During the first and second quarters of 2006, options to purchase common shares exercised by employees under the terms of their option agreements totaled 13,031 and 38,674, respectively. Also during the three months ended June 30, 2006 the Company recorded compensation expense related to 11,211 shares issued under its employee stock purchase plan of \$62 thousand, determined by the difference of the fair value on the day the shares were issued and cash price paid under the plan, which under plan design may be at a discount.

12. Recent Accounting Pronouncements

In February of 2006, the FASB issued SFAS No. 155, “Accounting for Certain Hybrid Instruments—An Amendment of FASB Statements No. 133 and No. 144” (“SFAS No. 155”). SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. It also clarifies which interest-only strips and principal-only strips are not subject to the requirements of FASB Statement No. 133, and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. Furthermore, SFAS No. 155 clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and it amends FASB Statement No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or

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issued after the beginning of the first fiscal year beginning after September 15, 2006. The Company's adoption of the provisions of SFAS No. 155 is not expected to impact its financial condition or results of operations.

In March of 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140" ("SFAS No. 156") This Statement amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations. It also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, prescribes subsequent measurement methods, and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 is adopted effective for an entity's first fiscal year that begins after September 15, 2006. The Company's adoption of the provisions of SFAS No. 156 is not expected to impact its financial condition or results of operations.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes by establishing minimum standards for the recognition and measurement of tax positions taken or expected to be taken in a tax return. Under the requirements of FIN 48, the Company must review all of its uncertain tax positions and make a determination as to whether its position is more-likely-than-not to be sustained upon examination by regulatory authorities. If a position meets the more-likely-than-not criterion, then the related tax benefit is measured based on the cumulative probability analysis of the amount that is more-likely-than-not to be realized upon ultimate settlement. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company's adoption of the provisions of FIN 48 is not expected to impact its financial condition or results of operations.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

This quarterly report on Form 10-Q includes forward-looking statements. We have based these statements on our current expectations and projections about future events. When words such as “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “plan,” “seek,” “should,” “will” and similar expressions or their negatives are used in this quarterly report, these are forward-looking statements. Many possible events or factors, including those discussed in “Risk Factors” under Item 1A of our report filed on Form 10-Q for the quarter ended March 31, 2006, could affect our future financial results and performance, and could cause actual results or performance to differ materially from those expressed. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this quarterly report.

In this report, “we,” “us,” “our,” “our company” and “the company” refer to Red Lion Hotels Corporation and, as the context requires, its wholly and partially owned subsidiaries, and “Red Lion” refers to Red Lion Hotels Corporation. The term “the system” or “system of hotels” refers to our entire group of owned, leased, managed and franchised hotels.

The following discussion and analysis should be read in connection with our consolidated financial statements and the condensed notes thereto and the other financial information included elsewhere in this quarterly report.

Overview

We operate in four reportable segments: hotels; franchise and management; entertainment; and real estate. The hotels segment derives revenue primarily from guest room rentals and food and beverage operations at our owned and leased hotels. The franchise and management segment is engaged primarily in licensing the Red Lion brand to franchisees and managing hotels for third-party owners. This segment generates revenue from franchise fees that are typically based on a percent of room revenues and are charged to hotel owners in exchange for the use of our brands and access to our central services programs. These programs include the reservation system, guest loyalty program, national and regional sales, revenue management tools, quality inspections, advertising and brand standards. It also reflects revenue from management fees charged to the owners of our managed hotels, typically based on a percentage of the hotel’s gross revenues plus an incentive fee based on operating performance. The entertainment segment derives revenue primarily from ticketing services and promotion and presentation of entertainment productions. Through our real estate division we own certain commercial real estate properties. Also, the real estate division has historically engaged in traditional real estate related services, including developing, managing and acting as a broker for sales and leases of commercial and multi-unit residential properties (collectively referred to as the real estate management business). Effective April 30, 2006 we divested the real estate management business.

Our system-wide hotels at June 30, 2006 consist of:

| | Hotels | Rooms | Meeting Space (sq. ft.) |
|--|-----------|---------------|----------------------------|
| Owned and Leased Hotels: ⁽¹⁾ | | | |
| Red Lion Hotels | 32 | 5,965 | 308,128 |
| Other | 2 | 483 | 19,608 |
| | 34 | 6,448 | 327,736 |
| Managed Hotels | 1 | 254 | 36,000 |
| Red Lion Franchised Hotels | 25 | 3,722 | 145,801 |
| Total | 60 | 10,424 | 509,537 |
| Total Red Lion Hotels | 57 | 9,687 | 453,929 |

(1) Statistics include three hotels identified as discontinued business units, agregating 621 rooms and 28,408 square feet of meeting space.

Hospitality Industry Performance Measures and Definitions

We believe that the following performance measures, which are widely used in the hospitality industry and appear throughout this analysis, are important to our discussion of operating performance:

- **Total available rooms** represents the number of rooms available multiplied by the number of days in the reported period. We use total available rooms as a measure of capacity in our system of hotels. We do not adjust total available rooms for rooms temporarily out of service for remodel or other short-term periods.

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- **Average occupancy** represents total paid rooms occupied divided by total available rooms. We use average occupancy as a measure of the utilization of capacity in our system of hotels.
- **Revenue per available room**, or **RevPAR**, represents total room and related revenues divided by total available rooms. We use RevPAR as a measure of performance yield in our system of hotels.
- **Average daily rate**, or **ADR**, represents total room revenues divided by the total number of paid rooms occupied by hotel guests. We use ADR as a measure of room pricing in our system of hotels.
- **Comparable hotels** are hotels that have been owned, leased, managed or franchised by us for each of the periods presented.

Throughout this discussion, unless otherwise stated, RevPAR, ADR and average occupancy statistics are calculated using statistics for comparable hotels. When presented in this discussion, the above performance measures will be identified as belonging to a particular market segment, system-wide, or for continuing operations versus discontinued operations or total combined operations.

Unless otherwise indicated, industry statistics are from Smith Travel Research, an independent statistical research service that specializes in the lodging industry. Some of the terms used in this report, such as full service, upscale and midscale are consistent with Smith Travel Research terms. We are a full service brand. Smith Travel Research categorizes hotels into seven chain scales. Our hotels are classified by Smith Travel Research in the upscale and midscale with food and beverage chain scales.

Operating Results and Statistics

A summary of our consolidated results, balance sheet data and hotel statistics for the three months and six month ended June 30, 2006 and 2005 is as follows:

| | <u>Three months ended June 30,</u> <u>2006</u> | <u>2005</u> | <u>Six months ended June 30,</u> <u>2006</u> | <u>2005</u> |
|--|---|-------------|---|-------------|
| | (In thousands, except % and per share data) | | | |
| Consolidated statement of operations data: | | | | |
| Hotels revenue ⁽¹⁾ | \$40,451 | \$39,423 | \$71,479 | \$69,765 |
| Direct margin ⁽²⁾ | \$ 9,902 | \$ 9,026 | \$13,054 | \$11,759 |
| Direct margin % | 24.5% | 22.9% | 18.3% | 16.9% |
| Franchise and management revenue | \$ 641 | \$ 607 | \$ 1,217 | \$ 1,418 |
| Direct margin ⁽²⁾ | \$ 454 | \$ 436 | \$ 808 | \$ 1,146 |
| Direct margin % | 70.8% | 71.8% | 66.4% | 80.8% |
| Entertainment revenue | \$ 2,488 | \$ 2,613 | \$ 5,858 | \$ 5,418 |
| Direct margin ⁽²⁾ | \$ 432 | \$ 292 | \$ 902 | \$ 629 |
| Direct margin % | 17.4% | 11.2% | 15.4% | 11.6% |
| Real estate ⁽¹⁾ | \$ 953 | \$ 1,229 | \$ 2,293 | \$ 2,458 |
| Direct margin ⁽²⁾ | \$ 340 | \$ 299 | \$ 764 | \$ 650 |
| Direct margin % | 35.7% | 24.3% | 33.3% | 26.4% |
| Total revenues | \$44,768 | \$44,220 | \$81,365 | \$79,692 |
| Total direct expenses | \$33,681 | \$34,059 | \$65,831 | \$65,327 |
| Depreciation and amortization | \$ 3,167 | \$ 2,881 | \$ 6,288 | \$ 5,720 |
| Hotel facility and land lease expense | \$ 1,716 | \$ 1,745 | \$ 3,411 | \$ 3,485 |
| Undistributed corporate expenses | \$ 1,234 | \$ 1,051 | \$ 2,218 | \$ 2,003 |
| Total operating expenses | \$38,643 | \$39,617 | \$76,411 | \$76,228 |
| Operating income | \$ 6,125 | \$ 4,603 | \$ 4,954 | \$ 3,464 |
| Operating income % | 13.7% | 10.4% | 6.1% | 4.3% |
| Interest expense | \$ 3,453 | \$ 3,598 | \$ 6,944 | \$ 7,199 |
| Income (loss) from continuing operations before income taxes | \$ 2,112 | \$ 1,061 | \$ (2,216) | \$ (3,634) |
| Income tax expense (benefit) | \$ 226 | \$ 279 | \$ (1,373) | \$ (1,416) |
| Income (loss) from discontinued operations | \$ 195 | \$ 951 | \$ (50) | \$ 828 |
| Net income (loss) | \$ 2,081 | \$ 1,733 | \$ (893) | \$ (1,390) |
| Continuing operations income (loss) per common share — diluted | \$ 0.12 | \$ 0.06 | \$ (0.06) | \$ (0.17) |
| Income (loss) per common share — diluted | \$ 0.13 | \$ 0.13 | \$ (0.06) | \$ (0.11) |

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| | <u>Three months ended June 30,</u> <u>2006</u> | <u>2005</u> | <u>Six months ended June 30,</u> <u>2006</u> | <u>2005</u> |
|---|---|---------------|---|---------------|
| | (In thousands, except % and per share data) | | | |
| Common size operations data: ⁽³⁾ | | | | |
| Revenues: | | | | |
| Hotels | 90.4% | 89.2% | 87.8% | 87.5% |
| Franchise and management | 1.4% | 1.3% | 1.5% | 1.8% |
| All other segments | 8.2% | 9.5% | 10.7% | 10.7% |
| Total revenues | <u>100.0%</u> | <u>100.0%</u> | <u>100.0%</u> | <u>100.0%</u> |
| Operating expenses | | | | |
| Hotels | 68.2% | 68.7% | 71.8% | 72.8% |
| Franchise and management | 0.4% | 0.4% | 0.5% | 0.3% |
| All other segments | 6.6% | 7.9% | 8.6% | 8.8% |
| Depreciation and amortization | 7.1% | 6.5% | 7.7% | 7.2% |
| Hotel facility and land lease expense | 3.8% | 3.9% | 4.2% | 4.4% |
| All other operating expenses | 0.2% | 2.1% | 1.1% | 2.1% |
| Total operating expenses | <u>86.3%</u> | <u>89.5%</u> | <u>93.9%</u> | <u>95.6%</u> |
| Interest expense | 7.7% | 8.1% | 8.5% | 9.0% |
| Income tax benefit | 0.5% | 0.6% | -1.7% | -1.8% |
| Income (loss) from continuing operations | 4.2% | 1.8% | -1.0% | -2.8% |
| Net income (loss) | 4.6% | 3.9% | -1.1% | -1.7% |
| Other operating data: | | | | |
| EBITDA | \$ 9,075 | \$ 9,479 | \$ 11,022 | \$11,391 |
| EBITDA from continuing operations | \$ 8,732 | \$ 7,540 | \$ 11,016 | \$ 9,285 |
| Net cash provided by operating activities | \$ 10,699 | \$ 6,807 | \$ 7,207 | \$ 8,147 |
| Net cash used in investing activities | \$(11,535) | \$(5,352) | \$(18,461) | \$(7,577) |
| Net cash provided by (used in) financing activities | \$ 42,192 | \$ (1,111) | \$ 41,277 | \$(2,358) |

(1) Represents results of continuing operations.

(2) Revenues less direct operating expenses.

(3) Balance as a percentage of total revenues.

| | <u>June 30,</u> <u>2006</u> | <u>December 31,</u> <u>2005</u> |
|---|--------------------------------|------------------------------------|
| | (In thousands) | |
| Consolidated balance sheet data: (end of period) | | |
| Working capital ⁽¹⁾ | \$ 51,319 | \$ 22,693 |
| Assets of discontinued operations | \$ 15,040 | \$ 20,217 |
| Property and equipment, net | \$253,905 | \$235,444 |
| Total assets | \$397,853 | \$355,596 |
| Liabilities of discontinued operations | \$ 2,597 | \$ 3,089 |
| Total long-term debt | \$128,509 | \$130,364 |
| Debentures due Red Lion Hotels Capital Trust | \$ 30,825 | \$ 47,423 |
| Total liabilities | \$215,239 | \$234,349 |
| Total stockholders' equity | \$182,614 | \$121,247 |

(1) Represents current assets less current liabilities, excluding assets and liabilities of discontinued operations and assets held for sale.

