

FIVE STAR QUALITY CARE INC  
Form 10-Q/A  
April 16, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC 20549

**FORM 10-Q/A**

Amendment No. 1

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

For the quarterly period ended June 30, 2013

or

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

Commission File Number 001-16817

**FIVE STAR QUALITY CARE, INC.**

(Exact Name of Registrant as Specified in Its Charter)

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**Maryland**

(State or Other Jurisdiction of Incorporation or Organization)

**04-3516029**

(IRS Employer Identification No.)

**400 Centre Street, Newton, Massachusetts 02458**

(Address of Principal Executive Offices) (Zip Code)

(Registrant's Telephone Number, Including Area Code): **617-796-8387**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

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

Number of registrant's shares of common stock, \$.01 par value, outstanding as of July 30, 2013: 48,271,522.

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JUNE 30, 2013

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*As used herein the terms “we”, “us” or “our” mean Five Star Quality Care, Inc. and its consolidated subsidiaries unless the context otherwise requires.*

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**EXPLANATORY NOTE**

**(dollars in thousands)**

We are filing this Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, or this Amended Quarterly Report, to amend and restate financial statements and other financial information in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, or our Quarterly Report, which was filed with the Securities and Exchange Commission, or the SEC, on July 31, 2013.

As more fully described in Note 12 to the Notes to our Condensed Consolidated Financial Statements included in Item 1 of this Amended Quarterly Report, subsequent to the filing of our Quarterly Report our management and the Audit Committee of our Board of Directors, or our Audit Committee, concluded that our consolidated financial statements for the years ended December 31, 2012 and 2011 contained within our Annual Report on Form 10-K for the year ended December 31, 2012, or our 2012 Annual Report, and our condensed consolidated financial statements for the quarters ended March 31, 2013 and June 30, 2013 contained within our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 and our Quarterly Report, respectively, should be restated, and that those financial statements previously filed with the SEC should no longer be relied upon. We are restating our condensed consolidated financial statements for the three and six months ended June 30, 2013 and 2012 contained within this Amended Quarterly Report to correct certain errors in the accounting for income taxes and other errors. Specifically, the accounting for income tax errors relate to, among other things, the measurement of deferred tax assets for net operating losses and tax credits and the measurement of deferred tax assets and liabilities for temporary differences related to fixed assets, intangible assets and investments. In addition, as part of the restatement we have corrected certain other errors related to insurance receivables, security deposits, accrual of fixed asset additions, classification of senior living operating expenses and certain other immaterial items. The net impact of correcting the errors resulted in an increase to our shareholders' equity of \$7,031 and \$6,749 at June 30, 2013 and December 31, 2012, respectively, a decrease to net income of \$27 and an increase to net income of \$178 for the three and six months ended June 30, 2013, respectively, and an increase to net income of \$272 and \$375 for the three and six months ended June 30, 2012, respectively. We corrected the presentation and disclosure of our consolidated statements of cash flows to separately identify the net cash flows from discontinued operations, by category and in total and reflect the correction of other errors in the separate disclosures of cash flows for continuing operations and discontinued operations. These corrections increased cash provided by operating activities by \$1,602 and \$1,050 for the six months ended June 30, 2013 and 2012, respectively. We have also corrected the footnote presentation of the classification of \$11,656 and \$11,550 as of June 30, 2013 and December 31, 2012, respectively, of our available for sale debt securities from Level 1 assets to Level 2 assets as defined in the fair value hierarchy and corrected the disclosure of the fair value of our mortgage notes payable which increased \$9,469 and \$9,947 as of June 30, 2013 and December 31, 2012, respectively.

In the third quarter of 2013, in connection with entering into a purchase agreement with Senior Housing Properties Trust and certain unrelated parties, we reclassified our rehabilitation hospital business as discontinued operations and our rehabilitation hospital business is retrospectively presented as discontinued operations throughout this Amended Quarterly Report. Please see Note 12 to the Notes to our Condensed Consolidated Financial Statements included in Item 1 of this Amended Quarterly Report for more information regarding the effect of the retrospective adjustments to reflect discontinued operations and the correction of errors for the three and six months ended June 30, 2013 and 2012.

As a result of the errors described above, we determined that our disclosure controls and procedures were not effective as of June 30, 2013. In addition, we reassessed the effectiveness of our internal control over financial reporting as of December 31, 2012 and determined that we had material weaknesses in our internal controls over accounting for income taxes, that we lacked sufficient personnel with requisite technical accounting competencies and that we had an insufficient level of oversight in the financial statement close process. As a result, we concluded that our internal control over financial reporting was ineffective at December 31, 2012. Those material weaknesses continued to exist as of June 30, 2013.

*Amendments to our Quarterly Report included in this Amended Quarterly Report*

The following sections of our Quarterly Report are amended and being filed in their entirety in this Amended Quarterly Report:

- Part I, Item 1. Condensed Consolidated Financial Statements;
- Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations;
- Part I, Item 4. Controls and Procedures; and
- Part II, Item 6. Exhibits.

This Amended Quarterly Report contains only the items and exhibits to our Quarterly Report that are being amended and restated, and unaffected items are not included herein.

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## FIVE STAR QUALITY CARE, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

(unaudited)

|  | June 30, 2013<br>(Restated) | December 31, 2012<br>(Restated) |
|--|-----------------------------|---------------------------------|
| <b>ASSETS</b>  |                             |                                 |
| Current assets:  |                             |                                 |
| Cash and cash equivalents  | \$ 19,311                   | \$ 24,638                       |
| Accounts receivable, net of allowance of \$3,905 and \$2,792 at June 30, 2013 and December 31, 2012, respectively                              | 44,440                      | 39,205                          |
| Due from related persons   | 5,810                       | 6,881                           |
| Investments in available for sale securities, of which \$3,699 and \$3,684 are restricted at June 30, 2013 and December 31, 2012, respectively | 16,352                      | 12,920                          |
| Restricted cash  | 11,202                      | 6,548                           |
| Prepaid expenses and other current assets  | 28,522                      | 38,318                          |
| Assets of discontinued operations  | 20,205                      | 30,100                          |
| Total current assets   | 145,842                     | 158,610                         |
| Property and equipment, net  | 330,685                     | 337,494                         |
| Equity investment in Affiliates Insurance Company  | 5,703                       | 5,629                           |
| Restricted cash  | 11,196                      | 12,166                          |
| Restricted investments in available for sale securities  | 6,979                       | 10,580                          |
| Goodwill and other intangible assets   | 27,122                      | 27,708                          |
| Other long term assets   | 40,736                      | 40,382                          |
|  | \$ 568,263                  | \$ 592,569                      |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                             |                                 |
| Current liabilities:   |                             |                                 |
| Revolving credit facility, secured, principally by real estate   | \$                          | \$                              |
| Revolving credit facility, secured, principally by accounts receivable   |                             |                                 |
| Convertible senior notes   | 24,872                      | 24,872                          |
| Accounts payable   | 24,737                      | 38,035                          |
| Accrued expenses   | 20,754                      | 28,010                          |
| Accrued compensation and benefits  | 38,346                      | 35,302                          |
| Due to related persons   | 19,790                      | 19,484                          |
| Mortgage notes payable   | 1,125                       | 1,092                           |
| Accrued real estate taxes  | 10,200                      | 10,723                          |
| Security deposit liability   | 8,754                       | 9,057                           |

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|   |            |            |
|---|------------|------------|
| Other current liabilities   | 18,294     | 14,775     |
| Liabilities of discontinued operations, of which \$0 and \$7,547 relate to mortgage notes payable at June 30, 2013 and December 31, 2012, respectively                    | 8,255      | 16,977     |
| Total current liabilities   | 175,127    | 198,327    |
| Long term liabilities:  |            |            |
| Mortgage notes payable  | 37,050     | 37,621     |
| Continuing care contracts   | 1,681      | 1,708      |
| Accrued self-insurance obligations  | 31,786     | 34,647     |
| Other long term liabilities   | 5,775      | 6,712      |
| Total long term liabilities   | 76,292     | 80,688     |
| Commitments and contingencies   |            |            |
| Shareholders' equity:   |            |            |
| Common stock, par value \$.01; 75,000,000 shares authorized, 48,271,522 and 48,234,022 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively | 482        | 482        |
| Additional paid in capital  | 354,752    | 354,164    |
| Accumulated deficit   | (41,517)   | (44,455)   |
| Accumulated other comprehensive income  | 3,127      | 3,363      |
| Total shareholders' equity  | 316,844    | 313,554    |
|   | \$ 568,263 | \$ 592,569 |

See accompanying notes.

