U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 1998
OR

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

For the transition period to

Commission file number 001-13957

CAVANAUGHS HOSPITALITY CORPORATION

(Exact name of registrant as specified in its charter)

Washington	91-1032187
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

201 W. North River Drive, Suite 100, Spokane, WA 99201
(Address of principal executive office)

(509) 459-6100
(Issuer's telephone number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 X No

As of October 31, 1998, there were 12,648,937 shares of the Registrant's common stock outstanding.

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CAVANAUGHS HOSPITALITY CORPORATION

Form 10-Q
For the Quarter Ended September 30, 1998

INDEX

Part I - Financial Information

Item 1 - Financial Statements:

- Consolidated Balance Sheets -- December 31, 1997 and September 30, 1998

- Consolidated Statements of Income and Comprehensive Income -- Three and Nine Months Ended September 30, 1997 and 1998

- Consolidated Statements of Cash Flows -- Nine Months Ended September 30, 1997 and 1998

- Notes to Consolidated Financial Statements

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

PART II - Other Information

Item 1 - Legal Proceedings

Item 2 - Changes in Securities and Use of Proceeds

Item 6 - Exhibits and Reports on Form 8-K

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ITEM 1. FINANCIAL STATEMENTS

CAVANAUGHS HOSPITALITY CORPORATION
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
December 31, 1997 and September 30, 1998
(in thousands, except share data)

	December 31, 1997	September 30, 1998
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,955	$ 6,721
Accounts receivable	2,785	6,365
Inventories	427	753
Prepaid expenses and deposits	1,100	418
Total current assets	9,267	14,257
Property and equipment, net	112,234	214,576
Other assets, net	3,616	5,017
Total assets	$125,117	$233,850
LIABILITIES AND STOCKHOLDERS' AND PARTNERS' EQUITY		
Current liabilities:		
Payable to affiliate	$ 1,133	
Note payable	1,075	$ 108
Accounts payable	3,234	5,383
Accrued payroll and related benefits	983	1,956
Accrued interest payable	689	375
Other accrued expenses	2,882	5,915
Long-term debt, due within one year	3,590	1,271
Capital lease obligations, due within one year	502	578
Total current liabilities	14,088	15,586
Long-term debt, due after one year	94,419	113,502
Capital lease obligations, due after one year	2,139	1,910
Deferred income taxes	5,415	5,415
Minority interest in partnerships	524	4,421
Total liabilities	116,585	140,834
Commitments and contingencies		

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CAVANAUGHS HOSPITALITY CORPORATION
CONSOLIDATED BALANCE SHEETS (UNAUDITED), CONTINUED
December 31, 1997 and September 30, 1998
(in thousands, except share data)

	December 31, 1997	September 30, 1998
Stockholders' and partners' equity:		
Preferred stock - 5,000,000 shares authorized, $0.01 par value, -0- shares issued and outstanding	$ --	$ --
Common stock - 50,000,000 shares authorized, $0.01 par value; 7,084,254 and 12,695,337 shares issued and outstanding	71	127
Partners' deficit	(879)	
Additional paid-in capital	3,935	81,328
Retained earnings	5,405	11,561
Total stockholders' and partners' equity	8,532	93,016
Total liabilities and stockholders' and partners' equity	$125,117	$233,850

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

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CAVANAUGHS HOSPITALITY CORPORATION
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(UNAUDITED)
for the three and nine months ended September 30, 1997 and 1998
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1998	1997	1998
Revenues:				
Hotels and restaurants				
Rooms	$ 8,426	$16,813	$19,845	$35,365
Food and beverage	3,824	6,778	10,302	16,636
Other	718	1,289	2,025	3,036
Total hotels and restaurants	12,968	24,880	32,172	55,037
Entertainment, management and services	1,015	907	2,824	2,933
Rental operations	1,579	1,801	4,799	5,315
Total revenues	15,562	27,588	39,795	63,285
Operating expenses:				
Direct:				
Hotels and restaurants:				
Rooms	1,983	4,035	5,176	9,080
Food and beverage	3,173	5,412	8,493	13,573
Other	329	590	803	1,366
Total hotels and restaurants	5,485	10,037	14,472	24,019
Entertainment, management and services	544	640	1,622	2,055
Rental operations	359	439	1,097	1,171
Total direct expenses	6,388	11,116	17,191	27,245
Undistributed operating expenses:				
Selling, general and administrative	2,102	3,427	5,904	8,494
Property operating costs	1,290	3,001	3,845	6,977
Depreciation and amortization	1,309	1,621	3,604	4,357
Total undistributed operating expenses	4,701	8,049	13,353	19,828
Total expenses	11,089	19,165	30,544	47,073
Operating income	4,473	8,423	9,251	16,212
Other income (expense):				
Interest expense, net of amounts capitalized	(2,190)	(1,936)	(6,791)	(5,990)
Interest income	106	75	276	271
Other income		6	346	5
Minority interest in partnerships	(28)	(203)	12	(247)