Key hotel segment revenue data from continuing operations are as follows (in thousands):

| | <u>Three months ended June 30,</u> <u>2006</u> | <u>2005</u> | <u>Six months ended June 30,</u> <u>2006</u> | <u>2005</u> |
|--|---|------------------|---|------------------|
| | (In thousands) | | | |
| Hotels segment revenues: | | | | |
| Room revenue and other rooms department revenues | \$ 27,138 | \$ 26,212 | \$ 46,887 | \$ 45,140 |
| Food and beverage revenues | 12,400 | 12,129 | 22,780 | 22,553 |
| Amenities and other department revenues | 913 | 1,082 | 1,812 | 2,072 |
| Total hotels segment revenues | <u>\$ 40,451</u> | <u>\$ 39,423</u> | <u>\$ 71,479</u> | <u>\$ 69,765</u> |

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System wide performance statistics are as follows:

| | Three months ended June 30, 2006 | | | Three months ended June 30, 2005 | | |
|---|----------------------------------|--------------------|-----------------------|----------------------------------|--------------------|-----------------------|
| | Average Occupancy ⁽¹⁾ | ADR ⁽²⁾ | RevPAR ⁽³⁾ | Average Occupancy ⁽¹⁾ | ADR ⁽²⁾ | RevPAR ⁽³⁾ |
| Owned and Leased Hotels: | | | | | | |
| Continuing Operations | 61.9% | \$83.22 | \$51.48 | 67.1% | \$74.32 | \$49.87 |
| Discontinued Operations | 43.8% | \$64.18 | \$28.08 | 48.0% | \$63.47 | 30.46 |
| Combined Owned and Leased Hotels | 60.1% | \$81.88 | \$49.22 | 65.0% | \$73.45 | 47.78 |
| System-wide ⁽⁴⁾ | 61.8% | \$80.39 | \$49.67 | 64.3% | \$73.98 | \$47.59 |
| Red Lion Hotels ⁽⁵⁾ | 62.7% | \$79.83 | \$50.08 | 65.3% | \$73.39 | \$47.90 |
| | Six months ended June 30, 2006 | | | Six months ended June 30, 2005 | | |
| | Average Occupancy ⁽¹⁾ | ADR ⁽²⁾ | RevPAR ⁽³⁾ | Average Occupancy ⁽¹⁾ | ADR ⁽²⁾ | RevPAR ⁽³⁾ |
| Owned or Leased Hotels: | | | | | | |
| Continuing Operations | 56.6% | \$78.99 | \$44.73 | 60.6% | \$71.22 | \$43.16 |
| Discontinued Operations | 36.3% | \$62.27 | \$22.61 | 39.3% | \$60.89 | \$23.96 |
| Combined Owned or Leased Hotels | 54.7% | \$77.92 | \$42.59 | 58.3% | \$70.47 | \$41.09 |
| System-wide ⁽⁴⁾ | 56.7% | \$78.12 | \$44.32 | 58.2% | \$71.75 | \$41.73 |
| Red Lion Hotels ⁽⁵⁾ | 57.8% | \$77.36 | \$44.74 | 59.2% | \$71.00 | \$42.04 |

(1) Average occupancy represents total paid rooms divided by total available rooms. Total available rooms represents the number of rooms available multiplied by the number of days in the reported period and includes rooms taken out of service for renovation.

(2) Average daily rate (“ADR”) represents total room revenues divided by the total number of paid rooms occupied by hotel guests.

(3) Revenue per available room (“RevPAR”) represents total room and related revenues divided by total available rooms.

(4) Includes all hotels owned, leased, managed and franchised for greater than one year by Red Lion Hotels Corporation. Includes three hotels classified as discontinued operations.

(5) Includes all hotels owned, leased, managed and franchised for greater than one year operated under the Red Lion brand name. Includes one hotel classified as discontinued operations.

EBITDA represents net income (or loss) before interest expense, income tax benefit or expense, depreciation, and amortization. We utilize EBITDA as a financial measure because management believes that investors find it to be a useful tool to perform more meaningful comparisons of past, present and future operating results and as a means to evaluate the results of core on-going operations. We believe it is a complement to net income and other financial performance measures. EBITDA from continuing operations is calculated in the same manner, but excludes the operating activities of business units identified as discontinued. EBITDA is not intended to represent net income or loss as defined by generally accepted accounting principles in the United States and such information should not be considered as an alternative to net income, cash flows from operations or any other measure of performance prescribed by generally accepted accounting principles in the United States (“GAAP”).

We use EBITDA to measure the financial performance of our owned and leased hotels because it excludes interest, taxes, depreciation and amortization, which bear little or no relationship to operating performance. By excluding interest expense, EBITDA measures our financial performance irrespective of our capital structure or how we finance our properties and operations. We generally pay federal and state income taxes on a consolidated basis, taking into account how the applicable taxing laws apply to our company in the aggregate. By excluding taxes on income, we believe EBITDA provides a basis for measuring the financial performance of our operations excluding factors that our hotels cannot control. By excluding depreciation and amortization expense, which can vary from hotel to hotel based on historical cost and other factors unrelated to the hotels’ financial performance, EBITDA measures the financial performance of our hotels without regard to their historical cost. For all of these reasons, we believe that EBITDA provides us and investors with information that is relevant and useful in evaluating our business. We believe that the presentation of EBITDA from continuing operations is useful for the same reasons, in addition to using it for comparative purposes for our intended operations going forward.

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However, because EBITDA excludes depreciation and amortization, it does not measure the capital we require to maintain or preserve our fixed assets. In addition, because EBITDA does not reflect interest expense, it does not take into account the total amount of interest we pay on outstanding debt nor does it show trends in interest costs due to changes in our borrowings or changes in interest rates. EBITDA from continuing operations excludes the activities of operations we have determined to be discontinued. It does not reflect the totality of operations as experienced for the periods presented. EBITDA, as defined by us, may not be comparable to EBITDA as reported by other companies that do not define EBITDA exactly as we define the term. Because we use EBITDA to evaluate our financial performance, we reconcile it to net income, which is the most comparable financial measure calculated and presented in accordance with GAAP. EBITDA does not represent cash generated from operating activities determined in accordance with GAAP, and should not be considered as an alternative to operating income or net income determined in accordance with GAAP as an indicator of performance or as an alternative to cash flows from operating activities as an indicator of liquidity.

The following is a reconciliation of EBITDA and EBITDA from continuing operations to net income (loss) for the periods presented: (in thousands).

| | Three months ended June 30, | | Six months ended June 30, | |
|---|-----------------------------|-----------------|---------------------------|-------------------|
| | 2006 | 2005 | 2006 | 2005 |
| | <i>(In thousands.)</i> | | | |
| EBITDA from continuing operations | \$ 8,732 | \$ 7,540 | \$ 11,016 | \$ 9,285 |
| Income tax (expense) benefit — continuing operations | (226) | (279) | 1,373 | 1,416 |
| Interest expense — continuing operations | (3,453) | (3,598) | (6,944) | (7,199) |
| Depreciation and amortization — continuing operations | (3,167) | (2,881) | (6,288) | (5,720) |
| Net income (loss) from continuing operations | 1,886 | 782 | (843) | (2,218) |
| Income (loss) from discontinued operations | 195 | 951 | (50) | 828 |
| Net income (loss) | <u>\$ 2,081</u> | <u>\$ 1,733</u> | <u>\$ (893)</u> | <u>\$ (1,390)</u> |
| EBITDA | \$ 9,075 | \$ 9,479 | \$ 11,022 | \$ 11,391 |
| Income tax (expense) benefit | (334) | (856) | 1,400 | 960 |
| Interest expense | (3,492) | (3,975) | (7,023) | (7,953) |
| Depreciation and amortization | (3,168) | (2,915) | (6,292) | (5,788) |
| Net income (loss) | <u>\$ 2,081</u> | <u>\$ 1,733</u> | <u>\$ (893)</u> | <u>\$ (1,390)</u> |

Results of Operations

The Three Months Ended June 30, 2006 Compared with the Three Months Ended June 30, 2005.

Revenues

Hotel revenues from continuing operations for the three months ended June 30, 2006 increased 2.6% or \$1.0 million, to \$40.5 million compared to \$39.4 million for the three months ended June 30, 2005. The increase was primarily due to growth of about \$849 thousand in room revenue between comparable periods, or 3.3%. RevPAR at owned and leased hotels was \$51.48 compared to \$49.87 for the second quarter of 2005. ADR was up 12.0% to \$83.22 in the second quarter of 2006 as compared to the second quarter of 2005. Average occupancy for owned and leased hotels that are part of continuing operations was down 5.2 percentage points resulting primarily from the impact of displacement during the implementation of our room renovations. Food and beverage revenues were up 2.2% overall with modest increase in banquet, outlet and beverage revenues. These increases in revenue were partially offset by a \$169 thousand decline in other revenues, including incidental revenues, driven by a 6.5% decrease in occupied rooms during the comparable quarters.

We believe 2006 continues to be a period of strong growth for us in the hotels segment and we saw improvement in its underlying fundamentals. Consumer demand is steady or growing in many of our markets, and our active management of ADR has proved successful. We believe the lodging industry as a whole will continue to see increases in ADR and RevPAR in the remainder of 2006 and into 2007. These expectations appear consistent with the overall national trends in the lodging industry.

As we continue to invest to renovate our hotels, we expect positive impacts from these upgrades. In 2005, we completed the implementation of our stay comfortable initiative, including new plush pillow top mattresses and upgraded linen and pillow packages. Also in 2005, we began major room renovations in

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several hotels including floor and wall coverings, case goods, and bathroom upgrades. In 2006 this work continued at additional hotels and work has begun on common areas such as lobbies and restaurants. Guest reaction to renovations in the hotels has been positive and the ADR for the renovated properties has increased.

During the second quarter of 2006 we completed substantially all of the room related remodels. For the second quarter of 2006, substantially all of our 31 owned or leased hotels that are part of continuing operations showed an increase in ADR. However, many of those hotels showed a decrease in occupancy, driven by displacement from rooms out of service related to the remodel work. Even with the displacement from the rooms out of service, we are driving strong profit growth from rooms departments and strength in our hotels overall.

During the second quarter of 2005 we completed installation of the new MICROS Opera Property Management System in 15 of our Red Lion hotels. Another of our hotels went live with the system in the second quarter of 2006. This system shares a single database with the company's central reservations system allowing for improvement of delivered rates and availability. This property management system and our redesigned websites further enhance our ability to manage reservations generated through electronic channels and help position us to take advantage of internet travel bookings.

Through 2005, our strategy was to increase occupancy through strategic marketing and investment in our properties, and then to increase rates as demand increases for our rooms. For six consecutive quarters through June 2005, we increased occupancy. We built on this demand by increasing the average daily rate during the second half of 2005 in the majority of our markets. In 2006, we began to see our ability to increase rate accelerate.

Our brand strengthening initiatives, marketing efforts and technological upgrades are achieving desired results. We continue to increase the number of reservations we receive through electronic distribution systems that include our own branded websites and third-party internet channels (alternative distribution systems or ADS). Our central reservations and distribution management technology allows us to manage the yield on these ADS channels on a real-time, hotel-by-hotel basis. We have merchant model agreements with leading ADS providers, which typically entitle the provider to keep a fixed percentage of the price paid by the customer for each room booked. This allows us to maximize the yield of a typically lower rated market segment. Our focus on driving customers to our branded website has made it one of our fastest growing sources of online reservations, allowing us to further maximize our yield on those types of bookings. Our success reflects our management of these distribution channels and our merchant model agreements.

We have continued to increase bookings as a result of our focus on direct sales, the "Stay Comfortable" advertising campaign and the "We Promise or We Pay" branded website booking initiative. The "We Promise or We Pay" initiative is designed to encourage guests to book on our branded website, www.redlion.com. Through this initiative, we guarantee to our guests that our branded websites will provide the best rate available compared to non-opaque ADS channels. We also launched a marketing campaign designed specifically to increase awareness of our Net4Guests and room amenity upgrade programs known as "Stay Comfortable." Net4Guests provides hotel guests in our owned and leased hotels access to free high speed wireless internet. We believe that a unique aspect of our Net4Guests program is that GuestAwards loyalty program members can use our hotels as a "hot spot" at any time, even if they are not staying at the hotel.

Revenue from the franchise and management segment was up \$34 thousand due primarily to RevPAR increases at franchised hotels and the temporary franchise agreements in place for hotels we have divested. Entertainment segment revenue decreased \$125 thousand between comparative quarters. This change was driven by revenue from the presentation of Broadway shows and is primarily the result of differences in the type and mix of shows presented in the two periods. Ticketing revenue in aggregate was relatively constant.

Revenue from our real estate segment was down \$276 thousand. The divestment from our real estate management business at the end of April 2006 resulted in a \$386 thousand decrease in segment revenues. We do not believe this divestment constitutes a discontinued operation under generally accepted accounting principles, so the activities of this revenue source have not been removed from comparable periods. Other real estate segment revenues, consisting primarily of rents from our two commercial buildings, were up \$82 thousand.

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Operating Expenses

In aggregate, operating expenses for the quarter ended June 30, 2006 decreased \$974 thousand or 2.5%. Gain on asset dispositions is a component of operating expenses and, as a result, this decrease reflects the \$1.0 million gain on the divestment from the real estate management business. Exclusive of this gain, operating costs were up \$156 thousand or less than 0.4%. This compares to a 1.2% increase in total revenues between comparative periods. Operating expenses include direct operating expenses for each of the operating segments, hotel facility and land lease expense, depreciation, amortization, gain or loss on asset dispositions, conversion expenses, if any, and undistributed corporate expenses. The resulting operating income for the period was \$6.1 million compared to \$4.6 million in the second quarter of 2005.

Direct hotel expenses increased \$152 thousand or 0.5% between comparative quarters. The direct margin for the hotels improved to 24.5% for the second quarter of 2006 compared to 22.9% in the second quarter of 2005. Rooms related expenses were down \$113 thousand and food and beverage related expenses were relatively flat for the quarter. All other hotel related expenses including utilities, the costs of incidental revenues and hotel administrative costs were up in aggregate \$317 thousand.

Direct costs for the franchise and management segment increased \$16 thousand, related to increased advertising and trade show activities and the addition of a Vice President, Brand Development, partially offset by a reduction in bad debt expense. The entertainment segment direct costs decreased \$265 thousand related primarily to show expenses.

Real estate segment direct expenses from continuing operations were down \$317 thousand. The divestment from our real estate management business at the end of April 2006 resulted in a \$427 thousand decrease in segment expenses. As noted above, we do not believe this divestment constitutes a discontinued operation under generally accepted accounting principles, so the activities of this revenue source have not been removed from comparable periods. Other real estate segment expenses, relating primarily to our two commercial buildings, were up \$110 thousand.

Depreciation and amortization increased \$286 thousand or 9.9% between the second quarter of 2006 and the second quarter of 2005. The increase is primarily related to increased capital investment in the hotel renovations. Facility and land lease expense was relatively flat between comparable periods. For the quarter ended June 30, 2006, the net gain on asset dispositions is primarily due to the recognition of deferred gains over time on both a previously sold office building and a hotel and a \$1.0 million gain on divestment from the real estate management business noted above.

Undistributed corporate expenses for the three months ended June 30, 2006 were \$1.2 million compared to \$1.1 million for the three months ended June 30, 2005. The increase of \$183 thousand was primarily due to the impact of adopting the provisions for stock based compensation under SFAS No. 123(R) in 2006 of \$117 thousand, discussed below, and outside consulting expenses related to Sarbanes-Oxley compliance efforts. Undistributed corporate expenses include general and administrative charges such as corporate payroll, legal expenses, contributions, directors and officers insurance, bank service charges, outside accountants and consultant expenses, and investor relations charges. We consider these expenses to be "undistributed" because the costs are not directly related to our business segments and therefore are not distributed to those segments. In contrast, costs more directly related to our business segments such as accounting, human resources and information technology expenses are distributed out to operating segments and are included in direct expenses.