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## FIVE STAR QUALITY CARE, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

|  | Three months ended June 30, |            | Six months ended June 30, |            |
|--|-----------------------------|------------|---------------------------|------------|
|  | 2013                        | 2012       | 2013                      | 2012       |
|  | (Restated)                  | (Restated) | (Restated)                | (Restated) |
| <b>Revenues:</b>   |                             |            |                           |            |
| Senior living revenue  | \$ 268,827                  | \$ 269,093 | \$ 538,067                | \$ 535,898 |
| Management fee revenue   | 2,281                       | 1,302      | 4,583                     | 2,390      |
| Reimbursed costs incurred on behalf of managed communities                                 | 52,153                      | 26,098     | 104,211                   | 49,503     |
| Total revenues   | 323,261                     | 296,493    | 646,861                   | 587,791    |
| <b>Operating expenses:</b>   |                             |            |                           |            |
| Senior living wages and benefits   | 130,390                     | 130,252    | 262,817                   | 262,062    |
| Other senior living operating expenses   | 65,752                      | 63,797     | 132,090                   | 128,057    |
| Costs incurred on behalf of managed communities  | 52,153                      | 26,098     | 104,211                   | 49,503     |
| Rent expense   | 48,279                      | 47,431     | 96,292                    | 94,792     |
| General and administrative   | 15,451                      | 15,434     | 30,583                    | 30,933     |
| Depreciation and amortization  | 6,585                       | 6,203      | 12,955                    | 12,021     |
| Gain on settlement   |                             | (3,365)    |                           | (3,365)    |
| Total operating expenses   | 318,610                     | 285,850    | 638,948                   | 574,003    |
| Operating income   | 4,651                       | 10,643     | 7,913                     | 13,788     |
| Interest, dividend and other income  | 211                         | 234        | 408                       | 439        |
| Interest and other expense   | (1,355)                     | (1,605)    | (2,811)                   | (3,031)    |
| Acquisition related costs  | (41)                        |            | (41)                      |            |
| Gain on early extinguishment of debt   |                             | 45         |                           | 45         |
| Loss on sale of available for sale securities reclassified from other comprehensive income | (117)                       |            | (30)                      | (1)        |
| Income from continuing operations before income taxes and equity in earnings of            |                             |            |                           |            |
| Affiliates Insurance Company   | 3,349                       | 9,317      | 5,439                     | 11,240     |
| Provision for income taxes   | (1,131)                     | (3,817)    | (356)                     | (4,618)    |
| Equity in earnings of Affiliates Insurance Company   | 79                          | 76         | 155                       | 121        |
| Income from continuing operations  | 2,297                       | 5,576      | 5,238                     | 6,743      |
| Loss from discontinued operations  | (1,499)                     | (666)      | (2,300)                   | (1,361)    |
| Net income   | \$ 798                      | \$ 4,910   | \$ 2,938                  | \$ 5,382   |
| Weighted average shares outstanding - basic  | 48,253                      | 47,914     | 48,244                    | 47,906     |
| Weighted average shares outstanding - diluted  | 50,166                      | 49,953     | 50,157                    | 50,360     |



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|                                |    |        |    |        |    |        |         |
|--------------------------------|----|--------|----|--------|----|--------|---------|
| Basic income per share from:   |    |        |    |        |    |        |         |
| Continuing operations          | \$ | 0.05   | \$ | 0.12   | \$ | 0.11   | \$ 0.14 |
| Discontinued operations        |    | (0.03) |    | (0.02) |    | (0.05) | (0.03)  |
| Net income per share - basic   | \$ | 0.02   | \$ | 0.10   | \$ | 0.06   | \$ 0.11 |
| Diluted income per share from: |    |        |    |        |    |        |         |
| Continuing operations          | \$ | 0.05   | \$ | 0.11   | \$ | 0.11   | \$ 0.14 |
| Discontinued operations        |    | (0.03) |    | (0.01) |    | (0.05) | (0.03)  |
| Net income per share - diluted | \$ | 0.02   | \$ | 0.10   | \$ | 0.06   | \$ 0.11 |

See accompanying notes.

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FIVE STAR QUALITY CARE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

|   | <b>Three months ended June 30,</b> |                   | <b>Six months ended June 30,</b> |                   |
|---|------------------------------------|-------------------|----------------------------------|-------------------|
|   | <b>2013</b>                        | <b>2012</b>       | <b>2013</b>                      | <b>2012</b>       |
|   | <b>(Restated)</b>                  | <b>(Restated)</b> | <b>(Restated)</b>                | <b>(Restated)</b> |
| Net income  | \$ 798                             | \$ 4,910          | \$ 2,938                         | \$ 5,382          |
| Other comprehensive income  |                                    |                   |                                  |                   |
| Unrealized (loss) gain on investments in available for sale securities, net of tax                                | (233)                              | 56                | (173)                            | 168               |
| Unrealized loss on equity investment in Affiliates Insurance Company  | (73)                               | (3)               | (81)                             | (4)               |
| Realized loss on investments in available for sale securities reclassified and included in net income, net of tax | 70                                 |                   | 18                               | 1                 |
| Other comprehensive (loss) income   | (236)                              | 53                | (236)                            | 165               |
| Comprehensive income  | \$ 562                             | \$ 4,963          | \$ 2,702                         | \$ 5,547          |

See accompanying notes.

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## FIVE STAR QUALITY CARE, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

|   | Six months ended June 30, |                    |
|---|---------------------------|--------------------|
|   | 2013<br>(Restated)        | 2012<br>(Restated) |
| Cash flows from operating activities:   |                           |                    |
| Net income  | \$ 2,938                  | \$ 5,382           |
| Adjustments to reconcile net income to cash provided by operating activities: |                           |                    |
| Depreciation and amortization   | 12,955                    | 12,021             |
| Gain on early extinguishment of debt  |                           | (45)               |
| Loss from discontinued operations   | 3,902                     | 2,411              |
| Loss on sale of available for sale securities                                 | 30                        | 1                  |
| Equity in earnings of Affiliates Insurance Company                            | (155)                     | (121)              |
| Stock-based compensation  | 588                       | 579                |
| Provision for losses on receivables   | 2,740                     | 1,828              |
| Changes in assets and liabilities:  |                           |                    |
| Accounts receivable   | (7,975)                   | (1,883)            |
| Prepaid expenses and other assets   | 9,560                     | 3,443              |
| Accounts payable and accrued expenses   | (15,750)                  | 1,865              |
| Accrued compensation and benefits   | 3,044                     | 4,800              |
| Due from (to) related persons, net  | 1,377                     | (2,622)            |
| Other current and long term liabilities                                       | (1,132)                   | 775                |
| Cash provided by operating activities   | 12,122                    | 28,434             |
| Cash flows from investing activities:   |                           |                    |
| Acquisition of property and equipment   | (23,712)                  | (25,288)           |
| Payments from restricted cash and investment accounts, net                    | (3,684)                   | (3,890)            |
| Purchase of available for sale securities                                     | (5,333)                   | (4,554)            |
| Proceeds from disposition of property and equipment held for sale             | 13,334                    | 11,067             |
| Proceeds from sale of available for sale securities                           | 5,213                     | 772                |
| Cash used in investing activities   | (14,182)                  | (21,893)           |
| Cash flows from financing activities:   |                           |                    |
| Proceeds from borrowings on credit facilities                                 | 20,000                    | 47,500             |
| Repayments of borrowings on credit facilities                                 | (20,000)                  | (10,000)           |
| Repayments of borrowings on bridge loan from Senior Housing Properties Trust  |                           | (38,000)           |
| Purchase and retirement of convertible senior notes                           |                           | (12,038)           |
| Repayments of mortgage notes payable  | (538)                     | (506)              |
| Cash used in financing activities   | (538)                     | (13,044)           |
| Cash flows from discontinued operations:                                      |                           |                    |
| Net cash (used in) provided by operating activities                           | (3,822)                   | 2,125              |
| Net cash provided by (used in) investing activities                           | 8,627                     | (291)              |
| Net cash used in financing activities   | (7,534)                   | (70)               |
| Net cash (used in) provided by discontinued operations                        | (2,729)                   | 1,764              |
| Change in cash and cash equivalents during the period                         | (5,327)                   | (4,739)            |

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|  |    |        |    |        |
|--|----|--------|----|--------|
| Cash and cash equivalents at beginning of period |    | 24,638 |    | 28,374 |
| Cash and cash equivalents at end of period       | \$ | 19,311 | \$ | 23,635 |
| Supplemental cash flow information:              |    |        |    |        |
| Cash paid for interest                           | \$ | 1,788  | \$ | 2,751  |
| Cash paid for income taxes                       | \$ | 1,394  | \$ | 1,235  |

See accompanying notes.

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FIVE STAR QUALITY CARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

**Note 1. Basis of Presentation and Organization**

*General*

The accompanying condensed consolidated financial statements of Five Star Quality Care, Inc. and its subsidiaries, which we refer to as we, us or our, have been prepared without audit. Certain information and disclosures required by U.S. generally accepted accounting principles for complete financial statements have been condensed or omitted. We believe the disclosures made are adequate to make the information presented not misleading. However, the accompanying financial statements should be read in conjunction with the financial statements and notes contained in our Amendment No. 1 to our Annual Report on Form 10-K/A for the year ended December 31, 2012, or our Amended 2012 Annual Report. In the opinion of our management, all adjustments, which include only normal recurring adjustments, considered necessary for a fair presentation have been included. All material intercompany transactions and balances have been eliminated. Our operating results for interim periods are not necessarily indicative of the results that may be expected for the full year. Reclassifications have been made to the prior year's condensed consolidated financial statements to conform to the current year's presentation.