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CAVANAUGHS HOSPITALITY CORPORATION
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(UNAUDITED), CONTINUED
for the three and nine months ended September 30, 1997 and 1998
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1998	1997	1998
Income before income taxes and extraordinary item	$ 2,361	$ 6,365	$ 3,094	$10,251
Income tax provision	803	2,228	1,055	3,549
Income before extraordinary item	1,558	4,137	2,039	6,702
Extraordinary item -- write off of deferred loan fees, net of tax		(16)		(546)
Net and comprehensive income	$ 1,558	$ 4,121	$ 2,039	$ 6,156
Income per share before extraordinary item	$ 0.22	$ 0.32	$ 0.29	$ 0.61
Net income per share:				
Basic	$ 0.22	$ 0.32	$ 0.29	$ 0.56
Diluted	$ 0.22	$ 0.32	$ 0.29	$ 0.56
Weighted-average shares outstanding:				
Basic	7,084	12,983	7,084	10,907
Diluted	7,084	13,379	7,084	11,201

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

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CAVANAUGHS HOSPITALITY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

for the nine months ended June 30, 1997 and 1998
(in thousands)

	1997	1998
Operating activities:		
Net income	$ 2,039	$ 6,156
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,604	4,357
Minority interest in partnerships	(12)	247
Stock issued for directors' compensation		9
Extraordinary item -- write off of deferred loan fees		546
Change in:		
Accounts receivable	(660)	(3,580)
Inventories	8	(326)
Prepaid expenses and deposits	762	682
Other assets		(388)
Accounts payable	(533)	2,149
Accrued payroll and related benefits	180	973
Accrued interest payable	14	(314)
Other accrued expenses	669	3,315
Net cash provided by operating activities	6,071	13,826
Investing activities:		
Additions to property and equipment	(4,957)	(4,917)
Proceeds from disposition of property and equipment	703	
Acquisitions of property and equipment		(86,132)
Issuance of note receivable		(17,112)
Payments on note receivable		17,112
Purchase of other assets		(300)
Other, net	(170)	(475)
Net cash used in investing activities	(4,424)	(91,824)

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CAVANAUGHS HOSPITALITY CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED), CONTINUED for the nine months ended September 30, 1997 and 1998

(in thousands)

	1997	1998
Financing activities:		
Distributions to stockholders and partners	$ (688)	$ (27)
Dividends to stockholders	(248)	
Proceeds from issuance of common stock under employee stock purchase plan		242
Net proceeds from initial public offering of common stock		81,468
Purchase and retirement of common stock	(163)	(3,391)
Proceeds from note payable		1,925
Repayment of note payable		(3,054)
Proceeds from long-term debt	3,395	75,483
Repayment of long-term debt	(2,383)	(70,124)
Advances from (payments to) affiliates	1,624	(1,133)
Principal payments on capital lease obligations	(64)	(415)
Additions to deferred financing costs		(1,210)
Net cash provided by financing activities	1,473	79,764
Change in cash and cash equivalents:		
Net increase in cash and cash equivalents	3,120	1,766
Cash and cash equivalents at beginning of period	5,703	4,955
Cash and cash equivalents at end of period	$ 8,823	$ 6,721
Supplemental disclosure of cash flow information:		
Cash paid during period for:		
Interest (net of amount capitalized)	$ 6,791	$ 5,990
Income taxes	1,325	1,213
Noncash investing and financing activities:		
Acquisition of equipment under capital leases		262
Issuance of operating partnership units for property acquisitions		4,548
Acquisition of property through assumption of debt and capital leases		11,404
Acquisition of property through issuance of note payable		162

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

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CAVANAUGHS HOSPITALITY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. QUARTERLY INFORMATION:

The unaudited consolidated financial statements included herein have been prepared by Cavanaughs Hospitality Corporation (the Company) 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, 1997 has been derived 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 financial statements and the notes thereto for the period ended December 31, 1997 previously filed with the SEC on Form S-1 which was effective in April 1998.

In the opinion of management, these unaudited consolidated financial statements contain all of the adjustments normal and recurring in nature, necessary to present fairly the consolidated financial position of the Company at September 30, 1998 and the consolidated results of operations and cash flows for the three and nine months ended September 30, 1998 and 1997. The results of operations for the periods presented may not be indicative of those which may be expected for a full year.

2. ORGANIZATION:

At September 30, 1997, the Company controlled and operated
(through ownership or lease with purchase option agreements)
seven hotel properties. At September 30, 1998, the Company controlled and operated 18 hotel properties in Seattle, Spokane, Yakima and Kennewick, Washington; Post Falls, Boise, Twin Falls, Pocatello and Idaho Falls, Idaho; Kalispell and Helena, Montana; Hillsboro, Oregon; and Salt Lake City, Utah under its Cavanaughs(TM) brand. Additionally, the Company provides computerized ticketing for entertainment events and arranges Broadway and other entertainment event productions. The Company also leases retail and office space in buildings owned by the Company and manages residential and commercial properties in Washington, Idaho and Montana. The Company's operations are classified into three divisions: (1) hotels and restaurants,
(2) entertainment, management and services, and (3) rental operations.