Interest Expense

Interest expense for the three months ended June 30, 2006 was \$3.5 million compared to \$3.6 million for the three months ended June 30, 2005. The average pre-tax interest rate on debt during the second quarter of both 2006 and 2005 was 7.9%. We had no borrowings during either comparative period on our revolving credit facility and \$16.6 million in 9.5% debentures due Red Lion Hotels Capital Trust were repaid in late June 2006.

Expense of Early Extinguishment of Debt

As further discussed below, in June 2006 we repaid approximately \$16.6 million of our outstanding 9.5% debentures due Red Lion Hotels Capital Trust at a 5% premium to face value in accordance with the

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governing trust agreement entered into at the offering of the underlying trust preferred securities in early 2004. Of the \$16.6 million, \$498 thousand was received back by us for the trust common securities. The \$805 thousand premium paid to retire the debentures early is separately identified on the consolidated statements of operations as expense of early extinguishment of debt.

Other income (loss)

The change in other income (loss) is primarily due to interest income on invested cash balances derived from the proceeds of asset sales and the proceeds from our offering in May 2006.

Income Taxes

Income tax expense on continuing operations for the three months ended June 30, 2006 and 2005 was \$226 thousand and \$279 thousand, respectively. This represents approximately 10.7% and 26.3% respectively of pre-tax net income. The experience rate on pre-tax net income differs from the statutory combined federal and state tax rates primarily due to the utilization of certain incentive tax credits allowed under federal law, certain tax free investment income in the second quarter of 2006, and the tax-free nature of the \$1.0 million gain on the divestment from the real estate management business in April 2006.

Discontinued Operations

In connection with the November 2004 announcement of plans to invest to improve comfort, freshen décor and upgrade technology at our hotels, we implemented a plan to divest 11 non-strategic owned hotels, one commercial office building and certain other non-core properties including condominium units and certain parcels of excess land (collectively these assets are referred to herein as “the divestment properties”). Each of the divestment properties meets the criteria to be classified as an asset held for sale. In addition, the activities of those 11 hotels and the commercial office building are considered discontinued operations under generally accepted accounting principles. Depreciation of these assets, if previously appropriate, has been suspended.

Our financial results for the three months ended June 30, 2005 includes the activities of all of the divestment properties, which had aggregate income of \$1.5 million before income tax expense. During the third and fourth quarters of 2005, we completed the sale of seven of the 11 hotels and the real estate office building. During the first quarter of 2006, we completed the sale of another divestment hotel and a portion of a second. The three months ended June 30, 2006 includes the activities of the three remaining divestment hotels, with aggregate income of \$302 thousand before income tax expense.

Net Income

The Company’s net income increased \$348 thousand or \$20.1% between comparable quarters. The improvement was primarily the result of improved operating margins in the hotels and entertainment segments of \$876 thousand and \$140 thousand respectively, the \$1.0 million gain on divestment from the real estate management business, and an increase in interest income on invested cash balances. These items were partially offset by the \$805 thousand expense of early extinguishment of debt and \$1.2 million less in operating income from discontinued business units related to fewer hotels in that group.

Earnings Per Share

The diluted earnings per share for the three months ended June 30, 2006 was \$0.13 compared to \$0.13 per share for the three months ended June 30, 2005. Net income improved by \$348 thousand as described above, while the number of weighted average common shares outstanding increased between comparable periods related to our second quarter 2006 common stock offering.

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The Six Months Ended June 30, 2006 Compared with the Six Months Ended June 30, 2005.

Revenues

Hotel revenues from continuing operations for the six months ended June 30, 2006 increased 2.5% or \$1.7 million, to \$71.5 million compared to \$69.8 million for the six months ended June 30, 2005. The increase was primarily due to growth of about \$1.6 million in room revenue between comparable periods, or 3.6%. RevPAR at owned and leased hotels was \$44.73 compared to \$43.16 for the first six months of 2005. ADR was up 10.9% to \$78.99 in the first six months of 2006 as compared to the first six months of 2005. Average occupancy for owned and leased hotels that are part of continuing operations was down 4.0 percentage points resulting primarily from the impact of displacement during the implementation of our room renovation plan. Food and beverage revenues were up 1.0% overall with modest increase in banquet, outlet and beverage revenues. These increases in revenue were partially offset by a \$259 thousand decline in other revenues, including incidental revenues, driven by a 4.8% reduction in overall number of room stays during the comparable periods.

We believe 2006 continues to be a period of strong growth for us in the hotels segment and we saw improvement in its underlying fundamentals. Consumer demand is steady or growing in many of our markets, and our active management of ADR has proved successful. We believe the lodging industry as a whole will continue to see increases in ADR and RevPAR in the remainder of 2006 and into 2007. These expectations appear consistent with the overall national trends in the lodging industry.

As we continue to invest to renovate our hotels, we expect positive impacts from these upgrades. In 2005, we completed the implementation of our stay comfortable initiative, including new plush pillow top mattresses and upgraded linen and pillow packages. Also in 2005, we began major room renovations in several hotels including floor and wall coverings, case goods, and bathroom upgrades. In 2006 this work continued at additional hotels and work has begun on common areas such as lobbies and restaurants. Guest reaction to renovations in the hotels has been positive and the ADR for the renovated properties has increased.

During the second quarter of 2006 we completed substantially all of the room related remodels. For the second quarter of 2006, all of our 31 owned or leased hotels that are part of continuing operations showed an increase in ADR. However, many of those hotels showed a decrease in occupancy, driven by displacement from rooms out of service related to the remodel work. Even with the displacement from the rooms out of service, we are driving strong profit growth from rooms departments and strength in our hotels overall.

During the second quarter of 2005 we completed installation of the new MICROS Opera Property Management System in 15 of our Red Lion hotels. Another of our hotels went live with the system in the second quarter of 2006. This system shares a single database with the company's central reservations system allowing for improvement of delivered rates and availability. This property management system and our redesigned websites further enhance our ability to manage reservations generated through electronic channels and help position us to take advantage of internet travel bookings.

Through 2005, our strategy was to increase occupancy through strategic marketing and investment in our properties, and then to increase rates as demand increased for our rooms. For six consecutive quarters through June 2005, we increased occupancy. We built on this demand by increasing the average daily rate during the second half of 2005 in the majority of our markets. In 2006, we began to see our ability to increase rates accelerate.

Our brand strengthening initiatives, marketing efforts and technological upgrades are achieving desired results. We continue to increase the number of reservations we receive through electronic distribution systems that include our own branded websites and third-party internet channels (alternative distribution systems or ADS). Our central reservations and distribution management technology allows us to manage the yield on these ADS channels on a real-time, hotel-by-hotel basis. We have merchant model agreements with leading ADS providers, which typically entitle the provider to keep a fixed percentage of the price paid by the customer for each room booked. This allows us to maximize the yield of a typically lower rated market segment. Our focus on driving customers to our branded website has made it one of our fastest growing sources of online reservations, allowing us to further maximize our yield on those types of

bookings. Our success reflects our management of these distribution channels and our merchant model agreements.

We have continued to increase bookings as a result of our focus on direct sales, the “Stay Comfortable” advertising campaign and the “We Promise or We Pay” branded website booking initiative. The “We Promise or We Pay” initiative is designed to encourage guests to book on our branded website, www.redlion.com. Through this initiative, we guarantee to our guests that our branded websites will provide the best rate available compared to non-opaque ADS channels. We also launched a marketing campaign designed specifically to increase awareness of our Net4Guests and room amenity upgrade programs known as “Stay Comfortable.” Net4Guests provides hotel guests in our owned and leased hotels access to free high speed wireless internet. We believe that a unique aspect of our Net4Guests program is that GuestAwards loyalty program members can use our hotels as a “hot spot” at any time, even if they are not staying at the hotel.

Revenue from the franchise and management segment was down \$201 thousand. During the first quarter of 2005, we received a \$250 thousand management contract termination fee triggered by the sale of a property that left our system in 2003. Without that termination fee in 2005, franchise and management related revenues were up slightly for the six month period ended June 30, 2006 due primarily to RevPAR increases at franchised hotels and the temporary franchise agreements in place for hotels we have divested. Entertainment segment revenue increased \$440 thousand between comparative six month periods. This increase was driven by revenue from the presentation of Broadway shows and is primarily the result of differences in the type and mix of shows presented. Ticketing revenue in aggregate was relatively constant.

Revenue from our real estate segment was down \$165 thousand. The divestment from our real estate management business at the end of April 2006 resulted in a \$386 thousand decrease in segment revenues. We do not believe this divestment constitutes a discontinued operation under generally accepted accounting principles, so the activities of this revenue source have not been removed from comparable periods. Other real estate segment revenues, consisting primarily of rents from our two commercial buildings, are up \$181 thousand.

Operating Expenses

In aggregate, operating expenses for the six months ended June 30, 2006 increased \$184 thousand or 0.2%. Gain on asset dispositions is a component of operating expenses and, as a result, this increase reflects the \$1.0 million gain on the divestment from the real estate management business. Exclusive of this gain, operating costs were up \$1.2 million or 1.6%. This compares to a 2.1% increase in total revenues between comparative periods. Operating expenses include direct operating expenses for each of the operating segments, hotel facility and land lease expense, depreciation, amortization, gain or loss on asset dispositions, conversion expenses, if any, and undistributed corporate expenses. The resulting operating loss for the period was \$5.0 million compared to \$3.5 million in the first six months of 2005.

Direct hotel expenses increased \$419 thousand or 0.7% between comparative periods. The direct margin for the hotels improved to 18.3% for the first six months of 2006 compared to 16.9% in the first six months of 2005. Rooms related expenses for the six months were down \$25 thousand on a decrease in the number of occupied rooms of 4.1%. Food and beverage related expenses were down \$134 thousand with fewer covers, and all other hotel related expenses including utilities, the costs of incidental revenues and hotel administrative costs were up in aggregate \$578 thousand.

Direct costs for the franchise and management segment increased \$137 thousand, related to increased advertising and trade show activities and the addition of a Vice President, Brand Development, partially offset by a reduction in bad debt expense. The entertainment segment direct costs increased \$167 thousand related primarily to show expenses.

Real estate segment direct expenses from continuing operations were down \$279 thousand. The divestment from our real estate management business at the end of April 2006 resulted in a \$427 thousand decrease in segment expenses. As noted above, we do not believe this divestment constitutes a discontinued operation under generally accepted accounting principles, so the activities of this revenue source have not been removed from comparable periods. Other real estate segment expenses, relating primarily to our two commercial buildings, were up \$200 thousand.

Depreciation and amortization increased \$568 thousand or 9.9% between the first six months of 2006 and the first six months of 2005. The increase is primarily related to increased capital investment in the

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hotel renovations. Facility and land lease expense was relatively flat between comparable periods. For the six months ended June 30, 2006, the net gain on asset dispositions is primarily due to the recognition of deferred gains over time on both a previously sold office building and a hotel and a \$1.0 million gain on divestment from the real estate management business noted above.

Undistributed corporate expenses for the six months ended June 30, 2006 were \$2.2 million compared to \$2.0 million for the six months ended June 30, 2005. The increase of \$215 thousand was primarily due to the impact of adopting the provisions for stock based compensation under SFAS No. 123(R) in 2006 of \$245 thousand, discussed below. Undistributed corporate expenses include general and administrative charges such as corporate payroll, legal expenses, contributions, directors and officers insurance, bank service charges, outside accountants and consultant expenses, and investor relations charges. We consider these expenses to be “undistributed” because the costs are not directly related to our business segments and therefore are not distributed to those segments. In contrast, costs more directly related to our business segments such as accounting, human resources and information technology expenses are distributed out to operating segments and are included in direct expenses.

Interest Expense

Interest expense for the six months ended June 30, 2006 was \$6.9 million compared to \$7.2 million for the six months ended June 30, 2005. The average pre-tax interest rate on debt during the first six months of both 2006 and 2005 was 7.9%. We had no borrowings during either comparative period on our revolving credit facility and \$16.6 million in 9.5% debentures due Red Lion Hotels Capital Trust were repaid in late June 2006.

Expense of Early Extinguishment of Debt

As further discussed below, in June 2006 we repaid approximately \$16.6 million of our outstanding 9.5% debentures due Red Lion Hotels Capital Trust at a 5% premium to face value in accordance with the governing trust agreement entered into at the offering of the underlying trust preferred securities in early 2004. Of the \$16.6 million, \$498 thousand was received back by us for the trust common securities. The \$805 thousand premium paid to retire the debentures early is separately identified on the consolidated statements of operations as expense of early extinguishment of debt.

Other income (loss)

The change in other income (loss) is primarily due to interest income on invested cash balances derived from the proceeds of asset sales and the proceeds from our offering in May 2006.

Income Taxes

Income tax benefit on continuing operations for both periods was approximately \$1.4 million. This represents approximately 62.0% and 39.0%, respectively, of pre-tax net loss. The experience rate on pre-tax net income differs from the statutory combined federal and state tax rates primarily due to the utilization of certain incentive tax credits allowed under federal law, certain tax free investment income in the second quarter of 2006, and the tax-free nature of the \$1.0 million gain on the divestment from the real estate management business in April 2006.

Discontinued Operations

In connection with the November 2004 announcement of plans to invest to improve comfort, freshen décor and upgrade technology at our hotels, we implemented a plan to divest 11 non-strategic owned hotels, one commercial office building and certain other non-core properties including condominium units and certain parcels of excess land (collectively these assets are referred to herein as “the divestment properties”). Each of the divestment properties meets the criteria to be classified as an asset held for sale. In addition, the activities of those 11 hotels and the commercial office building are considered discontinued operations under generally accepted accounting principles. Depreciation of these assets, if previously appropriate, has been suspended.

Our financial results for the six months ended June 30, 2005 includes the activities of all of the divestment properties, which had aggregate income of \$1.3 million before income tax expense. During the third and fourth quarters of 2005, we completed the sale of seven of the 11 hotels and the real estate office building. During the first quarter of 2006, we completed the sale of another divestment hotel and a portion

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of a second. The six months ended June 30, 2006 includes the activities of those two properties up to the date of sale and the three remaining divestment hotels, with an aggregate loss of \$124 thousand before income tax benefit.

Net Loss

The Company's net loss decreased \$497 thousand between comparable periods or 35.8%. The improvement was primarily the result of improved operating margins in the hotels and entertainment segments of \$1.3 million and \$273 thousand respectively, the \$1.0 million gain on divestment from the real estate management business, and an increase in interest income on invested cash balances. These items were partially offset by the \$805 thousand expense of early extinguishment of debt and \$878 thousand less in operating income from discontinued business units related to fewer hotels in that group.