We operate senior living communities, including independent living communities, assisted living communities and skilled nursing facilities, or SNFs. As of June 30, 2013, we operated 250 senior living communities (excluding those senior living communities we have classified as discontinued operations) located in 31 states containing 29,698 living units, including 219 primarily independent and assisted living communities with 26,876 living units and 31 SNFs with 2,822 living units. As of June 30, 2013, we owned and operated 30 communities (2,946 living units), we leased and operated 181 communities (20,074 living units) and we managed 39 communities (6,678 living units). These 250 senior living communities included 10,319 independent living apartments, 14,190 assisted living suites and 5,189 skilled nursing units. We have classified as discontinued operations one assisted living community owned and operated by us containing 32 living units as well as seven SNFs and four assisted living communities we lease from Senior Housing Properties Trust or its subsidiaries, or SNH, and operate containing 824 living units.

As of June 30, 2013, we also leased and operated two rehabilitation hospitals with 321 beds that provide inpatient rehabilitation services to patients at the two hospitals and at three satellite locations. In addition, as of that date, we leased and operated 13 outpatient clinics affiliated with these rehabilitation hospitals. In the third quarter of 2013, in connection with entering into a purchase agreement with SNH and certain unrelated parties, we reclassified our rehabilitation hospital business as discontinued operations and our rehabilitation hospital business is retrospectively presented as discontinued operations throughout this Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, or this Amended Quarterly Report.

***Restatement of Previously Issued Financial Statements***

As discussed further in Note 12, we are restating our condensed consolidated financial statements for the three and six months ended June 30, 2013 and 2012 contained within our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, or our Quarterly Report, to correct certain errors in the accounting for income taxes. In addition, as part of the restatement we have corrected certain other errors related to insurance receivables, security deposits, accrual of fixed asset additions, classification of senior living operating expenses and certain other immaterial items. We corrected the presentation and disclosure of our consolidated statements of cash flows to separately identify the net cash flows from discontinued operations, by category and in total. We have also corrected the footnote presentation of certain of our available for sale debt securities from Level 1 assets to Level 2 assets as defined in the fair value hierarchy and corrected the disclosure of the fair value of our mortgage notes payable.

***Recently Issued Accounting Pronouncements***

In April 2014, the FASB issued Accounting Standards Update 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*, or ASU 2014-08. ASU 2014-08 changes the criteria for reporting a discontinued operation. Under the new pronouncement, a disposal of a part of an organization that has a major effect on its operations and financial results is a discontinued operation. We are required to adopt ASU 2014-08 prospectively for all disposals or components of our business classified as held for sale during fiscal periods beginning after December 15, 2014 and are currently evaluating what impact, if any, its adoption will have to the presentation of our condensed consolidated financial statements.

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## FIVE STAR QUALITY CARE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

***Segment Information***

We have three operating segments: senior living communities, rehabilitation and wellness and rehabilitation hospitals. In the senior living community segment, we operate for our own account or manage for the account of SNH independent living communities, assisted living communities and SNFs that are subject to centralized oversight and provide housing and services to elderly residents. Our rehabilitation and wellness operating segment does not meet any of the quantitative thresholds of a reportable segment as prescribed under Financial Accounting Standards Board, or FASB, *Accounting Standards Codification*<sup>TM</sup>, or ASC, Topic 280, and as discussed further in Note 10, our rehabilitation hospital operating segment has been reclassified as discontinued operations. After the reclassification of our rehabilitation hospital business as discontinued operations, our business is comprised of one reportable segment, senior living.

**Note 2. Property and Equipment**

Property and equipment, at cost, consists of the following:

|                                   | <b>June 30,<br/>2013<br/>(Restated)</b> | <b>December 31,<br/>2012<br/>(Restated)</b> |
|-----------------------------------|---|---|
| Land                              | \$ 21,714                               | \$ 21,714                                   |
| Buildings and improvements        | 274,215                                 | 277,330                                     |
| Furniture, fixtures and equipment | 108,573                                 | 103,707                                     |
|                                   | 404,502                                 | 402,751                                     |
| Accumulated depreciation          | (73,817)                                | (65,257)                                    |
|                                   | \$ 330,685                              | \$ 337,494                                  |

We recorded depreciation expense of \$6,298 and \$5,193 for the three months ended June 30, 2013 and 2012, respectively, and \$12,382 and \$10,995 for the six months ended June 30, 2013 and 2012, respectively, relating to our property and equipment.

As of June 30, 2013, we had \$5,199 of assets included in our property and equipment that we currently expect to request that SNH purchase from us for an increase in future rent pursuant to the terms of our leases with SNH; however, we are not obligated to make these sales and SNH is not obligated to purchase these assets.





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## FIVE STAR QUALITY CARE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

**Note 3. Accumulated Other Comprehensive Income**

The following table details the changes in accumulated other comprehensive income for the six months ended June 30, 2013:

|   | Equity Investment<br>in Affiliates<br>Insurance<br>Company |    | Investments in<br>Available for<br>Sale Securities<br>(Restated) |    | Accumulated Other<br>Comprehensive<br>Income<br>(Restated) |
|---|--|----|--|----|--|
| Balance at January 1, 2013                        | \$ 99  | \$ | 3,264  | \$ | 3,363  |
| Unrealized (loss) gain on investments, net of tax | (8)  |    | 60   |    | 52   |
| Reclassification adjustment:                      |  |    |  |    |  |
| Realized gain on investments, net of tax          |  |    | (52)   |    | (52)   |
| Balance at March 31, 2013                         | 91   |    | 3,272  |    | 3,363  |
| Unrealized (loss) gain on investments, net of tax | (73)   |    | (233)  |    | (306)  |
| Reclassification adjustment:                      |  |    |  |    |  |
| Realized loss on investments, net of tax          |  |    | 70   |    | 70   |
| Balance at June 30, 2013                          | \$ 18  | \$ | 3,109  | \$ | 3,127  |

Accumulated other comprehensive income represents the net unrealized appreciation of investments and our share of other comprehensive income of Affiliates Insurance Company, or AIC.

**Note 4. Income Taxes**

For the six months ended June 30, 2013, we recognized tax expense from continuing operations of \$356, which includes a tax benefit of \$1,468 relating to a work opportunity tax credit program that expired in 2012 and which was retroactively reinstated on January 3, 2013 and extended by the American Taxpayer Relief Act of 2012, which was enacted on January 2, 2013. As prescribed by FASB ASC Topic 740, Accounting for Income Taxes, the effects of tax law changes are recognized in the period in which new legislation is enacted; and the total effect of the reinstatement of the work opportunity tax credit program relating to 2012 employee wages is recorded as a component of income tax expense in continuing operations during the first quarter of 2013. For the six months ended June 30, 2013, we recognized a tax benefit from discontinued operations of \$1,602. As of December 31, 2012, our federal net operating loss carry forward, which begins to expire in 2026 if unused, was approximately \$70,765, and our tax credit carry forward, which begins to expire in 2022 if unused, was approximately \$11,729. Our net operating loss carry forwards and tax credit carry forwards are subject to audit and adjustments by the Internal Revenue Service.

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We maintain a partial valuation allowance against certain deferred tax assets related to impaired investments. When we believe that we will more likely than not realize the benefit of these deferred tax assets, we will record deferred tax assets as an income tax benefit in our condensed consolidated statements of income, which will affect our results of operations.

### **Note 5. Earnings Per Share**

We computed basic earnings per common share, or EPS, for the three and six months ended June 30, 2013 and 2012 using the weighted average number of shares outstanding during the periods. Diluted EPS reflects the more dilutive earnings per common share amount calculated using the two-class method or the treasury stock method. The treasury stock method reflects dilutive potential common shares related to the Notes that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income applicable to common shareholders that would result from their assumed issuance. For the six months ended June 30, 2013, the effect of our convertible senior notes due in 2026, or the Notes, was not included in the computation of diluted EPS because to do so would have been antidilutive. Diluted EPS for the three months ended June 30, 2013 and for the three and six months ended June 30, 2012 reflects additional shares of our common stock, \$.01 par value per share, or our common shares, related to the

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Notes that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income applicable to common shareholders that would result from their assumed issuance. The weighted average shares outstanding used to calculate basic and diluted EPS include 540 and 556 unvested common shares as of June 30, 2013 and 2012, respectively, issued to our officers and others under our equity compensation plan, or the Share Award Plan. Unvested shares issued under the Share Award Plan are deemed participating securities because they participate equally in earnings with all of our other common shares.