Prior to January 1, 1998, the financial statements included the combined operations of Cavanaughs Hospitality Corporation (including its merged and predecessor entities) and G&B: Lincoln Building Limited Partnership (Lincoln Building). On January 1, 1998, the Company issued common stock and units in the Cavanaughs Hospitality Limited Partnership (OP Units) to the partners of

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2. ORGANIZATION, CONTINUED:

Lincoln Building in exchange for the assets and liabilities of Lincoln Building. Therefore, consolidated financial statements of the Company are presented at September 30, 1998.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

New Accounting Pronouncements

In June 1997, SFAS No. 130, "Reporting Comprehensive Income", was issued. This Statement requires that comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. This Statement does not require a specific format for the financial statement, but requires that an enterprise display net income as a component of comprehensive income in the financial statements. Comprehensive income is defined as the change in equity of a business enterprise arising from non-owner sources. The classifications of comprehensive income under current accounting standards include foreign currency items, minimum pension liability adjustments, and unrealized gains and losses on certain investments in debt and equity securities. The implementation of this standard on January 1, 1998 did not have a material impact on the presentation of the Company's consolidated financial statements.

In June 1997, the Financial Accounting Standards Board issued SFAS No. 131, "Disclosures about Segments for an Enterprise and Related Information". This Statement will change the way public companies report information about segments of their business in their annual financial statements and requires them to report selected segment information in their quarterly reports issued to shareholders. It also requires entity-wide disclosures about the products and services an entity provides, and its major customers. The implementation of SFAS No. 131 on January 1, 1998 did not have a material impact on the consolidated financial statements.

In April 1998, Statement of Position (SOP) 98-5, "Reporting on the Costs of Start-up Activities" was issued. The SOP requires that all costs of start-up activities and organization costs be expensed as incurred. The Company is required to implement the SOP on January 1, 1999 and report the change as a cumulative effect of an accounting change in the statement of income. The Company has not determined the effect of adopting this new standard.

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4. INITIAL PUBLIC OFFERING:

In April 1998, the Company completed an initial public offering (Offering) of 5,951,250 shares of common stock. The proceeds, after deducting the underwriting discount and before offering expenses, of approximately $83.0 million were used to repay certain debt and acquire hotel properties.

5. 1998 ACQUISITIONS:

In January 1998, the Company entered into a lease with purchase option to acquire certain assets of a hotel in Spokane, Washington for approximately $11.5 million and acquired certain assets of a hotel in Idaho Falls, Idaho for approximately $3.8 million. In April 1998, the purchase option on the Spokane, Washington hotel was exercised. In February 1998, the Company acquired certain assets of a hotel in Post Falls, Idaho for approximately $9.5 million. In April 1998, the Company acquired certain assets of a hotel in Hillsboro, Oregon for approximately $5.5 million. In June 1998, the Company acquired certain assets of a hotel in Kalispell, Montana for approximately $9.6 million. In June 1998, the Company acquired, through a management and purchase agreement, The Olympus Hotel and Conference Center, located in Salt Lake City, Utah for a total price of $31.6 million. A Current Report on Form 8-K/A was filed with the SEC on August 13, 1998, which included the pro forma disclosures of the acquisition. On July 31, 1998, the Company acquired four additional hotels for $30.3 million from one seller. The hotels are located in Boise, Twin Falls and Pocatello, Idaho and Helena, Montana. A Current Report on Form 8-K/A was filed with the SEC on October 14, 1998, which included the pro forma disclosures of the acquisition.

All of these acquisitions have been accounted for using the purchase method of accounting. Accordingly, the results of operations of these hotels have been included in the consolidated statement of operations since their respective dates of acquisition. The excess purchase price of the assets over their historical cost bases has been allocated to property and equipment and is being depreciated over the estimated remaining useful life of the related assets. Pro forma disclosures reflecting these acquisitions have been included in the Company's Form S-1 and Forms 8-K/A as previously filed with the SEC.

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6. LONG-TERM DEBT AND LINE OF CREDIT:

The Company used the net proceeds of the initial public offering to repay $68.6 million of debt. In connection with the debt repayment, approximately $546,000 of deferred loan fees and prepayment penalties, net of income taxes, were charged to operations during the second and third quarters of 1998 and are presented as an extraordinary item.

In May 1998, the Company obtained an $80 million revolving secured credit facility with a bank (Revolving Credit Facility). The credit facility requires that the Company maintain certain financial ratios and minimum levels of cash flows. Any outstanding borrowings bear interest based on prime rate or LIBOR. The credit facility matures in five years. The credit facility requires the payment of a 1% fee plus an annual standby fee of 0.25%. At September 30, 1998, $68,550,000 is outstanding under the credit facility. The Company was in compliance with all required covenants at September 30, 1998.