Earnings Per Share

The diluted loss per share for the six months ended June 30, 2006 was \$0.06 compared to \$0.11 per share for the six months ended June 30, 2005. The net loss improved by \$497 thousand as described above, while the number of weighted average common shares outstanding increased between comparable periods related to our second quarter 2006 common stock offering.

Liquidity and Capital Resources

We believe that our recent actions have strengthened our financial position, particularly for the long term. The most significant recent event was the completion of our common stock offering during the second quarter of 2006. Including the exercise of the underwriters option, we issued and registered 5,845,302 shares of RLH common stock at \$11 per share, for gross proceeds of approximately \$64.3 million. Underwriting costs and other expenses of the offering totaled approximately \$3.9 million, resulting in net cash proceeds to us of approximately \$60.4 million. The net proceeds are being used primarily to retire existing debt instruments and pay associated defeasance costs. Additionally, this offering expanded our public market float and coverage in the investment community, reduced the ownership percentage of related party ownership of our common stock, and increased our liquidity and working capital flexibility.

In March of 2004, we undertook a public offering of \$46 million of trust preferred securities through Red Lion Hotels Capital Trust. We simultaneously acquired \$1.4 million of trust common securities from the Trust. Both the trust preferred and the trust common securities were issued at a price of \$25.00 per security. We do not consolidate the Trust as it is considered a variable interest entity under FIN-46(R). We are not the primary beneficiary of the Trust. The trust securities earn a 9.5% rate of return and have a mandatory redemption feature maturing on February 24, 2044. This obligation appears as "Debentures due Red Lion Hotels Capital Trust" on our consolidated balance sheet. Among other things, this offering allowed us to eliminate our preferred stock and its associated non-deductible dividend requirement.

The Trust Agreement, entered into at the date of the offering with the trustees for the trust securities, required the mandatory redemption of 35% of the then outstanding trust securities at 105% of issued value if we completed an offering of common shares with gross proceeds to us of greater than \$50 million. Therefore, in connection with the offering of common stock described above, on June 23, 2006, we repaid approximately \$16.6 million of the debentures due the Trust. The Trust then redeemed 35% of the outstanding trust preferred securities and trust common securities at a price of \$26.25 per share, a 5% premium over the issued value of the securities. Of the \$16.6 million, we received approximately \$498,000 back in exchange for our trust common securities. The \$805 thousand premium paid to retire the debentures is separately identified on the consolidated statements of operations as expense of early extinguishment of debt.

Our other major recent initiative has been the owned and leased hotel capital improvement and reinvestment plan announced in November 2004. These activities are key to our growth strategy and represent one of the most significant facility improvement programs in company history. This investment accelerates our ongoing program to improve hotel quality by increasing customer comfort, freshening decor and modernizing with new technology. We believe that by improving the quality of our existing product in areas where customers' quality expectations are growing, we both position our hotels to take advantage of the growth potential in our existing markets, and make the Red Lion brand more attractive for franchise opportunities. In 2005 we spent a total of \$22.9 million on capital improvement projects company wide. During the first six months of 2006, we spent a total of \$24.2 million. In June 2006 we announced that

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substantially all of the room related renovations were complete for the owned and leased hotels. During the remainder of 2006, we expect to spend over \$17.4 million on capital improvements to complete our initial reinvestment plan with a focus on our hotels segment, primarily in non-room guest contact areas such as lobbies, exteriors, and banquet rooms.

These capital improvements have been financed in large part through our divestment plan for 11 non-strategic owned hotels, one commercial office building and certain other non-core properties including condominium units and three parcels of excess land. The divestment plan is also well underway and, we believe, has been successful to date. As of June 30, 2006, sales of eight of the hotel properties, one portion of another hotel, and the office building have closed. During the second quarter of 2006, the Company executed agreements for the sale of two of the remaining hotels and management expects that both transactions will be closed before September 30, 2006. We have also made significant investments in our hotel improvement program, which focuses on increasing customer comfort, freshening decor, and new technology.

We believe that all of these initiatives have strengthened and will continue to strengthen our financial position and the value of the Red Lion brand.

As we enter the second half of 2006, our cash balances are adequate to fund our continuing operations. We expect to meet our long-term liquidity requirements for the funding of property development, property acquisitions, renovations and other non-recurring capital improvements through net cash from operations, long-term secured and unsecured indebtedness, including our credit facility, the issuance of debt or equity securities and joint ventures. As discussed elsewhere in this analysis, we are also committed to completing the sale of the remaining non-core assets to help fund the remainder of our reinvestment plan in the hotels.

Our short-term liquidity needs include funds for interest payments on our outstanding indebtedness and on the debentures, funds for capital expenditures and, potentially, acquisitions. We expect to meet our short-term liquidity requirements generally through net cash provided by operations and reserves established from existing cash and, if necessary, by drawing upon our credit facility. A majority of our leased and owned hotels are subject to leases or debt agreements that require us to spend 3% to 4% of hotel revenues derived from these hotels on replacement of furniture, fixtures and equipment at these hotels, or require payment of insurance premiums or real and personal property taxes with respect to these hotels. This is consistent with what we would spend on furniture, fixtures and equipment under normal circumstances to maintain the competitive appearance of our owned and leased hotels.

Historically, our cash and capital requirements have been satisfied through cash generated from operating activities, borrowings under our credit facilities and the issuance of debt and equity securities. We believe cash flow from operations, borrowings under credit facilities, the issuance of debt or equity securities and existing cash on hand will provide adequate funds for our working capital needs, planned capital expenditures, debt service and other obligations for the foreseeable future.

Our ability to fund operations, make planned capital expenditures, make required payments on any securities we may issue in the future and remain in compliance with the financial covenants under our debt agreements will be dependent on our future operating performance. Our future operating performance is dependent on a number of factors, many of which are beyond our control, including occupancy and the room rates we can charge. These factors also include prevailing economic conditions and financial, competitive, regulatory and other factors affecting our business and operations, and may be dependent on the availability of borrowings under our credit facility or other borrowings or securities offerings.

Net cash provided by operations for the six months ended June 30, 2006, which includes the cash flows of business units identified as discontinued operations, totaled \$7.2 million compared to cash provided by operations for the six months ended June 30, 2005 which totaled \$8.1 million. Net earnings, after reconciling adjustments to net cash provided by operations (such as non-cash income statement impacts like gains on disposals, impairment loss, depreciation, loan fee write-offs, the deferred tax provision, other gains and losses on assets, and the provision for doubtful accounts) totaled a positive cash flow of \$6.4 million for the first six months of 2006. For the first six months of 2005, net earnings adjusted for those same items totaled \$4.9 million of positive cash flow. Working capital changes, including restricted cash, receivables, accruals, payables, and inventories, provided \$761 thousand in cash during the first six months of 2006. In the first six months of 2005, changes in working capital items accounted for \$3.2 million in positive cash flow.

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Net cash used in investing activities was \$18.5 million for the first six months of 2006. Net cash used in investing activities was \$7.6 million for the first six months of 2005. Cash additions to property and equipment totaled \$24.2 million in the six months ended June 30, 2006 compared to \$8.3 million for the comparative period in 2005. Net cash proceeds from the disposal of assets, including those classified as discontinued operations, totaled \$5.1 million for the first six months of 2006. In addition, in 2006 we received \$498 thousand in proceeds from the repayment of our investment in Red Lion Hotels Capital Trust.

Net financing activities provided \$41.3 million in cash during the first six months of 2006, including net proceeds from an offering of common stock of \$60.4 million, partially offset by a repayment of debentures totaling \$17.4 million including expense of early extinguishment, and scheduled principal payments of \$2.1 million. Net financing activities used \$2.4 million in the comparative period in 2005. This included borrowings related to our refinancing of a \$3.8 million term note, and \$2.4 million of scheduled principal payments. We had no net activity under the credit facility note for either period.

At June 30, 2006, we had \$58.7 million in cash and cash equivalents for continuing operations. We also had \$5.4 million of cash restricted under securitized borrowing arrangements for future payment of furniture, fixtures and equipment, repairs, insurance premiums and real and personal property taxes, or by agreement. At June 30, 2006, \$52.9 million of our cash and cash equivalent balance was held in short-term, liquid investments readily available for our use. Cash and cash equivalents included with assets of discontinued operations were \$97 thousand.

Financing

We have a revolving credit agreement with Wells Fargo Bank, National Association (“Wells Fargo”). Starting on February 9, 2005, the agreement provided a revolving credit facility with a total of \$20.0 million in borrowing capacity for working capital purposes. This included a \$4.0 million line-of-credit secured by our personal property and two hotels (“Line A”) and a \$16.0 million line of credit secured by our personal property and seven hotels that we then held for sale (“Line B”). Since the properties that secured New Line B were sold in 2005, New Line B expired unused.

On March 27, 2006, we entered into a revised credit agreement with Wells Fargo, providing for a revolving credit facility with a total of \$10.0 million in borrowing capacity for working capital purposes. This includes a \$6.0 million line-of-credit secured by two hotels (“New Line A”) and a \$4.0 million line of credit secured by personal property (“New Line B”). Interest under New Line A is set at 0.5% over the bank’s prime rate and does not require any principal payments until the end of its two year term. Interest under New Line B is set at 1.0% over the bank’s prime rate and does not require any principal payments until the end of its one year term. The revised agreement contains certain restrictions and covenants, the most restrictive of which requires us to maintain a minimum tangible net worth of \$120 million, a minimum EBITDA (as defined by the bank) coverage ratio of 1.25:1, and a maximum funded debt to EBITDA ratio of 5.25:1.

At June 30, 2006, we were in compliance with the covenants in effect as of that date under the credit agreement. No amounts were outstanding under any portion of the credit agreement at June 30, 2006.

On July 20, 2006, we received a commitment for a \$50.0 million credit facility from Calyon New York Branch which will replace the Wells Fargo credit facility. We plan to utilize this credit facility for general corporate purposes and to finance future growth.

At June 30, 2006, we had long-term debt of \$128.5 million for continuing operations (excluding debentures due Red Lion Hotels Capital Trust), of which \$124.4 million was securitized debt collateralized by individual hotels, with interest rates ranging from 6.7% to 8.1%. Of the amount of securitized debt, three pools of cross securitized debt exist, one consisting of five properties with total borrowings of \$21.6 million, a second consisting of four properties with total borrowings of \$24.2 million, and a third consisting of two properties with total borrowings of \$19.4 million. Each pool of securitized debt and the other collateralized hotel borrowings include defeasance provisions for early repayment.

Other Matters

Assets Held for Sale

In connection with the November 2004 announcement of the hotel renovation plan to improve comfort, freshen décor and upgrade technology at our hotels, we implemented a plan to divest 11 non-strategic owned hotels, one real estate office building and certain other non-core properties including condominium units and three parcels of excess land (collectively these assets are referred to herein as “the divestment properties”). Each of the divestment properties meets the criteria to be classified as an asset held for sale. In addition, the activities of those 11 hotels and the real estate office building are considered discontinued operations under generally accepted accounting principles. Depreciation of these assets, if previously appropriate, was suspended. At the time of the decision to divest from these assets, a net of tax impairment charge of \$5.8 million on four of the hotel properties was recorded.

During the third and fourth quarters of 2005, we completed the sale of seven of the hotels, the office building, and certain non-core real estate assets with gross aggregate proceeds of \$52.8 million. The resulting gain on disposition of discontinued operations was \$10.2 million. In addition, during 2005, we recorded an additional aggregate impairment of \$4.5 million on certain hotel properties. The net overall impact of these transactions in 2005, after the effect of income taxes, was a net of tax gain of \$3.7 million.

In the first quarter of 2006 we completed the sale of one hotel and a portion of a second for gross aggregate proceeds of \$5.3 million. The resulting gain on disposition of discontinued operations was \$46 thousand. During the second quarter of 2006, we executed agreements for the sale of two of the remaining hotels and management expects that both transactions will be closed before September 30, 2006. We continue to actively pursue disposition of the last hotel and surplus undeveloped land originally identified for sale.

Capital Spending

Key to our growth strategy is the planned reinvestment in our existing owned and leased Red Lion hotels, one of the most significant facility improvement programs in company history. This investment accelerates our ongoing program to improve hotel quality by increasing customer comfort, freshening decor and modernizing with new technology. We believe that by improving the quality of our existing product in areas where customers’ quality expectations are growing, we both position our hotels to take advantage of the growth potential in our existing markets, and make the Red Lion brand more attractive for franchise opportunities.

We are seeking to create an improved guest experience across our hotel portfolio. During the first six months of 2006, we spent a total of \$24.2 million on capital improvement programs. During the remainder of 2006, we expect to spend over \$17.4 million on capital improvements to complete our initial reinvestment plan with a focus on our hotels segment, primarily in guest contact areas such as lobbies, banquet rooms, halls and other common spaces.

Franchise and Management Contracts

At December 31, 2006, our system of hotels included one hotel under a long-term management contract, and 21 hotels under long-term franchise agreements. In addition, in connection with the 2005 sale of certain divestment assets, we entered into four short-term franchise agreements to facilitate the operation of those hotels during their transition to another brand. One of those properties transitioned off the system during the first quarter of 2006. However, during the same period we completed the sale of the Red Lion Hillsboro hotel, which entered into a similar short-term franchise contract.

In January 2006, two WestCoast Hotel properties, one managed and one franchised, terminated their agreements with us. In June 2006, one Red Lion franchised hotel in Texas did not renew its franchise agreement.

Acquisitions

There were no hotels acquired or other material operating acquisitions during the first six months of 2006.

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Asset Dispositions

In the first quarter of 2006 we completed the sale of one hotel and a portion of a second for gross aggregate proceeds of \$5.3 million. The resulting gain on disposition of discontinued operations was \$46 thousand. In April 2006 we divested from our real estate management business. The transaction resulted in a gain on sale of approximately \$1.1 million. For the full year 2005, the real estate management business contributed \$2.3 million and \$0.1 million to the company's revenue and operating income, respectively. There were no other significant asset dispositions during the first six months of 2006.

Stock Based Compensation under SFAS No. 123 (R)

Effective January 1, 2006, we adopted the provisions of FASB Statement of Financial Accounting Standards No. 123 Revised ("SFAS No. 123(R)") for stock based compensation, including options and other awards issued under our stock incentive plans and shares issued under our employee stock purchase plan. Under SFAS No. 123(R), stock based compensation expense reflects the fair value of stock based awards measured at grant date, is recognized over the relevant service period, and is adjusted each period for anticipated forfeitures. We have elected to use the modified prospective transition method as permitted by SFAS No. 123(R) and therefore have not restated our financial results for prior periods.