The following table provides a reconciliation of income from continuing operations to diluted loss from discontinued operations and a reconciliation of the number of common shares used in the computations of EPS from continuing operations to diluted EPS from continuing operations and diluted loss per share from discontinued operations:

|   | Three Months Ended June 30, |        |           |                    |        |           |
|---|-----------------------------|--------|-----------|--------------------|--------|-----------|
|   | 2013<br>(Restated)          |        |           | 2012<br>(Restated) |        |           |
|   | Income<br>(loss)            | Shares | Per Share | Income<br>(loss)   | Shares | Per Share |
| Income from continuing operations         | \$ 2,297                    | 48,253 | \$ 0.05   | \$ 5,576           | 47,914 | \$ 0.12   |
| Effect of the Notes                       | 159                         | 1,913  |           | 157                | 2,039  |           |
| Diluted income from continuing operations | \$ 2,297                    | 50,166 | \$ 0.05   | \$ 5,737           | 49,953 | \$ 0.11   |
| Diluted loss from discontinued operations | \$ (1,499)                  | 50,166 | \$ (0.03) | \$ (666)           | 49,953 | \$ (0.01) |

|   | Six Months Ended June 30, |        |           |                    |        |           |
|---|---------------------------|--------|-----------|--------------------|--------|-----------|
|   | 2013<br>(Restated)        |        |           | 2012<br>(Restated) |        |           |
|   | Income<br>(loss)          | Shares | Per Share | Income<br>(loss)   | Shares | Per Share |
| Income from continuing operations         | \$ 5,238                  | 48,244 | \$ 0.11   | \$ 6,743           | 47,906 | \$ 0.14   |
| Effect of the Notes                       | 331                       |        |           | 379                | 2,454  |           |
| Diluted income from continuing operations | \$ 5,238                  | 50,157 | \$ 0.11   | \$ 6,743           | 50,360 | \$ 0.14   |
| Diluted loss from discontinued operations | \$ (2,300)                | 50,157 | \$ (0.05) | \$ (1,361)         | 50,360 | \$ (0.03) |

**Note 6. Fair Values of Assets and Liabilities**

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Our assets recorded at fair value have been categorized based upon a fair value hierarchy in accordance with ASC Topic 820. We apply the following fair value hierarchy, which prioritizes the inputs used to measure fair value into three levels.

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access at the measurement date.

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets and quoted prices in inactive markets.

Level 3 inputs are unobservable inputs for the asset or liability in which there is little, if any, market activity for the asset or liability at the measurement date.

The table below presents the assets measured at fair value at June 30, 2013 and December 31, 2012 categorized by the level of inputs used in the valuation of each asset.

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| Description                         | Total     | As of June 30, 2013   |   |  | Total     | As of December 31, 2012  |   |  |
|-------------------------------------|-----------|---|---|--|-----------|--|---|--|
|                                     |           | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1)<br>(Restated) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2)<br>(Restated) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |           | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1)<br>(Restated) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2)<br>(Restated) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Cash equivalents (1)                | \$ 19,603 | \$ 19,603   | \$  | \$   | \$ 22,149 | \$ 22,149  | \$  | \$   |
| Available for sale securities: (2)  |           |   |   |  |           |  |   |  |
| Equity securities                   |           |   |   |  |           |  |   |  |
| Financial services industry         | 3,860     | 3,860   |   |  | 6,025     | 6,025  |   |  |
| Non-equity investment instrument    | 536       | 536   |   |  |           |  |   |  |
| REIT industry                       | 576       | 576   |   |  | 484       | 484  |   |  |
| Utilities industry                  | 484       | 484   |   |  |           |  |   |  |
| Other                               | 1,637     | 1,637   |   |  | 775       | 775  |   |  |
| Total equity securities             | 7,093     | 7,093   |   |  | 7,284     | 7,284  |   |  |
| Debt securities                     |           |   |   |  |           |  |   |  |
| International bond fund (3)         | 2,308     |   | 2,308   |  | 2,345     |  | 2,345   |  |
| High yield fund (4)                 | 2,191     |   | 2,191   |  | 2,168     |  | 2,168   |  |
| Industrial bonds                    | 3,893     |   | 3,893   |  | 5,186     |  | 5,186   |  |
| Government bonds                    | 4,871     | 4,582   | 289   |  | 4,666     | 4,666  |   |  |
| Financial bonds                     | 964       |   | 964   |  | 982       |  | 982   |  |
| Other                               | 2,011     |   | 2,011   |  | 869       |  | 869   |  |
| Total debt securities               | 16,238    | 4,582   | 11,656  |  | 16,216    | 4,666  | 11,550  |  |
| Total available for sale securities | 23,331    | 11,675  | 11,656  |  | 23,500    | 11,950   | 11,550  |  |
| Total                               | \$ 42,934 | \$ 31,278   | \$ 11,656   | \$   | \$ 45,649 | \$ 34,099  | \$ 11,550   | \$   |

(1) Cash equivalents, consisting of money market funds held principally for obligations arising from our self-insurance programs.

(2) Investments in available for sale securities are reported on our balance sheet as current and long term investments in available for sale securities and are reported at fair value of \$16,352 and \$6,979, respectively, at June 30, 2013 and \$12,920 and \$10,580, respectively, at December 31, 2012. We estimate the fair value of our available for sale securities by reviewing each security's current market price, the ratings

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of the security, the financial condition of the issuer and our intent and ability to retain the investment during temporary market price fluctuations or until maturity. In evaluating the factors described above, we presume a decline in value to be an other than temporary impairment if the quoted market price of the security is below the security's cost basis for an extended period. However, this presumption may be overcome if there is persuasive evidence indicating the value decline is temporary in nature, such as when the operating performance of the obligor is strong or if the market price of the security is historically volatile. Additionally, there may be instances in which impairment losses are recognized even if the decline in value does not fall within the criteria described above, such as if we plan to sell the security in the near term and the fair value is below our cost basis. When we believe that a change in fair value of an available for sale security is temporary, we record a corresponding credit or charge to other comprehensive income for any unrealized gains and losses. When we determine that an impairment in the fair value of an available for sale security is an other than temporary impairment, we record a charge to earnings.

(3) The investment strategy of this fund is to invest principally in fixed income securities. The fund invests in such securities or investment vehicles as it considers appropriate to achieve the fund's investment objective, which is to provide an above average rate of total return while attempting to limit investment risk by investing in a diversified portfolio of U.S. dollar investment grade fixed income securities. There are no unfunded commitments and the investment can be redeemed weekly.

(4) The investment strategy of this fund is to invest principally in fixed income securities. The fund invests in such securities or investment vehicles as it considers appropriate to achieve the fund's investment objective, which is to provide an above average rate of total return while attempting to limit investment risk by investing in a diversified portfolio of primarily fixed income securities issued by companies with below investment grade ratings. There are no unfunded commitments and the investment can be redeemed weekly.

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Our investments in available for sale securities had amortized costs of \$21,812 and \$21,720 as of June 30, 2013 and December 31, 2012, respectively, had unrealized gains of \$1,850 and \$2,050 as of June 30, 2013 and December 31, 2012, respectively, and had unrealized losses of \$331 and \$270 as of June 30, 2013 and December 31, 2012, respectively. At June 30, 2013, 47 of the securities we hold, with a fair value of \$7,448, have been in a loss position for less than 12 months. At June 30, 2013, three of the debt securities we hold, with a fair value of \$2,181, have been in a loss position for 12 months or longer. The amount of the unrealized losses for these investments was approximately \$68. We do not believe these securities are impaired primarily because the financial conditions of the issuers of these securities remain strong with solid fundamentals, we intend to hold these securities until recovery and other factors that support our conclusion that the loss is temporary. During the six months ended June 30, 2013 and 2012, we received gross proceeds of \$5,213 and \$772, respectively, in connection with the sales of available for sale securities and recorded gross realized gains totaling \$264 and \$2, respectively, and gross realized losses totaling \$294 and \$3, respectively. We record gains and losses on the sales of our available for sale securities using the specific identification method.

During the six months ended June 30, 2013, we did not change the type of inputs used to determine the fair value of any of our assets and liabilities that we measure at fair value; however as described in Note 12, we did correct the classification of \$11,656 and \$11,550 as of June 30, 2013 and December 31, 2012, respectively, of our available for sale debt securities from Level 1 assets to Level 2 assets and corrected the disclosure of the fair value of our mortgage notes payable which increased \$9,469 and \$9,947 as of June 30, 2013 and December 31, 2012, respectively. There were no transfers of assets or liabilities between levels of the fair value hierarchy during the six months ended June 30, 2013.

The carrying values of accounts receivable and accounts payable approximate fair value as of June 30, 2013 and December 31, 2012. The carrying value and fair value of the Notes were \$24,872 and \$24,879, respectively, as of June 30, 2013 and \$24,872 and \$24,623, respectively, as of December 31, 2012 and are categorized in Level 2 of the fair value hierarchy in their entirety. We estimate the fair value of the Notes using an average of the bid and ask prices of our then outstanding Notes on or about June 30, 2013. The carrying value and fair value of our mortgage notes payable were \$38,175 and \$42,158, respectively, as of June 30, 2013 and \$46,260 and \$53,115, respectively, as of December 31, 2012 and are categorized in Level 3 of the fair value hierarchy in their entirety. We estimate the fair values of our mortgage notes payable by using discounted cash flow analyses and currently prevailing market terms as of the measurement date. Because these Level 3 inputs are unobservable, our estimated fair value may differ materially from the actual fair value. We measured the fair value of our equity investment in AIC, which is an Indiana insurance company that we currently own in equal proportion as each of the other seven shareholders of that company (see Note 9), and categorized that investment in Level 2 of the fair value hierarchy in its entirety, by considering, among other things, the individual assets and liabilities held by AIC, AIC's overall financial condition and earning trends, and the financial condition and prospects for the insurance industry generally.