7. CONTINGENCY:

In 1994, the Company was sued by the contractor who constructed one of the Company's hotel properties asserting lack of payment of cost overruns. The Company filed a counter claim for the recovery of various damages. The Company obtained summary judgment for most of the claims. After the Company obtained summary judgment for most claims, the litigation was terminated on October 1, 1998 by a complete settlement of all claims within the amount of funds originally withheld from payment to the contractor until completion of the contract.

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8. EARNINGS PER SHARE:

The following table presents a reconciliation of the numerators and denominators used in the basic and diluted EPS computations (in thousands, except per share amounts). Also shown is the number of dilutive securities (stock options) that would have been included in the diluted EPS computation if they were not anti-dilutive.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1998	1997	1998
Numerator:				
Income before extra-ordinary item	$ 1,558	$ 4,137	$ 2,039	$ 6,702
Extraordinary item	--	(16)	--	(546)
Net income after extra-ordinary item - basic	1,558	4,121	2,039	6,156
Income effect of dilutive OP Units	--	126	--	180
Net income after extra-ordinary item - diluted	$ 1,558	$ 4,247	$ 2,039	$ 6,336
Denominator:				
Weighted-average shares outstanding - basic	7,084	12,983	7,084	10,907
Effect of dilutive OP Units	--	396	--	294
Effect of dilutive common stock options	--	--(A)	--	--(A)
Weighted-average shares outstanding - diluted	7,084	13,379	7,084	11,201
Earnings Per Share - basic and diluted				
Income per share before extraordinary item	$ 0.22	$ 0.32	$ 0.29	$ 0.61
Extraordinary item	--	--	--	(0.05)
Net income per share - basic and diluted	$ 0.22	$ 0.32	$ 0.29	$ 0.56

(A) At September 30, 1998, 645,028 stock options are outstanding. The effects of the shares which would be issued upon the exercise of these options have been excluded from the calculation of diluted earnings per share because they are anti-dilutive.

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CAVANAUGHS HOSPITALITY CORPORATION

Part I - Financial Information

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

General

The following discussion and analysis addresses the results of operations for the Company for the three and nine months ended September 30, 1997 and 1998. The following should be read in conjunction with the unaudited Consolidated Financial Statements and the notes thereto. In addition to historical information, the following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. The Company's actual results could differ significantly from those anticipated in these forward-looking statements as a result of certain factors, including those discussed in "Risk Factors" and elsewhere in the Form S-1 filed originally by the Company in April 1998 (File No. 333-44491).

The Company's revenues are derived primarily from the Hotels and reflect revenue from rooms, food and beverage and other sources, including telephone, guest services, banquet room rentals, gift shops and other amenities. Hotel revenues accounted for 87.0% of total revenue in the nine months ended September 30, 1998 and increased 71.1% from $32.2 million in 1997 to $55.0 million in 1998. This increase was primarily the result of the addition of eleven hotels in the period and an increase in revenue per available room (REVPAR) from the hotels owned for greater than one year ("Comparable Hotels") from $48.35 in 1997 to $53.06 in 1998, a 9.7% increase. The balance of the Company's revenues are derived from its entertainment, management and services and rental operations divisions. These revenues are generated from ticket distribution handling fees, real estate management fees, sales commissions and rents. In the nine months ended September 30, 1998, entertainment, management and services accounted for 4.6% of total revenues and rental operations accounted for 8.4% of total revenues. These two divisions are expected to represent a smaller percent of total revenues in the future as the Company continues to pursue its hotel growth strategy.

As is typical in the hospitality industry, REVPAR, average daily rates (ADR) and occupancy levels are important performance measures. The Company's operating strategy is focused on enhancing revenue and operating margins by increasing REVPAR, ADR, occupancy and operating efficiencies of the Hotels. These performance measures are impacted by a variety of factors, including national, regional and local economic conditions, degree of competition with other hotels in their respective market areas and, in the case of occupancy levels, changes in travel patterns.

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The following table sets forth selected items from the consolidated statements of income and comprehensive income as a percent of total revenues and certain other selected data:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1998	1997	1998
Revenues:				
Hotels and restaurants	83.3%	90.2%	80.8%	87.0%
Entertainment, management and services	6.5	3.3	7.1	4.6
Rental operations	10.2	6.5	12.1	8.4
Total revenues	100.0%	100.0%	100.0%	100.0%
Direct operating expenses	41.1%	40.3%	43.2%	43.1%
Undistributed operating expenses:				
Selling, general and administrative	13.5	12.4	14.8	13.4
Property operating costs	8.3	10.9	9.7	11.0
Depreciation and amortization	8.4	5.9	9.1	6.9
Total undistributed operating expenses	30.2	29.2	33.6	31.3
Operating income	28.7	30.5	23.2	25.6
Interest expense, net	(14.1)	(7.0)	(17.0)	(9.5)
Other income (expense)	0.6	(0.4)	1.6	0.1
Income before income taxes and extra-ordinary item	15.2	23.1	7.8	16.2
Income tax provision	5.2	8.1	2.7	5.6
Income before extraordinary item	10.0%	15.0%	5.1%	10.6%
Comparable Hotels:				
REVPAR	$60.73	$60.48	$48.35	$53.06
ADR	78.85	87.36	75.26	82.28
Occupancy	77.0%	69.2%	64.2%	64.5%

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RESULTS OF OPERATIONS

COMPARISON OF NINE MONTHS ENDED SEPTEMBER 30, 1998 TO NINE MONTHS ENDED
SEPTEMBER 30, 1997

Total revenues increased $23.5 million, or 59.0%, from $39.8 million in 1997 to $63.3 million in 1998. This increase is attributed primarily to revenue generated from increases in total rooms occupied and REVPAR and the addition of eleven hotels.