Compensation expense related to options to purchase common stock for the six months ended June 30, 2006 was \$245 thousand. Also during the six months ended June 30, 2006 the Company recorded compensation expense related to 11,211 shares issued under its employee stock purchase plan of \$62 thousand, determined by the difference of the fair value on the day the shares were issued and cash price paid under the plan, which under plan design may be at a discount.

OP Units Transaction

We are the general partner of Red Lion Hotels Limited Partnership ("RLHLP"). Through December 31 2005, we held approximately a 98% interest in that entity. Partners who hold operating partnership units ("OP Units") have the right to put those OP Units to RLHLP, in which event either (a) RLHLP must redeem the units for cash, or (b) we, as general partner, may elect to acquire the OP Units for cash or in exchange for a like number of shares of our common stock. In the first six months of 2006, we elected to issue 143,498 shares of our common stock in exchange for a like number of OP Units that certain then limited partners put to RLHLP. This resulted in a non-cash adjustment of the minority interest balance of \$2.2 million with a corresponding increase to common stock and additional paid-in capital. At June 30, 2006, we held approximately a 99% interest in RLHLP with the remaining 142,663 OP Units held by limited partners. We do not expect that the issuance of this common stock will materially affect our per share operating results.

Seasonality

Our business is subject to seasonal fluctuations. Significant portions of our revenues and profits are realized from May through October.

Inflation

The effect of inflation, as measured by fluctuations in the U.S. Consumer Price Index, has not had a material impact on our revenues or net income during the periods under review.

Contractual Obligations

The following tables summarize our significant contractual obligations as of June 30, 2006, including contractual obligations of business units identified as discontinued on our consolidated balance sheet (in thousands):

| | Total | Less than 1 year | 1-3 years | 4-5 years | After 5 years |
|---|------------------|---------------------|-----------------|-----------------|------------------|
| Long-term debt (1) | \$179,843 | \$14,093 | \$29,124 | \$55,908 | \$80,718 |
| Operating leases (2) | 70,938 | 3,833 | 3,704 | 14,461 | 48,940 |
| Debentures due Red Lion Hotels Capital Trust (1) | 121,311 | 2,381 | 4,762 | 4,762 | 109,406 |
| Total contractual obligations (3) | <u>\$372,092</u> | <u>\$20,307</u> | <u>\$37,590</u> | <u>\$75,131</u> | <u>\$239,064</u> |

- (1) Includes estimated interest payments over the life of the debt agreement.
- (2) Operating lease amounts are net of estimated sub-lease income totaling \$9.9 million annually.
- (3) We are not party to any significant long-term service or supply contracts with respect to our processes. We refrain from entering into any long-term purchase commitments in the ordinary course of business.

Critical Accounting Policies and Estimates

A critical accounting policy is one that is both important to the portrayal of our financial condition and results of operations and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. All of our significant accounting policies are described in Note 2 to our 2005 consolidated financial statements included with our 2005 annual report filed on Form 10-K. The accounting principles of our company comply with generally accepted accounting principles ("GAAP"). The more critical accounting policies and estimates used relate to:

Revenue is generally recognized as services are performed. Hotel revenues primarily represent room rental and food and beverage sales from owned and leased hotels and are recognized at the time of the hotel stay or sale of the restaurant services.

Franchise and management revenues represent fees received in connection with the franchise of our company's brand names and management fees we earn from managing third-party owned hotels. Such fees are recognized as earned in accordance with the contractual terms of the franchise or management agreements. Other fees are recognized when the services are provided and collection is reasonably assured.

Real estate division revenue represents leasing income on owned commercial and retail properties. Prior to the divestment of our real estate management business on April 30, 2006, real estate division revenue also represented property management income, development fees and leasing and sales commissions from residential and commercial properties managed by our company, typically under long-term contracts with the property owner. Lease revenues are recognized over the period of the leases. We record rental income from operating leases that contain fixed escalation clauses on the straight-line method. The difference between income earned and lease payments received from the tenants is included in other assets on the consolidated balance sheets. Rental income from retail leases, which is contingent upon the lessees' revenues, is recorded as income in the period earned. Management fees and leasing and sales commissions are recognized as these services are performed.

The entertainment segment derives revenue primarily from computerized event ticketing services and promotion of Broadway style shows and other special events. Where our company acts as an agent and receives a net fee or commission, it is recognized as revenue in the period the services are performed. When our company is the promoter of an event and is at risk for the production, revenues and expenses are recorded in the period of the event performance.

Property and equipment is stated at cost less accumulated depreciation. The assessment of long-lived assets for possible impairment requires us to make judgments regarding real estate values, estimated future cash flows from the respective properties and other matters. We review the recoverability of our long-lived assets when events or circumstances indicate that the carrying amount of an asset may not be recoverable.

We account for assets held for sale in accordance with Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"). Our company's assets held for sale are recorded at the lower of their historical carrying value (cost less accumulated depreciation) or market value. Depreciation is terminated when the asset is determined to be held for sale. If the assets are ultimately not sold within the guidelines of SFAS No. 144, depreciation would be recaptured for the period they were classified on the balance sheet as held for sale.

Our company's intangible assets include brands and goodwill. We account for our brands and goodwill in accordance with Statement of Financial Accounting Standards No. 142 ("SFAS No. 142"). We expect to receive future benefits from previously acquired brands and goodwill over an indefinite period of time and therefore do not amortize our brands and goodwill in accordance with SFAS No. 142. The annual impairment review requires us to make certain judgments, including estimates of future cash flow with

respect to brands and estimates of our company's fair value and its components with respect to goodwill and other intangible assets.

Our other intangible assets include management, marketing and lease contracts. The value of these contracts is amortized on a straight-line basis over the weighted average life of the agreements. The assessment of these contracts requires us to make certain judgments, including estimated future cash flow from the applicable properties.

We review the ability to collect individual accounts receivable on a routine basis. We record an allowance for doubtful accounts based on specifically identified amounts that we believe to be uncollectible and amounts that are past due beyond a certain date. The receivable is written off against the allowance for doubtful accounts if collection attempts fail. Our company's estimate for our allowance for doubtful accounts is impacted by, among other things, national and regional economic conditions.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates.

New Accounting Pronouncements

In February of 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Instruments—An Amendment of FASB Statements No. 133 and No. 144" ("SFAS No. 155"). SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. It also clarifies which interest-only strips and principal-only strips are not subject to the requirements of FASB Statement No. 133, and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. Furthermore, SFAS No. 155 clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and it amends FASB Statement No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year beginning after September 15, 2006. We do not expect the adoption of the provisions of SFAS No. 155 to impact our financial condition or results of operations.

In March of 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140" ("SFAS No. 156") This Statement amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations. It also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, prescribes subsequent measurement methods, and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 is adopted effective for an entity's fiscal year that begins after September 15, 2006. Our adoption of the provisions of SFAS No. 156 is not expected to impact our financial condition or results of operations.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes by establishing minimum standards for the recognition and measurement of tax positions taken or expected to be taken in a tax return. Under the requirements of FIN 48, a Company must review all of its uncertain tax positions and make a determination as to whether its position is more-likely-than-not to be sustained upon examination by regulatory authorities. If a position meets the more-likely-than-not criterion, then the related tax benefit is measured based on the cumulative probability analysis of the amount that is more-likely-than-not to be realized upon ultimate settlement. FIN 48 is effective for fiscal years beginning after December 15, 2006. Our adoption of the provisions of FIN 48 is not expected to impact our financial condition or results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The following tables summarize the financial instruments held by us at June 30, 2006 and December 31, 2005 which are sensitive to changes in interest rates, including those held as a component of liabilities of discontinued operations on our consolidated balance sheet. At June 30, 2006 approximately 3.8% of our debt was subject to changes in market interest rates and was sensitive to those changes. As of June 30, 2006 we had debt obligations of \$161.5 million, of which 77.0%, or \$124.4 million, were fixed rate debt securities secured primarily by individual properties. \$30.8 million of the debt obligations are uncollateralized debentures due the Trust at a fixed rate, making a total of 96.1% of our debt fixed rate obligations.

The following table presents principal cash flows for debt outstanding at June 30, 2006, including contractual obligations of business units identified as discontinued on our consolidated balance sheet, by maturity date (in thousands). Outstanding Debt Obligations

| | Remainder of 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | Thereafter | Total | Fair Value |
|--------------------------|----------------------|---------|---------|---------|---------|----------|------------|-----------|------------|
| Note payable to bank (a) | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — |
| Long-term debt | | | | | | | | | |
| Fixed Rate | \$1,765 | \$3,759 | \$4,068 | \$4,393 | \$3,796 | \$55,180 | \$51,457 | \$124,418 | \$121,652 |
| Variable Rate | \$ 342 | \$ 352 | \$1,984 | \$ 164 | \$3,370 | \$ — | \$ — | \$ 6,212 | \$ 6,212 |
| Debentures due Red Lion | | | | | | | | | |
| Hotels Capital Trust | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$30,825 | \$ 30,825 | \$ 33,097 |

(a) At June 30, 2006 there were no borrowings against our note payable to bank.

The following table presents principal cash flows for debt outstanding at December 31, 2005, by maturity date (in thousands). Outstanding Debt Obligations

| | 2006 | 2007 | 2008 | 2009 | 2010 | Thereafter | Total | Fair Value |
|--------------------------|---------|---------|---------|---------|---------|------------|-----------|------------|
| Note payable to bank (a) | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — |
| Long-term debt | | | | | | | | |
| Fixed Rate | \$3,501 | \$3,811 | \$4,125 | \$4,454 | \$3,864 | \$106,400 | \$126,155 | \$123,342 |
| Variable Rate | \$ 711 | \$ 383 | \$1,984 | \$ 187 | \$3,293 | \$ — | \$ 6,558 | \$ 6,558 |
| Debentures due Red Lion | | | | | | | | |
| Hotels Capital Trust | \$ — | \$ — | \$ — | \$ — | \$ — | \$ 47,423 | \$ 47,423 | \$ 48,987 |

(a) At December 31, 2005 there were no borrowings against our note payable to bank.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the date of the filing of this report, we carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer (“CEO”) and our Chief Financial Officer (“CFO”), of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our management, including the CEO and CFO, concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within time periods specified in Securities and Exchange Commission rules and forms.

Changes in Internal Controls

There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls during the period to which this quarterly report relates.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

At any given time, we are subject to claims and actions incidental to the operation of our business. While the outcome of these proceedings cannot be predicted, it is the opinion of management that none of such proceedings, individually or in the aggregate, will have a material adverse effect on our business, financial condition, cash flows or results of operations.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our quarterly report on Form 10-Q for the quarter ended March 31, 2006, which could materially affect our business, financial condition or future results. The risks described in that quarterly report are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

At the annual meeting of stockholders on May 18, 2006, the following actions were taken with the noted results:

Total Outstanding Common Stock: 13,299,022 Shares

| | Votes For | Votes Withhold | Total Votes | | |
|---|------------|----------------|---------------|-----------------|-------------|
| 1. Election of Directors | | | | | |
| 1. Peter F. Stanton | 11,477,598 | 913,308 | 12,390,906 | | |
| 2. Ryland P. “Skip” Davis | 11,478,680 | 912,226 | 12,390,906 | | |
| | Votes For | Votes Against | Votes Abstain | Total Votes | |
| 2. Ratification of Appointment of BDO Seidman, LLP as Independent Registered Public Accounting Firm | 11,973,187 | 416,312 | 1,407 | 12,390,906 | |
| | Votes For | Votes Against | Votes Abstain | Broker Non-Vote | Total Votes |
| 3. Approval of 2006 Stock Incentive Plan | 7,026,807 | 1,346,653 | 2,050 | 4,015,396 | 12,390,906 |

In addition to the directors elected at the meeting, the term of office of the following directors continued after the meeting: Donald K. Barbieri, Richard L. Barbieri, Arthur M. Coffey, Jon E. Eliassen and Ronald R. Taylor.

The votes for proposals 2 and 3 above were sufficient for approval of those proposals.

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Item 5. Other Information

None

Item 6. Exhibits

Index to Exhibits

| Exhibit Number | Description |
|-----------------------|--|
| 10.1 | Executive Compensation Agreement — Thomas L. McKeirnan |
| 10.2 | Executive Compensation Agreement — Anthony F. Dombrowik |
| 20.1 | Form of Stock Option Agreement — 2006 Stock Incentive Plan |
| 31.1 | Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) |
| 31.2 | Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) |
| 32.1 | Certification of Chief Executive Officer pursuant to Exchange Act Rule 13(a)-14(b) |
| 32.2 | Certification of Chief Financial Officer pursuant to Exchange Act Rule 13(a)-14(b) |

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.

Red Lion Hotels Corporation
Registrant

| | <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|-----|---|---|-----------------|
| By: | <u>/s/ Anupam Narayan</u> Anupam Narayan | Executive Vice President, Chief Investment Officer, and Chief Financial Officer (Principal Financial Officer) | August 14, 2006 |
| By: | <u>/s/ Anthony F. Dombrowik</u> Anthony F. Dombrowik | Senior Vice President, Corporate Controller (Principal Accounting Officer) | August 14, 2006 |

EXHIBIT 10.1

EXECUTIVE EMPLOYMENT AGREEMENT

THIS EXECUTIVE EMPLOYMENT AGREEMENT, is dated effective as of August 10, 2006 ("Effective Date") by and between Red Lion Hotels Corporation, a Washington corporation (the "Company"), and Thomas L. McKeirnan (the "Executive"), supersedes any prior employment agreements and replaces that certain Executive Employment Agreement between the Executive and the Company dated May 21, 2003.

The Company desires to employ the Executive in the capacities of Senior Vice President, General Counsel , and the Executive desires to be so employed, on the terms and subject to the conditions set forth in this agreement (the "Agreement");

Now, therefore, in consideration of the mutual covenants set forth herein and other good and valuable consideration the parties hereto hereby agree as follows:

1. EMPLOYMENT; TERM.

The Company employs the Executive, and the Executive agrees to be employed by the Company, upon the terms and subject to the conditions set forth herein, for a term commencing on the Effective Date and terminating on December 31, 2007 unless terminated earlier in accordance with Section 5 of this Agreement; provided, that such term shall automatically be extended from time to time for additional periods of one calendar year from the date on which it would otherwise expire unless the Executive, on one hand, or the Company, on the other, gives notice to the other party or parties not less than 120 days prior to such date that it elects to permit the term of this Agreement to expire without extension on such date. (The initial term of this Agreement as the same may be extended in accordance with the terms of this Agreement is hereinafter referred to as the "Term").