**Note 7. Indebtedness**

We have a \$35,000 revolving secured line of credit, or our Credit Agreement, that is available for general business purposes, including acquisitions. The maturity date of our Credit Agreement is March 18, 2016. Borrowings under our Credit Agreement typically bear interest at LIBOR plus a premium of 250 basis points, or 2.69% as of June 30, 2013. We may draw, repay and redraw funds under our Credit Agreement until maturity, and no principal repayment is due until maturity. We made no borrowings under our Credit Agreement during the three and six

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months ended June 30, 2013 and 2012. As of June 30, 2013 and July 30, 2013, we had \$0 outstanding under our Credit Agreement. We incurred facility costs related to our Credit Agreement of \$90 and \$287 for the three months ended June 30, 2013 and 2012, respectively, and \$242 and \$463 for the six months ended June 30, 2013 and 2012, respectively.

We are the borrower under our Credit Agreement and certain of our subsidiaries guarantee our obligations under our Credit Agreement, which is secured by our and our guarantor subsidiaries' accounts receivable and related collateral. Our Credit Agreement provides for acceleration of payment of all amounts due thereunder upon the occurrence and continuation of certain events of default, including a change of control of us and the termination of our business management and shared services agreement, or our business management agreement, with Reit Management & Research LLC, or RMR.



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We also have a \$150,000 secured revolving credit facility, or our Credit Facility, that is available for general business purposes, including acquisitions. The maturity date of our Credit Facility is April 13, 2015, and, subject to the payment of extension fees and meeting certain other conditions, includes options for us to extend the stated maturity date of our Credit Facility for two one-year periods. Borrowings under our Credit Facility typically bear interest at LIBOR plus a premium of 250 basis points, or 2.69% as of June 30, 2013. We may draw, repay and redraw funds under our Credit Facility until maturity, and no principal repayment is due until maturity. The weighted average interest rate for borrowings under our Credit Facility was 4.75% for the six months ended June 30, 2013. We made no borrowings under our Credit Facility during the three and six months ended June 30, 2012. As of June 30, 2013 and July 30, 2013, we had \$0 and \$10,000, respectively, outstanding under our Credit Facility. We incurred interest expense and other associated costs related to our Credit Facility of \$433 and \$416 for the three months ended June 30, 2013 and 2012, respectively, and \$900 and \$416 for the six months ended June 30, 2013 and 2012, respectively.

We are the borrower under our Credit Facility, and certain of our subsidiaries guarantee our obligations under our Credit Facility, which is secured by real estate mortgages on 15 senior living communities with 1,549 living units owned by our guarantor subsidiaries and our guarantor subsidiaries' accounts receivable and related collateral. Our Credit Facility provides for acceleration of payment of all amounts payable upon the occurrence and continuation of certain events of default, including a change of control of us.

Our Credit Agreement and our Credit Facility contain a number of financial and other covenants, including covenants that restrict our ability to incur indebtedness or to pay dividends or make other distributions under certain circumstances and require us to maintain financial ratios and a minimum net worth.

In October 2006, we issued \$126,500 principal amount of the Notes. Our net proceeds from this issuance were approximately \$122,600. The Notes bore interest at a rate of 3.75% per annum and were convertible into our common shares at any time. The conversion rate, which was subject to adjustment, was 76.9231 common shares per \$1 principal amount of the Notes, which represented a conversion price of \$13.00 per share. The Notes were guaranteed by certain of our wholly owned subsidiaries. The Notes were scheduled to mature on October 15, 2026. We could prepay the Notes at any time and the holders had rights to require us to purchase all or a portion of these Notes on each of October 15, 2013, 2016 and 2021 at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus any accrued and unpaid interest. As of June 30, 2013 and December 31, 2012, we had \$24,872 principal amount of the Notes outstanding, which are classified as current liabilities in our condensed consolidated balance sheets. We incurred interest expense and other associated costs related to the Notes of \$245 and \$264 for the three months ended June 30, 2013 and 2012, respectively, and \$490 and \$631 for the six months ended June 30, 2013 and 2012. We issued these Notes pursuant to an indenture which contained various customary covenants. As of June 30, 2013, we believe we were in compliance with all applicable covenants of this indenture. On July 8, 2013, we redeemed all of the \$24,872 principal amount of the Notes outstanding at a redemption price equal to the principal amount thereof, plus accrued and unpaid interest. We will record a loss on early extinguishment of debt, net of unamortized issuance costs, of \$599 in the third quarter of 2013.

At June 30, 2013, four of our senior living communities were encumbered by mortgage notes with an aggregate outstanding principal balance of \$38,175: (1) one of our communities was encumbered by a Federal National Mortgage Association, or FNMA, mortgage note and; (2) three of our communities were encumbered by Federal Home Loan Mortgage Corporation, or FHLMC, mortgage notes. These mortgages contain FNMA

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and FMCC, respectively, standard mortgage covenants. We recorded a mortgage premium in connection with our assumption of the FNMA and FMCC mortgage notes as part of our acquisitions of the encumbered communities in order to record the assumed mortgage notes at their estimated fair value. We are amortizing the mortgage premiums as a reduction of interest expense until the maturity of the respective mortgage notes. The weighted average interest rate on these four notes was 6.91% as of June 30, 2013. Payments of principal and interest are due monthly until maturities at varying dates ranging from June 2023 to September 2032. We incurred mortgage interest expense, net of premium amortization, of \$1,145 and \$708 for the three months ended June 30, 2013 and 2012, respectively, and \$1,844 and \$1,425 for the six months ended June 30, 2013 and 2012, respectively, including some interest expense recorded in discontinued operations. Our mortgages require monthly payments into escrows for taxes, insurance and property replacement funds; withdrawals from these escrows require

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applicable FNMA and FMCC approval. As of June 30, 2013, we believe we were in compliance with all applicable covenants under these mortgages.

In May 2011, we entered into a bridge loan, or the Bridge Loan, agreement with SNH under which SNH agreed to lend us up to \$80,000 to fund a part of the purchase price for our acquisitions of certain assets of six senior living communities located in Indiana, or the Indiana Communities. During 2011, we completed our acquisitions of the assets of the Indiana Communities and, in connection with the acquisitions, borrowed \$80,000 under the Bridge Loan. During 2011, we repaid \$42,000 of this advance with proceeds from a public offering of our common shares, or the Public Offering, and cash generated by operations. In April 2012, we repaid in full the principal amount then outstanding under the Bridge Loan, resulting in termination of the Bridge Loan. We funded the April 2012 repayment of the Bridge Loan with borrowings under our Credit Facility and cash on hand. We incurred interest expense and other associated costs related to the Bridge Loan of \$39 and \$314 for the three and six months ended June 30, 2012.

**Note 8. Off Balance Sheet Arrangements**

We have pledged our accounts receivable and certain other assets, with a carrying value, as of June 30, 2013, of \$12,719 arising from our operation of 26 properties owned by SNH and leased to us to secure SNH's borrowings from its lender, FNMA. As of June 30, 2013, we had no other off balance sheet arrangements that have had or that we expect would be reasonably likely to have a future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

**Note 9. Related Person Transactions**

We were formerly a 100% owned subsidiary of SNH, SNH is our largest landlord and our largest stockholder and we manage senior living communities for SNH. In 2001, SNH distributed substantially all of our then outstanding common shares to its shareholders. As of June 30, 2013, SNH owned 4,235 of our common shares, or approximately 8.8% of our outstanding common shares. One of our Managing Directors, Mr. Barry Portnoy, is a managing trustee of SNH. Mr. Barry Portnoy's son, Mr. Adam Portnoy, also serves as a managing trustee of SNH.

As of June 30, 2013, we leased 188 senior living communities (including 11 senior living communities that we have classified as discontinued operations) and two rehabilitation hospitals (which we have classified as discontinued operations) from SNH. Under our leases with SNH, we pay SNH minimum rent plus percentage rent based on increases in gross revenues at certain properties. Our total minimum annual rent payable to SNH as of June 30, 2013 was \$198,984, excluding percentage rent. Our total rent expense under all of our leases with SNH, net of lease inducement amortization, was \$50,866 and \$49,920 for the three months ended June 30, 2013 and 2012, respectively, and \$101,466 and \$99,723

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for the six months ended June 30, 2013 and 2012, respectively. As of June 30, 2013 and 2012, we had outstanding rent due and payable to SNH of \$17,883 and \$17,522, respectively. During the six months ended June 30, 2013, pursuant to the terms of our leases with SNH, we sold \$15,901 of improvements made to properties leased from SNH, and, as a result, our annual rent payable to SNH increased by approximately \$1,272. As of June 30, 2013, our property and equipment and assets in our discontinued operations included \$5,679 for similar improvements we have made to properties we lease from SNH that we currently expect to request that SNH purchase from us for an increase in future rent; however, we are not obligated to make these sales and SNH is not obligated to purchase those assets.