Total hotel and restaurant revenues increased $22.9 million, or 71.1%, from $32.2 million in 1997 to $55.0 million in 1998. ADR for the seven Comparable Hotels increased $7.02, or 9.3%, from $75.26 in 1997 to $82.28 in 1998. Available room nights increased 86.5% in 1998. REVPAR for the Comparable Hotels increased $4.71, or 9.7% from $48.35 in 1997 to $53.06 in 1998. The results also reflect the addition of the eleven hotels acquired since October 1997 which contributed, in part, to this increase in revenues.

Entertainment, management and services revenues increased $0.1 million, or 3.9% in 1998. Management and services revenue increased from the addition of new third-party management contracts.

Rental income increased $0.5 million, or 10.7%, from $4.8 million in 1997 to $5.3 million in 1998. This increase is due primarily to the addition of leased space in the Crescent Court property to The Travelers company which commenced occupancy in January 1998.

Direct operating expenses increased $10.0 million, or 58.5%, from $17.2 million in 1997 to $27.2 million in 1998, primarily due to the increase in the number of hotel guests served and the addition of eleven hotels. This represents a decrease in direct operating expenses as a percentage of total revenues from 43.2% in 1997 to 43.1% in 1998.

Total undistributed operating expenses increased $6.5 million, or 48.5%, from $13.4 million in 1997 to $19.8 million in 1998. Total undistributed operating expenses include selling, general and administrative expenses, which increased 43.9% from $5.9 million in 1997 to $8.5 million in 1998, and depreciation and amortization, which increased 20.9% from $3.6 million in 1997 to $4.4 million in 1998. Total undistributed operating expenses as a percentage of total revenues decreased 2.3% from 33.6% in 1997 to 31.3% in 1998. The decrease in undistributed operating expenses as a percentage of total revenues is primarily attributed to the increased REVPAR and the Company controlling sales and administrative expenses.

Operating income increased $7.0 million, or 75.2%, from $9.3 million in 1997 to $16.2 million in 1998. As a percentage of total revenues, operating income increased from 23.2% in 1997 to 25.6% in 1998. This increase is due primarily to an increase in REVPAR, the addition of eleven hotels and improvements in the undistributed operating expense margins.

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Interest expense decreased $0.8 million, or 11.8%, from $6.8 million in 1997 to $6.0 million in 1998. Interest expense declined as a result of the application of the net proceeds of the Offering to repay certain indebtedness, but is expected to increase in the future due to the funding of hotel acquisitions with additional debt.

Income tax provision increased 236.4%, from $1.1 million in 1997 to $3.5 million in 1998, due to the increase in the income before income taxes. The effective income tax rate for 1997 and 1998 was 34.0% and 34.6%, respectively.

Income before extraordinary item (noncash write off of deferred loan fees) increased $4.7 million, or 228.8%, from $2.0 million in 1997 to $6.7 million in 1998.

COMPARISON OF THREE MONTHS ENDED SEPTEMBER 30, 1998 TO THREE MONTHS ENDED SEPTEMBER 30, 1997

Total revenues increased $12.0 million, or 77.3%, from $15.6 million in 1997 to $27.6 million in 1998. This increase is attributed primarily to revenue generated from increases in total rooms occupied and REVPAR and the addition of eleven hotels.

Total hotel and restaurant revenues increased $11.9 million, or 91.9%, from $13.0 million in 1997 to $24.9 million in 1998. ADR for the Comparable Hotels increased $8.51, or 10.8%, from $78.85 in 1997 to $87.36 in 1998. REVPAR for the Comparable Hotels decreased $0.25, or
0.4% from $60.73 in 1997 to $60.48 in 1998. The results also reflect the addition of the eleven hotels acquired since October 1997 which contributed, in part, to this increase in revenues.

Entertainment, management and services revenues decreased $0.1 million, or 10.6% in 1998. Management and services revenue decreased because fewer event tickets were sold in the 1998 quarter.

Rental income increased $0.2 million, or 14.1%, from $1.6 million in 1997 to $1.8 million in 1998. This increase is due primarily to the addition of leased space in the Crescent Court property to The Travelers company which commenced occupancy in January 1998.

Direct operating expenses increased $4.7 million, or 74.0%, from $6.4 million in 1997 to $11.1 million in 1998, primarily due to the increase in the number of hotel guests served and the addition of eleven hotels. This represents a decrease in direct operating expenses as a percentage of total revenues from 41.1% in 1997 to 40.3% in 1998.