2. POSITIONS; CONDUCT.

(a) During the Term, the Executive will hold the title and office of, and serve in the position of, Senior Vice President, General Counsel of the Company. The Executive shall report to the Chief Executive Officer of the Company and shall perform such specific duties and services (including service as an officer, director or equivalent position of any direct or indirect subsidiary without additional compensation) as the Company shall reasonably request consistent with the Executive's position.

(b) During the Term, the Executive agrees to devote his full business time and attention to the business and affairs of the Company and to faithfully and diligently perform, to the best of his ability, all of his duties and responsibilities hereunder. Nothing in this Agreement shall preclude the Executive from devoting reasonable time and attention to the following (the "Exempted Activities"): (i) serving, with the approval of the Chief Executive Officer of the Company, as an officer, director, trustee or member of any organization, (ii) engaging in charitable and community activities and (iii) managing his personal investments and affairs. In no event shall the Exempted Activities involve any material conflict of interest with the interests of the Company or, individually or collectively, interfere materially with the performance by the Executive of his duties and responsibilities under this Agreement.

(c) The Executive's office and place of rendering his services under this Agreement shall be in the principal executive offices of the Company. During the Term, the Company shall provide the Executive with executive office space, and administrative and secretarial assistance and other support services consistent with his positions and with his duties and responsibilities hereunder.

3. BOARD OF DIRECTORS; COMMITTEES.

It is understood that the right to elect directors of the Company is by law vested in the stockholders and directors of the Company, and it is mutually contemplated that service on the Board of Directors of the Company or any of its subsidiaries or on any respective committee of the Board of Directors of the Company or any of its subsidiaries is not a condition of this Agreement.

4. SALARY; ADDITIONAL COMPENSATION; PERQUISITES AND BENEFITS.

(a) During the Term, the Company will pay the Executive a base salary at an annual rate of not less than \$159,500 per annum, subject to annual review by the Compensation Committee of the Board of Directors of the Company (the "Compensation Committee") and in the discretion of such Committee, increased from time to time. Once increased, such base salary may not be decreased. Such salary shall be paid in periodic installments in accordance with the Company's standard practice, but not less frequently than semi-monthly.

(b) During the Term, Executive shall be eligible to receive a cash bonus ("Bonus") as follows: Executive shall participate in such annual Bonus plans or programs as may be adopted by the Company's Compensation Committee (collectively with any of its successors in authority, the "Committee") from time to time for senior executives, provided, however, that conditioned upon attainment of target performance measure requirements based on one or more performance measures as may be determined by the Committee, the target Bonus for each calendar year during the Term for which Executive shall be eligible shall be 30% of Executive's base salary.

(c) The Board (or the committee to which it has delegate applicable authority) in its sole discretion may award any additional or other amounts of cash, restricted stock or Options or other equity based awards in respect of any whole or partial year during the Term.

(d) The Company will reimburse the Executive, in accordance with its standard policies from time to time in effect, for all out-of-pocket business expenses as may be incurred by the Executive in the performance of his duties under this Agreement.

(e) The Executive shall be entitled to vacation time to be credited and taken in accordance with the Company's policy from time to time in effect for senior executives, which in any event shall not be less than a total of four weeks per calendar year.

(f) The Company shall indemnify the Executive to the fullest extent permitted under the law of the State of Washington.

5. TERMINATION

(a) The Term will terminate upon the Executive's death or, upon notice by the Company or the Executive to the other, in the case of a determination of the Executive's Disability. As used herein the term "Disability" means the Executive's inability to perform his duties and responsibilities under this Agreement for a period of more than 120 consecutive days, or for more than 180 days, whether or not continuous, during any 365-day period, due to physical or mental incapacity or impairment. A determination of Disability will be made by a physician satisfactory to both the Executive and the Company; provided that if they cannot agree as to a physician, then each shall select a physician and these two together shall select a third physician whose determination of Disability shall be binding on the Executive and the Company. Should the Executive become incapacitated, his employment shall continue and all base and other compensation due the Executive hereunder shall continue to be paid through the date upon which the Executive's employment is terminated for Disability in accordance with this section.

(b) The Term may be terminated by the Company upon notice to the Executive upon the occurrence of any event constituting "Cause" as defined herein.

(c) The Term may be terminated by the Executive upon notice to the Company within six months of the occurrence of any event constituting "Good Reason" as defined herein.

6. SEVERANCE.

(a) If the Term is terminated by the Company for Cause, the Company will pay to the Executive an aggregate amount equal to the Executive's accrued and unpaid base salary through the date of such termination, additional salary payments in lieu of the Executive's accrued and unused vacation time, unreimbursed business expenses, unreimbursed medical, dental and other employee benefit expenses in accordance with the applicable plans, and any and all other benefits provided under the terms of applicable employee plans to terminated employees (the "Standard Termination Payments").

(b) If the Term is terminated upon the Executive's death or Disability, the Company and the Subsidiary will pay to the Executive's estate or the Executive, as the case may be, the Standard Termination Payments and all death or disability payments or other employee benefits under their employee benefit plans.

(c) Subject to Section 6(d), if the Company terminates the Executive's employment under this Agreement without Cause other than by reason of his death or Disability or if the Executive terminates his employment hereunder for Good Reason, the Company shall (i) pay the Executive the Standard Termination Payments, (ii) pay the Executive a lump sum payment equal to the Executive's total cash compensation for the previous fiscal year (but not less than \$159,500) and (iii) continue in effect the Executive's benefits with respect to life, health and insurance plans or their equivalent for one year. Such payments and the obligations set forth below in Section 6(e) shall be the Company's only obligations to Executive in such a case. The Company shall incur no further liability for such a termination.

(d) If the Term is not extended pursuant to the proviso to Section 1 as a result of the Company giving notice thereunder that it elects to permit the term of this Agreement to expire without extension, the Company shall (i) pay the Executive the Standard Termination Payments, (ii) pay the Executive a lump sum payment equal to the Executive's total cash compensation for the previous fiscal year (but not less than \$159,500) and (iii) continue in effect the Executive's benefits with respect to life, health and insurance plans or their equivalent for one year. Such payments and the obligations set forth below in Section 6(e) shall be the Company's only obligations to Executive in such a case. The Company shall incur no further liability for such a termination.

(e) If the Company terminates the Executive's employment under this Agreement without Cause other than by reason of his death or Disability, or if the Term is not extended as a result of the Company giving notice that it elects to permit the term of this Agreement to expire without extension, or if the Executive terminates his employment hereunder for Good Reason pursuant to Section 5(c): all stock options granted to the Executive shall immediately vest and be exercisable and any stock grant to the Executive shall immediately vest, all Company imposed restrictions on restricted stock issued to the Executive shall be terminated and all restricted stock awarded to Executive but not yet issued shall be promptly issued to Executive.

(f) As used herein, the term "Cause" means: (i) the Executive's willful and intentional failure or refusal to perform or observe any of his material duties, responsibilities or obligations set forth in this Agreement, if such breach is not cured within 30 days after notice thereof to the Executive by the Company, which notice shall state that such conduct shall, without cure, constitute Cause and makes specific reference to this Section 6(g); (ii) any willful and intentional act of the Executive involving fraud, theft, embezzlement or dishonesty affecting the Company; or (iii) the Executive's conviction of (or a plea of nolo contendere to) an offense which is a felony in the jurisdiction involved.

(g) As used herein, the term "Good Reason" means the occurrence of any of the following, without the prior written consent of the Executive: (i) assignment to the Executive of duties materially inconsistent with the Executive's positions and responsibilities as described in Section 2(a) hereof; (ii) the removal of the Executive from the position as described in Section 2(a); (iii) any material breach of this Agreement by the Company which is continuing; or (iv) a Change in Control; provided that a Change of Control shall only constitute Good Reason if, within 18 months after such Change of Control: (a) the Company changes its headquarters office location to a location more than 40 miles from the city limits of Spokane, Washington, (b) the Company changes Executive's job titles, or (c) Executive experiences a significant diminution in his duties or responsibilities or compensation compared to prior to the Change in Control, other than in connection with the termination of the Executive's employment for Cause, Disability or as a result of the Executive's death or by the Executive other than for Good Reason.

Notwithstanding anything to the contrary in this

Section 6(g), the Executive shall not be deemed to have Good Reason unless the Executive gives the Company written notice that the specified conduct or event has occurred giving rise to Executive having Good Reason, and the Company fails to cure such conduct or event within thirty (30) days after the receipt of such notice.

(h) As used herein, the term "Change of Control" means the occurrence of any one of the following events: (i) the majority of the Board of Directors of the Company consists of individuals other than Incumbent Members, which shall mean the members of the Company's Board of Directors on the Effective Date; provided that any person becoming a director subsequent to the Effective Date whose election or nomination for election was supported by the Executive or a majority of the directors who then comprised the Incumbent Directors shall be considered an Incumbent Director; (ii) the Company adopts a plan of liquidation providing for the distribution of all or substantially all of the assets of the Company on a consolidated basis; or (iii) the Company sells all or substantially all of its assets on a consolidated basis in a single transaction or series of transactions. As used herein, an Affiliate of a person or other entity means a person or other entity that directly or indirectly controls, is controlled by or is under common control with the person or other entity specified (including without limitation any investment entity managed by the person or other entity specified or a person or entity that directly or indirectly controls, is controlled by or under common control with the person or other entity specified).

(i) The amounts required to be paid and the benefits required to be made available to the Executive under this Section 6 are absolute. Under no circumstances shall the Executive, upon the termination of his employment hereunder, be required to seek alternative employment and, in the event that the Executive does secure other employment, no compensation or other benefits received in respect of such employment shall be set-off or in any other way limit or reduce the obligations of the Company and the Subsidiary under this Section 6.

7. CONFIDENTIAL INFORMATION.

(a) The Executive acknowledges that the Company and its Affiliates own and have developed and compile, and will in the future own, develop and compile certain Confidential Information and that during the course of his rendering services to the Company Confidential Information has and will be disclosed to the Executive by the Company and its Affiliates. The Executive hereby agrees that, during the Term (except as required to conduct the business of the Company) and thereafter, he will not in any way use or disclose, furnish or make accessible to anyone, directly or indirectly, any Confidential Information of the Company or its Affiliates.

(b) As used herein, the term "Confidential Information" means any trade secrets, confidential or proprietary information, or other knowledge, know-how, information, documents or materials, owned, developed or possessed by a Company Affiliate pertaining to its businesses the confidentiality of which such company takes reasonable measures to protect, including, but not limited to, trade secrets, techniques, know-how (including designs, plans, procedures, processes and research records), software, computer programs, innovations, discoveries, improvements, research, developments, test results, reports, specifications, data, formats, marketing data and business plans and strategies, business opportunities,

guest lists, vendor terms, agreements and other forms of documents, expansion plans, budgets, projections, and salary, staffing and employment information. Notwithstanding the foregoing, Confidential Information shall not in any event include information which (i) was generally known or generally available to the public prior to its disclosure to the Executive, (ii) becomes generally known or generally available to the public subsequent to its disclosure to the Executive through no wrongful act of the Executive, (iii) is or becomes available to the Executive from sources other than the Company Affiliates which sources are not known to the Executive to be under any duty of confidentiality with respect thereto or (iv) the Executive is required to disclose by applicable law or regulation or by order of any court or federal, state or local regulatory or administrative body (provided that the Executive provides the Company with prior notice of the contemplated disclosure and reasonably cooperates with the Company, at the Company's sole expense, in seeking a protective order or other appropriate protection of such information).

8. RESTRICTIVE COVENANTS.

(a) The Executive agrees that during his employment hereunder and for a period of twelve months thereafter the Executive will not, directly or indirectly, engage or participate or make any financial investments in (other than ownership of up to 5% of the aggregate of any class of securities of any corporation if such securities are listed on a national stock exchange or under section 12(g) of the Securities Exchange Act of 1934) or become employed by, or act as an agent or principal of, or render advisory or other management services to or for, any Competing Business. As used herein the term "Competing Business" means any business which includes hotel ownership, hotel management, hotel services or hotel franchising and has a headquarters in Washington, Oregon, Idaho, Montana, Utah or Northern California, defined as the area from San Jose, California north to California's border with Oregon.

(b) The Executive agrees that during his employment hereunder and for a period of twenty-four months thereafter he will not solicit, raid, entice or induce any person that then is or at any time during the twelve-month period prior to the end of the Term was an employee of the Company or a Company Affiliate (other than a person whose employment with such Company Affiliate has been terminated by such Company Affiliate), to become employed by any person, firm or corporation.

9. SPECIFIC PERFORMANCE.

(a) The Executive acknowledges that the services to be rendered by him hereunder are of a special, unique, extraordinary and personal character and that the Company Affiliates would sustain irreparable harm in the event of a violation by the Executive of Section 7 or 8 hereof. Therefore, in addition to any other remedies available, the Company shall be entitled to specific enforcement and/or an injunction from any court of competent jurisdiction restraining the Executive from committing or continuing any such violation of this Agreement without proving actual damages or posting a bond or other security. Nothing herein shall be construed as prohibiting the Company from pursuing any other remedies available to it for such breach or threatened breach, including the recovery of damages.

(b) If any of the restrictions on activities of the Executive contained in Sections 7 or 8 shall for any reason be held by a court of competent jurisdiction to be excessively broad as to duration, geographical scope or activity of subject, such restrictions shall be construed so as thereafter to be limited or reduced to be enforceable to the maximum extent compatible with the applicable law as it shall then appear; it being understood that by the execution of this Agreement the parties hereto regard such restrictions as reasonable and compatible with their respective rights.

(c) Notwithstanding anything in this Agreement to the contrary, in the event that the Company fails to make any payment of any amounts or provide any of the benefits to the Executive when due as called for under Section 6 of this Agreement and such failure shall continue for twenty (20) days after notice thereof

from the Executive, all restrictions on the activities of the Executive under Sections 7 and 8 shall be immediately and permanently terminated.

10. WITHHOLDING.

The parties agree that all payments to be made to the Executive by the Company pursuant to the Agreement shall be subject to all applicable withholding obligations of such company.

11. NOTICES.

All notices required or permitted hereunder shall be in writing and shall be deemed given and received when delivered personally, four days after being mailed if sent by registered or certified mail, postage pre-paid, or by one day after delivery if sent by air courier (for next-day delivery) with evidence of receipt thereof or by facsimile with receipt confirmed by the addressee. Such notices shall be addressed respectively:

IF TO THE EXECUTIVE, to:

Thomas L. McKeirnan
235 E 9th
Spokane, WA 99202

IF TO THE COMPANY, to:

Red Lion Hotels Corporation
201 W. North River Drive
Spokane, WA 99201
Attn: Chief Executive Officer

or to any other address of which such party may have given notice to the other parties in the manner specified above.