As of June 30, 2013, we managed 39 senior living communities for the account of SNH. We manage these SNH communities pursuant to long term management agreements on substantially similar terms. In connection with the management agreements, we and SNH have entered into three pooling agreements, two pooling agreements which pool our management agreements with SNH for communities that include assisted living units, or the AL Pooling Agreements, and a third pooling agreement, which pools our management agreements with SNH for communities that include only independent living units, or the IL Pooling Agreement. One of our AL Pooling Agreements includes 20 identified communities. The second AL Pooling Agreement includes the management agreements for the remaining communities that include assisted living units that we currently manage for SNH (other than with respect to the senior living community in New York described below). Each of the AL Pooling Agreements and the IL Pooling Agreement

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aggregates the determinations of fees and expenses of the various communities that are subject to the applicable pooling agreement, including determinations of our incentive fees.

We earned management fees from SNH of \$2,281 and \$4,576 for the three and six months ended June 30, 2013, respectively, and \$1,080 and \$2,148 for the three and six months ended June 30, 2012, respectively, with respect to the communities we manage. We expect that we may enter additional management arrangements with SNH for senior living communities that SNH may acquire in the future on terms similar to those management arrangements we currently have with SNH. For example, on April 16, 2013, SNH entered an agreement to acquire a senior living community located in Georgia with 93 assisted living units; on July 15, 2013, SNH entered an agreement to acquire a senior living community located in Tennessee with 60 assisted living units; and on July 29, 2013, SNH entered an agreement to acquire two senior living communities located in Georgia with a total of 153 assisted living units. If these acquisitions are completed, we expect to manage these senior living communities pursuant to separate long term management agreements with SNH on terms similar to those management arrangements that we currently have with SNH for senior living communities that include assisted living units and that these management agreements would be added to the second AL Pooling Agreement. Each of these acquisitions is subject to due diligence and other conditions and there can be no assurance that any of these acquisitions will be completed or that we will manage any of these communities.

We manage a portion of a senior living community in New York that is not subject to the requirements of New York healthcare licensing laws, consisting of 198 living units, pursuant to a long term management agreement with SNH. The terms of this management agreement are substantially consistent with the terms of our other management agreements with SNH for communities that include assisted living units, except that the management fee payable to us is equal to 5% of the gross revenues realized at that portion of the community, and there is no incentive fee payable to us under this management agreement. In order to accommodate certain requirements of New York healthcare licensing laws, SNH subleases a portion of this senior living community that is subject to those requirements, consisting of 111 living units, to an entity, D&R Yonkers LLC, which is owned by SNH's President and Chief Operating Officer and its Treasurer and Chief Financial Officer. We manage this portion of the community pursuant to a long term management agreement with D&R Yonkers LLC. Pursuant to that management agreement, D&R Yonkers LLC pays us a management fee equal to 3% of the gross revenues realized at that portion of the community and we are not entitled to any incentive fee under that agreement.

We and SNH have agreed that SNH will offer for sale 10 senior living communities we lease from SNH, which we have classified as discontinued operations. Our rent payable to SNH will be reduced if and as these sales may occur pursuant to our leases with SNH. We can provide no assurance these communities will be sold or what the terms of any sale may provide. As of June 30, 2013, we and SNH had entered an agreement to sell one of these communities, a SNF with 112 living units, for a sales price of \$2,550. This sale is subject to conditions and may not occur, may be delayed or the terms may change. If and when this SNF is sold, our annual minimum rent payable to SNH will decrease by 10% of the net proceeds of the sale to SNH, in accordance with the terms of our applicable lease with SNH.

As discussed above in Note 7, in May 2011, we and SNH entered into the Bridge Loan, under which SNH lent to us \$80,000. In April 2012, we repaid in full the then outstanding principal amount under the Bridge Loan, resulting in the termination of the Bridge Loan. We incurred interest expense and other associated costs on the Bridge Loan of \$39 and \$314 for the three and six months ended June 30, 2012, respectively.

RMR provides business management and shared services to us pursuant to our business management agreement. RMR also provides management services to SNH. One of our Managing Directors, Mr. Barry Portnoy, is Chairman, majority owner and an employee of RMR. Mr. Barry Portnoy's son, Mr. Adam Portnoy, is an owner of RMR and serves as President, Chief Executive Officer and a director of RMR. Our other Managing Director, Mr. Gerard Martin, is a director of RMR. Mr. Bruce Mackey, our President and Chief Executive Officer, is an Executive Vice President of RMR and Mr. Paul Hoagland, our Treasurer and Chief Financial Officer, is a Senior Vice President of RMR. SNH's executive officers are officers of RMR and SNH's President and Chief Operating Officer is a director of RMR. Our Independent Directors also serve as independent directors or independent trustees of other public companies to which RMR provide management services. Mr. Barry Portnoy serves as a managing director or managing trustee of those

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companies, including SNH, and Mr. Adam Portnoy serves as a managing trustee of a majority of those companies, including SNH. In addition, officers of RMR serve as officers of those companies.

Pursuant to our business management agreement with RMR, we recognized aggregate business management, administrative and information system service fees of \$3,829 and \$3,285 for the three months ended June 30, 2013 and 2012, respectively, and \$7,161 and \$6,578 for the six months ended June 30, 2013 and 2012, respectively. These amounts are included in general and administrative expenses in our condensed consolidated statements of income. We also lease our headquarters from an affiliate of RMR for annual rent as of July 2013 of approximately \$767, which amount is subject to fixed increases. Our rent expense for our headquarters, which included our utilities and real estate taxes that we are required to pay as additional rent, under this lease, was \$347 and \$355 for the three months ended June 30, 2013 and 2012, respectively, and \$694 and \$709 for the six months ended June 30, 2013 and 2012, respectively.

We, RMR, SNH and five other companies to which RMR provides management services each currently own 12.5% of AIC, an Indiana insurance company. All of our Directors, all of the trustees and directors of the other publicly held AIC shareholders and nearly all of the directors of RMR currently serve on the board of directors of AIC. RMR provides management and administrative services to AIC pursuant to a management and administrative services agreement with AIC.

As of June 30, 2013, we have invested \$5,209 in AIC since its formation in November 2008. Although we own less than 20% of AIC, we use the equity method to account for this investment because we believe that we have significant influence over AIC because all of our Directors are also directors of AIC. Our investment in AIC had a carrying value of \$5,703 and \$5,629 as of June 30, 2013 and December 31, 2012, respectively. We recognized income of \$79 and \$76 for the three months ended June 30, 2013 and 2012, respectively, and \$155 and \$121 for the six months ended June 30, 2013 and 2012, respectively, related to our investment in AIC. We and the other shareholders of AIC have purchased property insurance providing \$500,000 of coverage pursuant to an insurance program arranged by AIC and with respect to which AIC is a reinsurer of certain coverage amounts. This program was modified and extended in June 2013 for a one year term, and we expect to pay a premium, including taxes and fees, of \$5,428 in connection with that renewal, which amount may be adjusted from time to time as we acquire or dispose of properties that are included in this program. We periodically consider the possibilities for expanding our insurance relationships with AIC to include other types of insurance and may in the future participate in additional insurance offerings AIC may provide or arrange. We may invest additional amounts in AIC in the future if the expansion of this insurance business requires additional capital, but we are not obligated to do so. By participating in this insurance business with RMR and the other companies to which RMR provides management services, we expect that we may benefit financially by possibly reducing our insurance expenses or by realizing our pro rata share of any profits of this insurance business.

**Note 10. Discontinued Operations**

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In 2011, we decided to offer for sale two SNFs we owned located in Michigan with a total of 271 living units. On April 30, 2013, we completed the sale of these two SNFs for an aggregate sales price of \$8,000, which included as part of the sales price the prepayment by the buyer of the then outstanding \$7,510 of United States Department of Housing and Urban Development mortgage debt that encumbered these SNFs.

In August 2011, we agreed with SNH that SNH should sell one assisted living community we lease from SNH located in Pennsylvania with 103 living units. We and SNH are in the process of offering this assisted living community for sale and, if sold, our annual minimum rent payable to SNH will decrease by 9.0% of the net proceeds of the sale to SNH, in accordance with the terms of our applicable lease with SNH.

In September 2012, we completed the sale of our pharmacy business to Omnicare. We received \$34,298 in sale proceeds from Omnicare, including \$3,789 in working capital and excluding transaction costs and taxes. We recorded a pre-tax capital gain on the sale of the pharmacy business of \$23,347. In connection with the sale, Omnicare did not acquire the real estate we owned associated with one pharmacy located in South Carolina. We intend to sell this real estate and we



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FIVE STAR QUALITY CARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

recorded a \$350 asset impairment charge during the third quarter of 2012 to reduce the carrying value of this property to its estimated fair value less costs to sell. The fair value of assets held for sale is determined based upon the use of appraisals, input from market participants, and our experience selling similar assets.