Total undistributed operating expenses increased $3.3 million, or 71.2%, from $4.7 million in 1997 to $8.0 million in 1998. Total undistributed operating expenses include selling, general and administrative expenses, which increased 63.0% from $2.1 million in 1997 to $3.4 million in 1998, and depreciation and amortization, which increased 23.9% from $1.3 million in 1997 to $1.6 million in 1998. Total undistributed operating expenses as a percentage of total

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revenues decreased 1.0% from 30.2% in 1997 to 29.2% in 1998. The decrease in undistributed operating expenses as a percentage of total revenues is primarily attributed to the increased REVPAR and the Company controlling sales and administrative expenses.

Operating income increased $3.9 million, or 88.3%, from $4.5 million in 1997 to $8.4 million in 1998. As a percentage of total revenues, operating income increased from 28.7% in 1997 to 30.5% in 1998. This increase is due primarily to an increase in REVPAR, the addition of eleven hotels and improvements in the undistributed operating expense margins.

Interest expense decreased $0.3 million, or 11.6%, from $2.2 million in 1997 to $1.9 million in 1998. Interest expense declined as a result of the application of the net proceeds of the Offering to repay certain indebtedness, but is expected to increase in the future due to the funding of hotel acquisitions with additional debt.

Income tax provision increased 177.6%, from $0.8 million in 1997 to $2.2 million in 1998, due to the increase in the income before income taxes. The effective income tax rate for 1997 was 34.0% and 1998 was 35.0%.

Income before extraordinary item (noncash write off of deferred loan fees) increased $2.6 million, or 165.6%, from $1.6 in 1997 to $4.1 million in 1998.

LIQUIDITY AND CAPITAL RESOURCES

The Company's principal sources of liquidity are cash on hand, cash generated by operations and borrowings under a $80.0 million Revolving Credit Facility. Cash generated by operations in excess of operating expenses is used for capital expenditures and to reduce amounts outstanding under the Revolving Credit Facility. Hotel acquisitions, development and expansion have been and will be financed through a combination of internally generated cash, borrowing under credit facilities, and the issuance of common stock or OP Units.

The Company's short-term capital needs include food and beverage inventory, payroll and the repayment of interest expense on outstanding mortgage indebtedness. Historically, the Company has met these needs through internally generated cash.

The Company's long-term capital needs include funds for property acquisitions, scheduled debt maturities and renovations and other non-recurring capital improvements. The Company anticipates meeting its future long-term capital needs through the borrowing of additional debt financing secured by the Hotels, unsecured private or public debt offerings, additional equity offerings or the issuances of OP Units, along with cash generated from internal operations. In April 1998, the Company completed its initial public offering of 5,951,250 shares at $15.00 per share. The proceeds to the Company after deducting the underwriter's commission, but before other expenses, was $83.0 million.

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In April, the Company used the proceeds from the offering to repay approximately $68.6 million of debt, the balance was used to fund the acquisition of the fee interest in the Cavanaughs Ridpath and to acquire the Cavanaughs Hillsboro Hotel.

At September 30, 1998, the Company had $6.7 million in cash and cash equivalents, an increase of $1.8 million from $4.9 million on December 31, 1997. The Company has acquired ten hotels during the nine months ended September 30, 1998 and has expended $91.8 million for these acquisitions and capital expenditures. The Company establishes reserves for capital replacement in the amount of 4.0% of gross income to maintain the Hotels at acceptable levels. Acquired hotel properties have a separate capital budget for purchase, construction, renovation, and branding costs. Capital expenditures planned for existing Hotels in 1998 are expected to be approximately $6.0 million. Management believes the consistent renovation and upgrading of the Hotels and other properties is imperative to its long-term reputation and customer satisfaction.

To fund its acquisition program and meet its working capital needs, the Company has received an $80 million Revolving Credit Facility from U.S. Bank which was consummated on May 5, 1998. The current interest rate is 185 basis points over LIBOR. The Revolving Credit Facility has an initial term of five years and an annualized fee for the unutilized portion of the facility. The Company selects from four different interest rates when it draws funds: the lender's prime rate or one, three, or six month LIBOR plus the applicable margin of 165 to 235 basis points, depending on the ratio of EBITDA to total funded debt. The Revolving Credit Facility has covenants that allow for the Company to draw funds based on the trailing 12 months performance on a pro forma basis for both acquired and owned properties. The Revolving Credit Facility allows the Company to choose which properties are part of the collateral base and, therefore, gives the Company the ability to utilize other long-term credit facilities that may be more favorable to the Company. Funds from the Revolving Credit Facility may be used for acquisitions, renovations, construction and general corporate purposes. The Company believes the structure and availability of funds under the Revolving Credit Facility will be sufficient to meet the Company's long-term growth plans.