12. MISCELLANEOUS.

(a) This Agreement is a personal contract calling for the provision of unique services by the Executive, and the Executive's rights and obligations hereunder may not be sold, transferred, assigned, pledged or hypothecated by the Executive. The rights and obligations of the Company hereunder will be binding upon and run in favor of their respective successors and assigns.

(b) This Agreement shall be governed by and construed and enforced in accordance with the internal laws of the State of Washington.

(c) Any controversy arising out of or relating to this Agreement or any breach hereof shall be settled by arbitration in Spokane, Washington by a single neutral arbitrator who shall be a retired federal or state court judge in accordance with the Commercial Arbitration Rules of the American Arbitration Association and judgment upon any award rendered may be entered in any court having jurisdiction thereof, except in the event of a controversy relating to any alleged violation by the Executive of Section 7 or 8 hereof, the Company and the Subsidiary shall be entitled to seek injunctive relief from a court of competent jurisdiction without the requirement to seek arbitration. In addition to all other relief, the substantially prevailing party in any arbitration or court action shall be entitled to their reasonable attorney fees and costs incurred by reason of the controversy (including any appellate review and bankruptcy or enforcement proceedings).

(d) The headings of the various sections of this Agreement are for convenience of reference only and shall not define or limit any of the terms or provisions hereof.

(e) The provisions of this Agreement which by their terms call for performance subsequent to the expiration or termination of the Term shall survive such expiration or termination.

(f) Upon the Effective Date, this Agreement supersedes any existing employment agreements between the Employee and the Company and any of its Affiliates all of which shall be terminated upon the Commencement Date of this Agreement.

IN WITNESS WHEREOF, THE PARTIES HERETO HAVE EXECUTED THIS AGREEMENT AS OF THE EFFECTIVE DATE FIRST ABOVE WRITTEN.

EXECUTIVE:

/s/ Thomas L. McKeirnan

Thomas L. McKeirnan

COMPANY:

RED LION HOTELS CORPORATION

By /s/ Arthur Coffey

*Arthur Coffey, President and
Chief Executive Officer*

EXHIBIT 10.2

EXECUTIVE EMPLOYMENT AGREEMENT

THIS EXECUTIVE EMPLOYMENT AGREEMENT, is dated effective as of August 10, 2006 ("Effective Date") by and between Red Lion Hotels Corporation, a Washington corporation (the "Company"), and Anthony Dombrowik (the "Executive").

The Company desires to employ the Executive in the capacities of Senior Vice President, Controller, and the Executive desires to be so employed, on the terms and subject to the conditions set forth in this agreement (the "Agreement");

Now, therefore, in consideration of the mutual covenants set forth herein and other good and valuable consideration the parties hereto hereby agree as follows:

1. EMPLOYMENT; TERM.

The Company employs the Executive, and the Executive agrees to be employed by the Company, upon the terms and subject to the conditions set forth herein, for a term commencing on the Effective Date and terminating on December 31, 2007 unless terminated earlier in accordance with Section 5 of this Agreement; provided, that such term shall automatically be extended from time to time for additional periods of one calendar year from the date on which it would otherwise expire unless the Executive, on one hand, or the Company, on the other, gives notice to the other party or parties not less than 120 days prior to such date that it elects to permit the term of this Agreement to expire without extension on such date. (The initial term of this Agreement as the same may be extended in accordance with the terms of this Agreement is hereinafter referred to as the "Term").

2. POSITIONS; CONDUCT.

(a) During the Term, the Executive will hold the title and office of, and serve in the position of, Senior Vice President, Controller of the Company. The Executive shall report to the Chief Financial Officer of the Company and shall perform such specific duties and services (including service as an officer, director or equivalent position of any direct or indirect subsidiary without additional compensation) as the Company shall reasonably request consistent with the Executive's position.

(b) During the Term, the Executive agrees to devote his full business time and attention to the business and affairs of the Company and to faithfully and diligently perform, to the best of his ability, all of his duties and responsibilities hereunder. Nothing in this Agreement shall preclude the Executive from devoting reasonable time and attention to the following (the "Exempted Activities"): (i) serving, with the approval of the Chief Financial Officer of the Company, as an officer, director, trustee or member of any organization, (ii) engaging in charitable and community activities and (iii) managing his personal investments and affairs. In no event shall the Exempted Activities involve any material conflict of interest with the interests of the Company or, individually or collectively, interfere materially with the performance by the Executive of his duties and responsibilities under this Agreement.

(c) The Executive's office and place of rendering his services under this Agreement shall be in the principal executive offices of the Company. During the Term, the Company shall provide the Executive with executive office space, and administrative and secretarial assistance and other support services consistent with his positions and with his duties and responsibilities hereunder.

3. BOARD OF DIRECTORS; COMMITTEES.

It is understood that the right to elect directors of the Company is by law vested in the stockholders and directors of the Company, and it is mutually contemplated that service on the Board of Directors of the Company or any of its subsidiaries or on any respective committee of the Board of Directors of the Company or any of its subsidiaries is not a condition of this Agreement.

4. SALARY; ADDITIONAL COMPENSATION; PERQUISITES AND BENEFITS.

(a) During the Term, the Company will pay the Executive a base salary at an annual rate of not less than \$120,960 per annum, subject to annual review by the Compensation Committee of the Board of Directors of the Company (the "Compensation Committee") and in the discretion of such Committee, increased from time to time. Once increased, such base salary may not be decreased. Such salary shall be paid in periodic installments in accordance with the Company's standard practice, but not less frequently than semi-monthly.

(b) During the Term, Executive shall be eligible to receive a cash bonus ("Bonus") as follows: Executive shall participate in such annual Bonus plans or programs as may be adopted by the Company's Compensation Committee (collectively with any of its successors in authority, the "Committee") from time to time for senior executives, provided, however, that conditioned upon attainment of target performance measure requirements based on one or more performance measures as may be determined by the Committee, the target Bonus for each calendar year during the Term for which Executive shall be eligible shall be 30% of Executive's base salary.

(c) The Board (or the committee to which it has delegate applicable authority) in its sole discretion may award any additional or other amounts of cash, restricted stock or Options or other equity based awards in respect of any whole or partial year during the Term.

(d) The Company will reimburse the Executive, in accordance with its standard policies from time to time in effect, for all out-of-pocket business expenses as may be incurred by the Executive in the performance of his duties under this Agreement.

(e) The Executive shall be entitled to vacation time to be credited and taken in accordance with the Company's policy from time to time in effect for senior executives, which in any event shall not be less than a total of four weeks per calendar year.

(f) The Company shall indemnify the Executive to the fullest extent permitted under the law of the State of Washington.

5. TERMINATION

(a) The Term will terminate upon the Executive's death or, upon notice by the Company or the Executive to the other, in the case of a determination of the Executive's Disability. As used herein the term "Disability" means the Executive's inability to perform his duties and responsibilities under this Agreement for a period of more than 120 consecutive days, or for more than 180 days, whether or not continuous, during any 365-day period, due to physical or mental incapacity or impairment. A determination of Disability will be made by a physician satisfactory to both the Executive and the Company; provided that if they cannot agree as to a physician, then each shall select a physician and these two together shall select a third physician whose determination of Disability shall be binding on the Executive and the Company. Should the Executive become incapacitated, his employment shall continue

and all base and other compensation due the Executive hereunder shall continue to be paid through the date upon which the Executive's employment is terminated for Disability in accordance with this section.

(b) The Term may be terminated by the Company upon notice to the Executive upon the occurrence of any event constituting "Cause" as defined herein.

(c) The Term may be terminated by the Executive upon notice to the Company within six months of the occurrence of any event constituting "Good Reason" as defined herein.

6. SEVERANCE.

(a) If the Term is terminated by the Company for Cause, the Company will pay to the Executive an aggregate amount equal to the Executive's accrued and unpaid base salary through the date of such termination, additional salary payments in lieu of the Executive's accrued and unused vacation time, unreimbursed business expenses, unreimbursed medical, dental and other employee benefit expenses in accordance with the applicable plans, and any and all other benefits provided under the terms of applicable employee plans to terminated employees (the "Standard Termination Payments").

(b) If the Term is terminated upon the Executive's death or Disability, the Company and the Subsidiary will pay to the Executive's estate or the Executive, as the case may be, the Standard Termination Payments and all death or disability payments or other employee benefits under their employee benefit plans.

(c) Subject to Section 6(d), if the Company terminates the Executive's employment under this Agreement without Cause other than by reason of his death or Disability or if the Executive terminates his employment hereunder for Good Reason, the Company shall (i) pay the Executive the Standard Termination Payments, (ii) pay the Executive a lump sum payment equal to the Executive's total cash compensation for the previous fiscal year (but not less than \$120,960) and (iii) continue in effect the Executive's benefits with respect to life, health and insurance plans or their equivalent for one year. Such payments and the obligations set forth below in Section 6(e) shall be the Company's only obligations to Executive in such a case. The Company shall incur no further liability for such a termination.

(d) If the Term is not extended pursuant to the proviso to Section 1 as a result of the Company giving notice thereunder that it elects to permit the term of this Agreement to expire without extension, the Company shall (i) pay the Executive the Standard Termination Payments, (ii) pay the Executive a lump sum payment equal to the Executive's total cash compensation for the previous fiscal year (but not less than \$120,960) and (iii) continue in effect the Executive's benefits with respect to life, health and insurance plans or their equivalent for one year. Such payments and the obligations set forth below in Section 6(e) shall be the Company's only obligations to Executive in such a case. The Company shall incur no further liability for such a termination.

(e) If the Company terminates the Executive's employment under this Agreement without Cause other than by reason of his death or Disability, or if the Term is not extended as a result of the Company giving notice that it elects to permit the term of this Agreement to expire without extension, or if the Executive terminates his employment hereunder for Good Reason pursuant to Section 5(c): all stock options granted to the Executive shall immediately vest and be exercisable and any stock grant to the Executive shall immediately vest, all Company imposed restrictions on restricted stock issued to the Executive shall be terminated and all restricted stock awarded to Executive but not yet issued shall be promptly issued to Executive.

(f) As used herein, the term "Cause" means: (i) the Executive's willful and intentional failure or refusal to perform or observe any of his material duties, responsibilities or obligations set forth in this Agreement, if such breach is not cured within 30 days after notice thereof to the Executive by the Company, which notice shall state that such conduct shall, without cure, constitute Cause and makes specific reference to this Section 6(g); (ii) any willful and intentional act of the Executive involving fraud,

theft, embezzlement or dishonesty affecting the Company; or (iii) the Executive's conviction of (or a plea of nolo contendere to) an offense which is a felony in the jurisdiction involved.

(g) As used herein, the term "Good Reason" means the occurrence of any of the following, without the prior written consent of the Executive: (i) assignment to the Executive of duties materially inconsistent with the Executive's positions and responsibilities as described in Section 2(a) hereof; (ii) the removal of the Executive from the position as described in Section 2(a); (iii) any material breach of this Agreement by the Company which is continuing; or (iv) a Change in Control; provided that a Change of Control shall only constitute Good Reason if, within 18 months after such Change of Control: (a) the Company changes its headquarters office location to a location more than 40 miles from the city limits of Spokane, Washington, (b) the Company changes Executive's job titles, or (c) Executive experiences a significant diminution in his duties or responsibilities or compensation compared to prior to the Change in Control, other than in connection with the termination of the Executive's employment for Cause, Disability or as a result of the Executive's death or by the Executive other than for Good Reason.

Notwithstanding anything to the contrary in this

Section 6(g), the Executive shall not be deemed to have Good Reason unless the Executive gives the Company written notice that the specified conduct or event has occurred giving rise to Executive having Good Reason, and the Company fails to cure such conduct or event within thirty (30) days after the receipt of such notice.

(h) As used herein, the term "Change of Control" means the occurrence of any one of the following events: (i) the majority of the Board of Directors of the Company consists of individuals other than Incumbent Members, which shall mean the members of the Company's Board of Directors on the Effective Date; provided that any person becoming a director subsequent to the Effective Date whose election or nomination for election was supported by the Executive or a majority of the directors who then comprised the Incumbent Directors shall be considered an Incumbent Director; (ii) the Company adopts a plan of liquidation providing for the distribution of all or substantially all of the assets of the Company on a consolidated basis; or (iii) the Company sells all or substantially all of its assets on a consolidated basis in a single transaction or series of transactions. As used herein, an Affiliate of a person or other entity means a person or other entity that directly or indirectly controls, is controlled by or is under common control with the person or other entity specified (including without limitation any investment entity managed by the person or other entity specified or a person or entity that directly or indirectly controls, is controlled by or under common control with the person or other entity specified).

(i) The amounts required to be paid and the benefits required to be made available to the Executive under this Section 6 are absolute. Under no circumstances shall the Executive, upon the termination of his employment hereunder, be required to seek alternative employment and, in the event that the Executive does secure other employment, no compensation or other benefits received in respect of such employment shall be set-off or in any other way limit or reduce the obligations of the Company and the Subsidiary under this Section 6.

7. CONFIDENTIAL INFORMATION.

(a) The Executive acknowledges that the Company and its Affiliates own and have developed and compile, and will in the future own, develop and compile certain Confidential Information and that during the course of his rendering services to the Company Confidential Information has and will be disclosed to the Executive by the Company and its Affiliates. The Executive hereby agrees that, during the Term (except as required to conduct the business of the Company) and thereafter, he will not in any way use or disclose, furnish or make accessible to anyone, directly or indirectly, any Confidential Information of the Company or its Affiliates.

(b) As used herein, the term "Confidential Information" means any trade secrets, confidential or proprietary information, or other knowledge, know-how, information, documents or materials, owned, developed or possessed by a Company Affiliate pertaining to its businesses the confidentiality of which such company takes reasonable measures to protect, including, but not limited to, trade secrets, techniques, know-how (including designs, plans, procedures, processes and research records), software, computer

programs, innovations, discoveries, improvements, research, developments, test results, reports, specifications, data, formats, marketing data and business plans and strategies, business opportunities, guest lists, vendor terms, agreements and other forms of documents, expansion plans, budgets, projections, and salary, staffing and employment information. Notwithstanding the foregoing, Confidential Information shall not in any event include information which (i) was generally known or generally available to the public prior to its disclosure to the Executive, (ii) becomes generally known or generally available to the public subsequent to its disclosure to the Executive through no wrongful act of the Executive, (iii) is or becomes available to the Executive from sources other than the Company Affiliates which sources are not known to the Executive to be under any duty of confidentiality with respect thereto or (iv) the Executive is required to disclose by applicable law or regulation or by order of any court or federal, state or local regulatory or administrative body (provided that the Executive provides the Company with prior notice of the contemplated disclosure and reasonably cooperates with the Company, at the Company's sole expense, in seeking a protective order or other appropriate protection of such information).