In June 2013, we agreed with SNH that SNH will offer for sale 10 senior living communities we lease from SNH with 721 living units. Seven of these 10 communities with 578 living units are SNFs and three of these 10 communities with 143 living units are assisted living communities. As of June 30, 2013, we and SNH had entered an agreement to sell one of the 10 communities, a SNF with 112 living units, for a sales price of \$2,550. This sale is subject to conditions and may not occur, may be delayed or the terms may change. If and when this SNF is sold, our annual minimum rent payable to SNH will decrease by 10% of the net proceeds of the sale to SNH, in accordance with the terms of our applicable lease with SNH. We are in the process of offering the other nine communities for sale, and if sold, our annual minimum rent payable to SNH will decrease between 8.75% and 10% of the net proceeds of the sales to SNH, in accordance with the terms of our applicable leases with SNH. We recorded a \$1,231 asset impairment charge during the second quarter of 2013 to reduce the assets we own relating to these 10 communities to their estimated fair market values.

Also in June 2013, we decided to offer for sale one assisted living community we own with 32 living units. We are in the process of offering this community for sale but we can provide no assurance that a sale of this community will occur.

In August 2013, we and SNH entered into a purchase agreement with certain unrelated parties, pursuant to which SNH agreed to sell the real estate associated with two rehabilitation hospitals and certain related assets, and in connection with such sale, we agreed to transfer the operations of those hospitals and several leased in-patient and out-patient clinics that are affiliated with those hospitals to those third parties. We and SNH completed the sale and transfer of our rehabilitation hospital business on December 31, 2013. Our rehabilitation hospital business, which we classified as discontinued operations during the third quarter of 2013, is retrospectively accounted for as discontinued operations throughout this Amended Quarterly Report.

We have reclassified the condensed consolidated balance sheets, the condensed consolidated statements of income and the consolidated statement of cash flows for all periods presented to show the financial position, results of operations and cash flows of our pharmacies, our rehabilitation hospital business and the communities that have been sold or are expected to be sold as discontinued. Below is a summary of the operating results of these discontinued operations included in the condensed consolidated financial statements for the three and six months ended June 30, 2013 and 2012:

| Three months ended June 30, |            | Six months ended June 30, |            |
|-----------------------------|------------|---------------------------|------------|
| 2013                        | 2012       | 2013                      | 2012       |
| (Restated)                  | (Restated) | (Restated)                | (Restated) |

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|                                 |    |          |    |          |    |          |    |           |
|---------------------------------|----|----------|----|----------|----|----------|----|-----------|
| Revenues                        | \$ | 38,055   | \$ | 57,976   | \$ | 80,134   | \$ | 118,127   |
| Expenses                        |    | (39,264) |    | (59,112) |    | (82,805) |    | (120,538) |
| Impairment of long-lived assets |    | (1,231)  |    |          |    | (1,231)  |    |           |
| Benefit for income taxes        |    | 941      |    | 470      |    | 1,602    |    | 1,050     |
| Net loss                        | \$ | (1,499)  | \$ | (666)    | \$ | (2,300)  | \$ | (1,361)   |

**Note 11. Litigation Settlement**

On May 29, 2012, we entered into a settlement agreement, or the Settlement Agreement, with subsidiaries of Sunrise Senior Living, Inc., or Sunrise, pursuant to which we agreed to settle our long running litigation with Sunrise, involving amounts charged by Sunrise to us for certain insurance programs for senior living communities previously managed by Sunrise for us. Pursuant to the Settlement Agreement, Sunrise paid us \$4,000 in cash and we recorded a gain of \$3,365, net of legal fees, in our condensed consolidated statements of income.

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**Note 12. Restatement of Previously Issued Financial Statements**

Subsequent to the issuance of our Quarterly Report, we identified certain errors primarily related to the accounting for income taxes. The Audit Committee of our Board of Directors, or our Audit Committee, after consideration of relevant facts and circumstances and after consultation with our management, concluded that our consolidated financial statements for the years ended December 31, 2012 and 2011 contained within our 2012 Annual Report, and our condensed consolidated financial statements for the quarters ended March 31, 2013 and June 30, 2013 contained within our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 and our Quarterly Report, respectively, should be restated, and that those financial statements previously filed with the SEC should no longer be relied upon.

Our condensed consolidated financial statements for the three and six months ended June 30, 2013 and 2012 are restated to correct certain errors related to the accounting for income taxes and other errors. We have corrected our condensed consolidated balance sheets as of June 30, 2013 and December 31, 2012 to reflect the effects of the restatement of our 2011 and 2012 annual financial statements. The accounting for income tax errors relate to, among other things, the measurement of deferred tax assets for net operating losses and tax credits and the measurement of deferred tax assets and liabilities for temporary differences related to fixed assets, intangible assets and investments.

Prior to 2011, we recognized a valuation allowance for most of our net deferred tax assets; therefore, errors in the measurement of our deferred tax assets and liabilities for years prior to 2011 were substantially offset by corresponding errors in the valuation allowance, with minimal net impact to our consolidated financial statements. We have corrected the errors relating to the quarter ended June 30, 2013 by decreasing the income tax provision by \$133 and \$277 for the three and six months ended June 30, 2013, respectively. We have corrected the errors for the three and six months ended June 30, 2012 by decreasing the income tax provision by \$255 and \$336, respectively.

In addition, as part of the restatement, our condensed consolidated financial statements for the three and six months ended June 30, 2013 and 2012 also have been adjusted to correct certain other errors in those periods, including:

- In 2013, we discovered certain errors relating to our security deposit liability. We have corrected the errors relating to 2013 by decreasing senior living revenues by \$256 and \$407 for the three and six months ended June 30, 2013, respectively. We have corrected the errors relating to the three and six months ended June 30, 2012 by increasing senior living revenues by \$54 and \$125, respectively.
- In the fourth quarter of 2013, we determined that certain assets acquired and placed into service as of June 30, 2013 and December 31, 2012 were not recorded in the proper time period. We have corrected the balance sheet error by recording \$126 and \$5,622 of fixed asset additions and related accrued liabilities as of June 30, 2013 and December 31, 2012, respectively.

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- We made certain other immaterial corrections that impacted our condensed consolidated statements of income, including adjustments to general and administrative and depreciation expense, and made other balance sheet classification changes that are not material, individually or in aggregate, in the restated condensed consolidated financial statements included herein.

The net impact of correcting the errors resulted in an increase to our shareholders' equity of \$7,031 and \$6,749 at June 30, 2013 and December 31, 2012, respectively, and a decrease to net income of \$27 and an increase to net income of \$178 for the three and six months ended June 30, 2013, respectively, and an increase of \$272 and \$375 for the three and six months ended June 30, 2012, respectively.

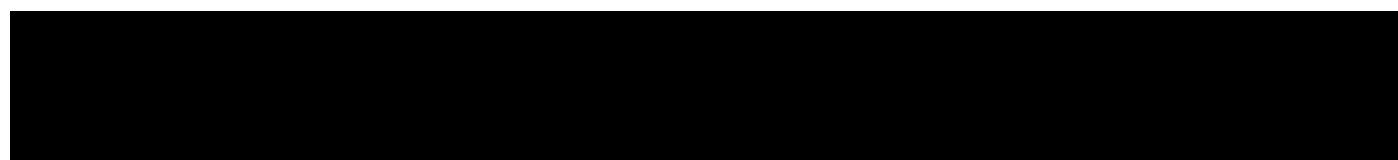
We corrected the presentation and disclosure of our consolidated statements of cash flows to separately identify the net cash flows from discontinued operations, by category and in total, and corrected certain other immaterial errors in cash flow presentation. These corrections increased cash provided by operating activities by \$1,602 and \$1,050 for the six months ended June 30, 2013 and 2012, respectively.

We have also corrected the footnote presentation in Note 6 of the classification of \$11,656 and \$11,550 as of June 30, 2013 and December 31, 2012, respectively, of our available for sale debt securities from Level 1 assets to Level 2 assets as defined in the fair value hierarchy and corrected the disclosure of the fair value of our mortgage notes payable which increased \$9,469 and \$9,947 as of June 30, 2013 and December 31, 2012, respectively.

In the third quarter of 2013, in connection with entering into a purchase agreement with SNH and certain unrelated parties, we reclassified our rehabilitation hospital business as discontinued operations and our rehabilitation hospital business is retrospectively presented as discontinued operations throughout the financial statements. These reclassifications to discontinued operations had no impact upon our shareholders' equity or net income but these reclassifications decreased our income from continuing operations by \$626 and \$866, and decreased our loss from discontinued operations by those same amounts for the three and six months ended June 30, 2013, respectively. These reclassifications decreased our income from continuing operations by \$26 and \$143, and decreased our loss from discontinued operations by those same amounts for the three and six months ended June 30, 2012, respectively.

The financial information included in the financial statements and the Notes thereto reflect the effects of the corrections and retrospective adjustments described above.