The Revolving Credit Facility contains various representations, warranties, covenants and events of default deemed appropriate for financing of a similar size and nature. Covenants and provisions in the definitive agreements governing the Revolving Credit Facility include, among other things, limitations on: (i) substantive changes in the Company's current business activities, (ii) liquidation, dissolution, mergers, consolidations, dispositions of material property or assets and acquisitions of property or assets of others, (iii) the creation or existence of liens on property or assets, (iv) the addition or existence of indebtedness, including guarantees and other contingent obligations, (v) loans and advances to others and investments in others, redemption of subordinated debt, (vi) amendment or modification of certain material documents or of the Articles in a manner adverse to the interests of the lenders under the Revolving

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Credit Facility, (vii) payment of dividends or distributions on the Company's capital stock, and (viii) maintenance of certain financial ratios. Each of the covenants described above will provide for certain ordinary course of business and other exceptions. If the Company breaches any of these covenants and does not obtain a waiver of that breach, the breach will constitute an event of default under the Revolving Credit Facility.

As of September 30, 1998, the Company had debt outstanding of $117.3 million consisting of primarily variable and fixed rate debt secured by individual properties. In April 1998, the Company completed its initial public offering and entered into the $80.0 million Revolving Credit Facility, which has $68.6 million outstanding at September 30, 1998 and $11.4 million available to be drawn.

On August 5, 1998, the Company authorized the repurchase of up to $10.0 million of Company stock. As of September 30, 1998, the Company had acquired 358,700 shares for $3.4 million.

The Company believes that cash generated by operations will be sufficient to fund the Company's operating strategy for the foreseeable future, and that any remaining cash generated by operations, together with capital available under the Revolving Credit Facility (subject to the terms and covenants included therein) and secured debt will be adequate to fund the Company's growth strategy in the near term. Thereafter, the Company expects that future capital needs, including property acquisitions, will be met through a combination of net cash provided by operations, borrowings and additional issuances of Common Stock or OP Units.

SEASONALITY

The lodging industry is affected by normally recurring seasonal patterns. At most Hotels, demand is higher in the late spring through and early fall (May through October) than during the balance of the year. Demand also changes on different days of the week, with Sunday generally having the lowest occupancy. Accordingly, the Company's revenue, operating profit and cash flow are lower during the first and fourth calendar quarters and higher during the second and third calendar quarters.

INFLATION

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

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YEAR 2000 ASSESSMENT

BACKGROUND: The "Year 2000 problem" arose because many existing computer programs use only the last two digits to refer to a year. Therefore, these computer programs do not properly recognize a year that begins with "20" instead of the familiar "19". If not corrected, many computer applications could fail or create erroneous results. The extent of the potential impact of the Year 2000 problem is not yet known, and if not timely corrected, could affect the global economy.

State of Readiness:

IT SYSTEMS: The Company has completed 100% of the assessment of all of its information technology ("IT") hardware and software systems for Year 2000 issues. Of the critical hardware and software applications evaluated (hardware and software applications for reservation, accounting, payroll and billing functions), only the payroll application has been determined to be non-compliant with Year 2000 functionality. The Company had anticipated retiring its non-compliant payroll application independent of any Year 2000 issues and will complete replacement of it with a Year 2000 compliant system by July of 1999. Individual older personal computers which are scheduled for replacement in ordinary course of upgrades are not included in these percentages. The Company relies upon certifications from the manufacturers, developers and authorized vendors of the specific hardware and software applications for evaluation of compliance with Year 2000 functionality.

EMBEDDED SYSTEMS: The Company has completed approximately 95% of the assessment of its critical Embedded Technology systems, which are those systems in properties owned or leased by the Company in which a microprocessor is embedded in equipment controlling building environment, power, lighting, transportation, security, and fire safety. The Company anticipates completion of evaluation of all embedded systems by the end of 1998. The evaluation completed to date has not revealed any critical Embedded System which is not (or will not become so with minor software modifications) compliant with Year 2000 functionality. Embedded Systems in properties for which the Company provides management services but which are not owned or leased by the Company are not included in these percentages. The Company relies upon certifications from the manufacturers, developers and authorized vendors of the specific components containing Embedded Systems for evaluation of compliance with Year 2000 functionality.

THIRD PARTY SERVICES: The Company will commence its evaluation of the assessment of services provided by third parties with which the Company has a material relationship in 1999 and anticipates completing that evaluation by July of 1999. These material Third Party Services include the private companies and municipalities supplying all utilities and communications to the Company. Evaluation will be by means of review of representations made by the third parties or of

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responses to written questionnaires by the Company to the third parties. The Company does not anticipate that its exposure to a failure of Third Party Services to be Year 2000 compliant will differ from the exposure of communities at large to such failure.

COST TO ADDRESS YEAR 2000 ISSUES: The Company's projection of capital expenditures and other financial items related to remediation and testing of Year 2000 issues is necessarily an estimate because it anticipates how remediation and testing will proceed in the future. This assessment also cannot include property specific issues for properties which may be acquired in the future and have not as yet been evaluated. Nevertheless, based on the evaluation completed to date, the costs to the Company of replacing or modifying IT and Embedded Systems to bring them to Year 2000 compliance does not appear to be material. The preceding statement does not include the cost of replacement and modification of systems for which the replacement or modification was not accelerated by Year 2000 issues, such as the Company's payroll system, the costs for which are included in the normal capital and operating budgets of the Company.