8. RESTRICTIVE COVENANTS.

(a) The Executive agrees that during his employment hereunder and for a period of twelve months thereafter the Executive will not, directly or indirectly, engage or participate or make any financial investments in (other than ownership of up to 5% of the aggregate of any class of securities of any corporation if such securities are listed on a national stock exchange or under section 12(g) of the Securities Exchange Act of 1934) or become employed by, or act as an agent or principal of, or render advisory or other management services to or for, any Competing Business. As used herein the term "Competing Business" means any business which includes hotel ownership, hotel management, hotel services or hotel franchising and has a headquarters in Washington, Oregon, Idaho, Montana, Utah or Northern California, defined as the area from San Jose, California north to California's border with Oregon.

(b) The Executive agrees that during his employment hereunder and for a period of twenty-four months thereafter he will not solicit, raid, entice or induce any person that then is or at any time during the twelve-month period prior to the end of the Term was an employee of the Company or a Company Affiliate (other than a person whose employment with such Company Affiliate has been terminated by such Company Affiliate), to become employed by any person, firm or corporation.

9. SPECIFIC PERFORMANCE.

(a) The Executive acknowledges that the services to be rendered by him hereunder are of a special, unique, extraordinary and personal character and that the Company Affiliates would sustain irreparable harm in the event of a violation by the Executive of Section 7 or 8 hereof. Therefore, in addition to any other remedies available, the Company shall be entitled to specific enforcement and/or an injunction from any court of competent jurisdiction restraining the Executive from committing or continuing any such violation of this Agreement without proving actual damages or posting a bond or other security. Nothing herein shall be construed as prohibiting the Company from pursuing any other remedies available to it for such breach or threatened breach, including the recovery of damages.

(b) If any of the restrictions on activities of the Executive contained in Sections 7 or 8 shall for any reason be held by a court of competent jurisdiction to be excessively broad as to duration, geographical scope or activity of subject, such restrictions shall be construed so as thereafter to be limited or reduced to be enforceable to the maximum extent compatible with the applicable law as it shall then appear; it being understood that by the execution of this Agreement the parties hereto regard such restrictions as reasonable and compatible with their respective rights.

(c) Notwithstanding anything in this Agreement to the contrary, in the event that the Company fails to make any payment of any amounts or provide any of the benefits to the Executive when due as called for

under Section 6 of this Agreement and such failure shall continue for twenty (20) days after notice thereof from the Executive, all restrictions on the activities of the Executive under Sections 7 and 8 shall be immediately and permanently terminated.

10. WITHHOLDING.

The parties agree that all payments to be made to the Executive by the Company pursuant to the Agreement shall be subject to all applicable withholding obligations of such company.

11. NOTICES.

All notices required or permitted hereunder shall be in writing and shall be deemed given and received when delivered personally, four days after being mailed if sent by registered or certified mail, postage pre-paid, or by one day after delivery if sent by air courier (for next-day delivery) with evidence of receipt thereof or by facsimile with receipt confirmed by the addressee. Such notices shall be addressed respectively:

IF TO THE EXECUTIVE, to:

Anthony Dombrowik
2313 Brookfield Lane
Spokane, WA 99223

IF TO THE COMPANY, to:

Red Lion Hotels Corporation
201 W. North River Drive
Spokane, WA 99201
Attn: Chief Executive Officer

With copy to:
Red Lion Hotels Corporation
201 W. North River Drive
Spokane, WA 99201
Attn. Corporate Counsel

or to any other address of which such party may have given notice to the other parties in the manner specified above.

12. MISCELLANEOUS.

(a) This Agreement is a personal contract calling for the provision of unique services by the Executive, and the Executive's rights and obligations hereunder may not be sold, transferred, assigned, pledged or hypothecated by the Executive. The rights and obligations of the Company hereunder will be binding upon and run in favor of their respective successors and assigns.

(b) This Agreement shall be governed by and construed and enforced in accordance with the internal laws of the State of Washington.

(c) Any controversy arising out of or relating to this Agreement or any breach hereof shall be settled by arbitration in Spokane, Washington by a single neutral arbitrator who shall be a retired federal or state court judge in accordance with the Commercial Arbitration Rules of the American Arbitration Association and judgment upon any award rendered may be entered in any court having jurisdiction thereof, except in the event of a controversy relating to any alleged violation by the Executive of Section 7 or 8 hereof, the Company and the Subsidiary shall be entitled to seek injunctive relief from a court of competent jurisdiction without the requirement to seek arbitration. In addition to all other relief, the substantially prevailing party in any arbitration or court action shall be entitled to their reasonable attorney fees and

costs incurred by reason of the controversy (including any appellate review and bankruptcy or enforcement proceedings).

(d) The headings of the various sections of this Agreement are for convenience of reference only and shall not define or limit any of the terms or provisions hereof.

(e) The provisions of this Agreement which by their terms call for performance subsequent to the expiration or termination of the Term shall survive such expiration or termination.

(f) Upon the Effective Date, this Agreement supersedes any existing employment agreements between the Employee and the Company and any of its Affiliates all of which shall be terminated upon the Commencement Date of this Agreement.

IN WITNESS WHEREOF, THE PARTIES HERETO HAVE EXECUTED THIS AGREEMENT AS OF THE EFFECTIVE DATE FIRST ABOVE WRITTEN.

EXECUTIVE :

/s/ Anthony Dombrowik

Anthony Dombrowik

COMPANY :

RED LION HOTELS CORPORATION

By /s/ Arthur Coffey

*Arthur Coffey, President and
Chief Executive Officer*

EXHIBIT 20.1

NOTICE OF GRANT OF STOCK OPTIONS AND OPTION AGREEMENT

**RED LION HOTELS CORPORATION
201 W. NORTH RIVER DRIVE
SPOKANE, WA 99201**

_____ ID: _____

Effective _____, (the "Effective Date"), you have been granted a Non-Qualified Stock Option to buy _____ shares of Red Lion Hotels Corporation (the "Company" or "RLH") at \$_____ per share. Your grant has been made under the Company's 2006 Stock Incentive Plan (incorporated herein by reference and hereinafter referred to as the "Plan"), which, together with the terms contained herein, sets forth the terms and conditions of your grant. A copy of the Plan is available on file at the Company corporate office. Please carefully review these documents.

Exercise Price: \$_____ per share. The total exercise price of the shares granted is \$_____.

Vesting: Your option shares vest 25% on each of the first, second, third and fourth anniversaries of the Effective Date.

Expiration Date: Your right to exercise your option with respect to vested shares will expire on the tenth (10th) anniversary of the Effective Date, or earlier in connection with the termination of your employment as described more fully in Exhibit A, "Additional Terms and Conditions."

Exercise: You may exercise this option from time to time, in whole or in part, to purchase a whole number of vested shares, by following the exercise procedures implemented by the Company from time to time. All exercises must take place before the Expiration Date, or such earlier date as set forth in Exhibit A following your retirement, permanent and total disability, death or your separation from employment. The number of shares you may purchase as of any date cannot exceed the total number of shares vested by that date, less any shares you have previously acquired by exercising this Option. You will be responsible for any taxes or any applicable brokerage or administrative fees due when you exercise your option. You will also be responsible for any applicable taxes, brokerage fees and administrative fees due when you sell or transfer any shares you receive upon exercise of your option.

By your signature and the Company's signature below, you and the Company agree that these options are granted under and governed by the terms and conditions of the Plan as amended by this Notice of Grant of Stock Options and Option Agreement.

RED LION HOTELS CORPORATION

By:
Arthur M. Coffey
President and CEO

ASSOCIATE:

EXHIBIT A

ADDITIONAL TERMS AND CONDITIONS

This option is a valuable part of your total compensation at RLH. You are an important part of our strategy for success, and you have been granted an option to purchase a significant number of shares of RLH. This option enables you to become an owner of the Company or increase your ownership of the Company, and to benefit financially from our success.

This option is your opportunity to buy, within ten years of the option's grant, a specific number of shares of RLH stock. You can buy these shares at the price set at the time you are granted the option - no matter how high the market value of the stock at the time.

THE FUTURE VALUE OF YOUR STOCK OPTIONS

While no one can predict the future of RLH's stock performance, your option can become very valuable. Your potential gain is the difference between the exercise price of your option and the market value of the option shares at the time you exercise your option. Obviously, if the market price is less than the exercise price, your option would have no value.

For example, if the exercise price of your vested option is \$_____, and the market price is \$_____, your potential gain would be \$5 per share if you exercised your option at that time.

Stock performance is affected by many factors, including the company's ability to meet financial performance expectations, growth in net income and market perception of the company's growth potential.

EXERCISING YOUR STOCK OPTION

When you exercise your option, you are buying shares of RLH stock at the fixed exercise price. You may exercise your option as to some or all of the vested shares at any time before the ten-year expiration date, subject to earlier termination as outlined below in connection with earlier separation from the Company. You become vested as follows:

First anniversary of the Effective Date - 25% of your option shares vest; Second anniversary of the Effective Date - 25% of your option shares vest; Third anniversary of the Effective Date - 25% of your option shares vest; and Fourth anniversary of the Effective Date - 25% of your options shares vest

Once you exercise your option, you own RLH stock. You may choose to hold your stock in hopes of future appreciation. As a shareholder, your potential gain depends on how well the company's stock performs over time.

EXERCISING YOUR OPTIONS WITH CASH

When you exercise your options and purchase RLH stock, you pay the option price times the number of shares you wish to purchase. For example, if the option price is \$_____, and you want to buy 1,000 shares of stock, you would pay \$_____ regardless of the current market value of the 1,000 shares. Since the excess of the market value of the purchased shares over the option price constitutes compensation to you, it is subject to withholding by the company. The required tax withholding amount must be paid by you to the company with the option price at the time of the exercise.

EXERCISING YOUR OPTIONS WITHOUT CASH

If you want to exercise your options and plan to immediately sell the shares (versus waiting to sell them), you may conduct a cashless exercise, subject to such policies as the Company may implement from time to time with respect to cashless exercises. In such a case, sale of your option shares would be arranged through a stock broker and you would be paid the difference between the option price and the market value of the stock at the time you exercise, less applicable tax withholding, brokerage fees and administrative fees.

CASHLESS EXERCISE EXAMPLE

1) ASSUME THAT THE MARKET PRICE OF RLH STOCK WHEN YOU EXERCISE YOUR OPTIONS IS...

\$ _____ PER SHARE

2. YOU EXERCISE YOUR VESTED OPTION TO PURCHASE 1,000 SHARES FOR \$ _____ PER SHARE...

1,000 X \$ _____ = \$ _____

3. YOU RECEIVE THE DIFFERENCE BETWEEN THE MARKET PRICE AND THE EXERCISE PRICE OF YOUR SHARES, LESS TAX WITHHOLDING...

MARKET PRICE: 1,000 X \$ _____ = \$ _____
EXERCISE PRICE: 1,000 X \$ _____ = \$ _____

AMOUNT PAYABLE TO YOU...

\$5,000*

* Less applicable tax withholding, brokerage fees and administrative fees

SUMMARY OF OTHER ISSUES (PLEASE SEE THE MORE SPECIFIC TERMS AND CONDITIONS SET FORTH IN THE PLAN):

- IN THE EVENT OF SEPARATION FROM EMPLOYMENT...

If the nature of your separation of employment with RLH is other than retirement, disability or death, then you will have until the earlier of the Expiration Date or the date which is three months after your employment ceases or is suspended to exercise your vested options (assuming you are not terminated by the Company for "Cause" as defined in the Plan). If you are not vested, or if you are terminated for Cause, you will not be able to exercise your options.

- IN THE EVENT OF RETIREMENT OR PERMANENT AND TOTAL DISABILITY...

If you are vested, you will have until the earlier of the Expiration Date or 12 months from your last day of employment to exercise such vested options. If you are not vested, you will not be able to exercise your options.

- IN THE EVENT OF DEATH DURING EMPLOYMENT...

As long as you are vested at the time of your death, your surviving beneficiary will have until the earlier of the Expiration Date or 12 months from your death to exercise your vested options. If you are not vested, your survivors will not be able to exercise your options.

FOR ADDITIONAL INFORMATION PLEASE CONTACT RLH INVESTOR RELATIONS...

Please send your questions to:
201 W. North River Drive
Spokane, WA 99201

or e-mail your questions to:
investorrelations@redlion.com

Exhibit 31.1

RED LION HOTELS CORPORATION

CERTIFICATION PURSUANT TO EXCHANGE ACT RULE 13a-14(a)

I, Arthur M. Coffey, President and Chief Executive Officer of Red Lion Hotels Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Red Lion Hotels Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-25(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2006

/s/ARTHUR M. COFFEY

Arthur M. Coffey
President and Chief Executive Officer

Exhibit 31.2

RED LION HOTELS CORPORATION

CERTIFICATION PURSUANT TO EXCHANGE ACT RULE 13a-14(a)

I, Anupam Narayan, Executive Vice President, Chief Investment Officer and Chief Financial Officer of Red Lion Hotels Corporation certify that:

1. I have reviewed this quarterly report on Form 10-Q of Red Lion Hotels Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-25(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2006

/s/ ANUPAM NARAYAN

*Anupam Narayan
Executive Vice President, Chief Investment Officer
and Chief Financial Officer*

Exhibit 32.1

RED LION HOTELS CORPORATION

CERTIFICATION PURSUANT TO EXCHANGE ACT RULE 13a-14(b)

In connection with the quarterly report of Red Lion Hotels Corporation (the "Company") on Form 10-Q for the period ended June 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Arthur M. Coffey, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

August 14, 2006

/s/ ARTHUR M. COFFEY

Arthur M. Coffey
President and Chief Executive Officer

Exhibit 32.2

RED LION HOTELS CORPORATION

CERTIFICATION PURSUANT TO EXCHANGE ACT RULE 13a-14(b)

In connection with the quarterly report of Red Lion Hotels Corporation (the "Company") on Form 10-Q for the period ended June 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Anupam Narayan, Executive Vice President, Chief Investment Officer and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

August 14, 2006

/s/ ANUPAM NARAYAN

Anupam Narayan
Executive Vice President, Chief Investment Officer
and Chief Financial Officer