RISKS OF YEAR 2000 ISSUES: The only certainty about the Year 2000 problem is the difficulty of predicting with certainty what will happen. The Company cannot guarantee that its efforts will prevent all consequences. The failure of vendors, suppliers, customers, transportation systems and utilities systems to anticipate and solve Year 2000 issues could impact the Company and each community in which it operates. The Company has not identified a material effect from Year 2000 issues on the Company's results of operations, liquidity, and financial condition. The worst case effects would appear to be analogous to a natural disaster such as a storm or flood, with the primary effect being a temporary interruption of utilities, transportation and communication services.

CONTINGENCY PLANS: Each property owned and/or managed by the Company has a contingency plan in place for interruption of utility and communication services, which includes the alternatives for providing services to guests and tenants. The Company anticipates completing an update of the operational contingency plans for each property upon completion of review of responses from providers of all material Third Party Services.

NEW ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 131, Disclosures about Segments for an Enterprise and Related Information ("SFAS 131"). This Statement requires public companies to report selected segment information in their quarterly and annual reports issued to shareholders, and entity wide disclosures about products and services and major customers. The statement was adopted by the Company on January 1, 1998.

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In June 1997, the FASB issued SFAS No. 130, Reporting Comprehensive Income. This Statement requires that comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. Comprehensive income is defined as the change in equity of a business enterprise arising from non-owner sources. This Statement was adopted by the Company on January 1, 1998.

In April 1998, Statement of Position (SOP) 98-5, "Reporting on the Costs of Start-up Activities" was issued. The SOP requires that all costs of start-up activities and organization costs be expensed as incurred. The Company is required to implement the SOP on January 1, 1999 and report the change as a cumulative effect of an accounting change in the statement of income. The Company has not determined the effect of adopting this new standard.

Part II - Other Information

ITEM 1. LEGAL PROCEEDINGS

In 1994, the Company was sued by the contractor who constructed one of the Company's hotel properties asserting lack of payment of cost overruns. The Company filed a counter claim for the recovery of various damages. The Company obtained summary judgment for most of the claims. After the Company obtained summary judgement for most claims, the litigation was terminated on October 1, 1998 by a complete settlement of all claims within the amount of funds originally withheld from payment to the contractor until completion of the contract.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

The Company's Registration Statement for its initial public offering of securities (File No. 333-44491) became effective on April 3, 1998.

Of the total net proceeds to the Company from the Offering which are estimated to be in the amount of $81.4 million, the following amounts were used from the date of the Offering through the date of this report:

Category of Use	Amount of Use
Purchases of real estate	$12.8 million
Repayment of indebtedness	68.6 million

None of the net proceeds to the Company of the offering was paid to directors, officers, ten percent shareholders or affiliates of the Company.

ITEMS 3, 4 and 5 of Part II are omitted from this report as they are not applicable.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

27.1 Financial Data Schedule

(b) Reports on Form 8-K

On August 14, 1998, the Company filed a Current Report on Form 8-K relating to the purchase of four hotels: Boise Park Suites, Best Western Colonial Park, Best Western Canyon Springs, Quality Inn and associated restaurants, rental space and facilities from Sunstone Hotels, L.L.C. On October 14, 1998, the Company filed an Amendment No. 1 to said Report on Form 8-K/A to include the audited financial statements of the acquired hotels and properties.

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CAVANAUGHS HOSPITALITY CORPORATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following person on behalf of the registrant and in the capacities stated and on the date indicated.

CAVANAUGHS HOSPITALITY CORPORATION
(Registrant)

Date: November 13, 1998 *By: /s/ Arthur M. Coffey*

Arthur M. Coffey, Executive Vice President and Chief Financial Officer

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ARTICLE 5
MULTIPLIER: 1000

PERIOD TYPE	9 MOS
FISCAL YEAR END	DEC 31 1998
PERIOD END	SEP 30 1998
CASH	6721
SECURITIES	0
RECEIVABLES	6365
ALLOWANCES	0
INVENTORY	753
CURRENT ASSETS	14257
PP&E	253234
DEPRECIATION	(38658)
TOTAL ASSETS	233850
CURRENT LIABILITIES	15586
BONDS	0
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	127
OTHER SE	92889
TOTAL LIABILITY AND EQUITY	233850
SALES	63285
TOTAL REVENUES	63285
CGS	27245
TOTAL COSTS	47043
OTHER EXPENSES	0
LOSS PROVISION	0
INTEREST EXPENSE	5990
INCOME PRETAX	10251
INCOME TAX	3549
INCOME CONTINUING	6702
DISCONTINUED	0
EXTRAORDINARY	546
CHANGES	0
NET INCOME	6156
EPS PRIMARY	.56
EPS DILUTED	.56

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