The following tables summarize the effect of the retrospective adjustments to reflect discontinued operations and the correction of errors by financial statement line item for the three and six months ended June 30, 2013 and 2012, and as of December 31, 2012:



**Consolidated  
Balance Sheet  
data:**

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|   |            |          |            |         |        |          |          |            |             |            |
|---|------------|----------|------------|---------|--------|----------|----------|------------|-------------|------------|
| Accounts receivable                       | \$ 56,763  | \$       | \$         | \$ (62) | \$     | \$ 1,612 | \$ 1,550 | \$ 58,313  | \$ (13,873) | \$ 44,440  |
| Prepaid expenses and other current assets | 19,382     | 10,450   | (1,763)    |         |        | 1,045    | 9,732    | 29,114     | (592)       | 28,522     |
| Assets of discontinued operations         | 4,978      |          |            |         | 1      |          | 1        | 4,979      | 15,226      | 20,205     |
| Total current assets                      | 133,798    | 10,450   | (1,763)    | (62)    | 1      | 2,657    | 11,283   | 145,081    | 761         | 145,842    |
| Property and equipment, net               | 331,172    |          |            | 149     | 125    |          | 274      | 331,446    | (761)       | 330,685    |
| Other long term assets                    | 42,916     | (2,180)  |            |         |        |          | (2,180)  | 40,736     |             | 40,736     |
| Total assets                              | 558,886    | 8,270    | (1,763)    | 87      | 126    | 2,657    | 9,377    | 568,263    |             | 568,263    |
| Accounts payable                          | 23,553     |          |            |         |        | 2,340    | 2,340    | 25,893     | (1,156)     | 24,737     |
| Accrued expenses                          | 20,792     | (277)    |            |         | 125    | 317      | 165      | 20,957     | (203)       | 20,754     |
| Accrued compensation and benefits         | 43,059     |          |            |         |        |          |          | 43,059     | (4,713)     | 38,346     |
| Due to related persons                    | 18,840     |          |            |         |        | 950      | 950      | 19,790     |             | 19,790     |
| Accrued real estate taxes                 | 11,175     |          |            |         |        | (950)    | (950)    | 10,225     | (25)        | 10,200     |
| Security deposits                         | 8,997      |          |            | (243)   |        |          |          | (243)      | 8,754       | 8,754      |
| Liabilities of discontinued operations    | 2,175      |          |            | (18)    | 1      |          | (17)     | 2,158      | 6,097       | 8,255      |
| Total current liabilities                 | 172,882    | (277)    |            | (261)   | 126    | 2,657    | 2,245    | 175,127    |             | 175,127    |
| Other long term liabilities               | 5,674      | 101      |            |         |        |          | 101      | 5,775      |             | 5,775      |
| Total long term liabilities               | 76,191     | 101      |            |         |        |          | 101      | 76,292     |             | 76,292     |
| Additional paid in capital                | 354,671    |          |            | 81      |        |          | 81       | 354,752    |             | 354,752    |
| Accumulated deficit                       | (46,877)   | 6,856    | (1,763)    | 267     |        |          | 5,360    | (41,517)   |             | (41,517)   |
| Cumulative other comprehensive income     | 1,537      | 1,590    |            |         |        |          | 1,590    | 3,127      |             | 3,127      |
| Total shareholders equity                 | 309,813    | 8,446    | (1,763)    | 348     |        |          | 7,031    | 316,844    |             | 316,844    |
| Total liabilities and shareholders equity | \$ 558,886 | \$ 8,270 | \$ (1,763) | \$ 87   | \$ 126 | \$ 2,657 | \$ 9,377 | \$ 568,263 | \$          | \$ 568,263 |

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**Consolidated  
Statement of  
Income data:**

|  |    |         |    |       |    |       |    |        |    |          |    |          |    |         |
|--|----|---------|----|-------|----|-------|----|--------|----|----------|----|----------|----|---------|
| Senior living revenue  | \$ | 269,081 | \$ |       | \$ | (253) | \$ | (253)  | \$ | 268,828  | \$ | (1)      | \$ | 268,827 |
| Rehabilitation hospital revenue  |    | 28,343  |    |       |    |       |    | 28,343 |    | (28,343) |    |          |    |         |
| Total revenues   |    | 351,858 |    |       |    | (253) |    | (253)  |    | 351,605  |    | (28,344) |    | 323,261 |
| Senior living wages and benefits   |    | 130,466 |    |       |    | (76)  |    | (76)   |    | 130,390  |    |          |    | 130,390 |
| Rehabilitation hospital expense  |    | 24,710  |    |       |    |       |    | 24,710 |    | (24,710) |    |          |    |         |
| Rent expense   |    | 50,936  |    |       |    |       |    | 50,936 |    | (2,657)  |    |          |    | 48,279  |
| Depreciation and amortization  |    | 6,651   |    |       |    | (20)  |    | (20)   |    | 6,631    |    | (46)     |    | 6,585   |
| Total operating expenses   |    | 346,119 |    |       |    | (96)  |    | (96)   |    | 346,023  |    | (27,413) |    | 318,610 |
| Operating income   |    | 5,739   |    |       |    | (157) |    | (157)  |    | 5,582    |    | (931)    |    | 4,651   |
| Income from continuing operations before income taxes and equity in earnings of Affiliates |    |         |    |       |    |       |    |        |    |          |    |          |    |         |
| Insurance Company  |    | 4,437   |    |       |    | (157) |    | (157)  |    | 4,280    |    | (931)    |    | 3,349   |
| Provision for income taxes   |    | (1,854) |    | 418   |    |       |    | 418    |    | (1,436)  |    | 305      |    | (1,131) |
| Income from continuing operations  |    | 2,662   |    | 418   |    | (157) |    | 261    |    | 2,923    |    | (626)    |    | 2,297   |
| Loss from discontinued operations  |    | (1,837) |    | (285) |    | (3)   |    | (288)  |    | (2,125)  |    | 626      |    | (1,499) |
| Net income   | \$ | 825     | \$ | 133   | \$ | (160) | \$ | (27)   | \$ | 798      | \$ |          | \$ | 798     |

**Per Share Data:**

|                                |    |        |  |  |  |  |  |    |      |        |  |    |      |        |
|--------------------------------|----|--------|--|--|--|--|--|----|------|--------|--|----|------|--------|
| Basic income per share from:   |    |        |  |  |  |  |  |    |      |        |  |    |      |        |
| Continuing operations          | \$ | 0.06   |  |  |  |  |  | \$ | 0.06 |        |  | \$ | 0.05 |        |
| Discontinued operations        |    | (0.04) |  |  |  |  |  |    |      | (0.04) |  |    |      | (0.03) |
| Net income per share - basic   | \$ | 0.02   |  |  |  |  |  | \$ | 0.02 |        |  | \$ | 0.02 |        |
| Diluted income per share from: |    |        |  |  |  |  |  |    |      |        |  |    |      |        |
| Continuing operations          | \$ | 0.06   |  |  |  |  |  | \$ | 0.06 |        |  | \$ | 0.05 |        |
| Discontinued operations        |    | (0.04) |  |  |  |  |  |    |      | (0.04) |  |    |      | (0.03) |
| Net income per share - diluted | \$ | 0.02   |  |  |  |  |  | \$ | 0.02 |        |  | \$ | 0.02 |        |

**For the Three Months Ended June 30, 2013**  
As Reported As Restated

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**Error  
Corrections**

**Consolidated Statement of  
Comprehensive Income:**

|  |    |       |    |      |    |       |
|--|----|-------|----|------|----|-------|
| Net income   | \$ | 825   | \$ | (27) | \$ | 798   |
| Other comprehensive income (loss):   |    |       |    |      |    |       |
| Unrealized gain on investments in available for sale securities, net of tax  |    | (390) |    | 157  |    | (233) |
| Realized loss (gain) on investments in available for sale securities reclassified and included in net income, net of tax |    | 117   |    | (47) |    | 70    |
| Unrealized gains on equity investment in Affiliates Insurance Company  |    | (73)  |    |      |    | (73)  |
| Other comprehensive income (loss)  |    | (346) |    | 110  |    | (236) |
| Comprehensive income   | \$ | 479   | \$ | 83   | \$ | 562   |

**Consolidated  
Statement of Income  
data:**

|  |    |         |    |       |    |       |    |         |    |          |
|--|----|---------|----|-------|----|-------|----|---------|----|----------|
| Senior living revenue  | \$ | 538,471 | \$ | (404) | \$ | (404) | \$ | 538,067 | \$ | 538,067  |
| Rehabilitation hospital revenue  |    | 55,824  |    |       |    |       |    | 55,824  |    | (55,824) |
| Total revenues   |    | 703,089 |    | (404) |    | (404) |    | 702,685 |    | (55,824) |
| Senior living wages and benefits   |    | 263,086 |    | (269) |    | (269) |    | 262,817 |    | 262,817  |
| Rehabilitation hospital expense  |    | 49,604  |    |       |    |       |    | 49,604  |    | (49,604) |
| Rent expense   |    | 101,129 |    |       |    |       |    | 101,129 |    | (4,837)  |
| Depreciation and amortization  |    | 13,089  |    | (39)  |    | (39)  |    | 13,050  |    | (95)     |
| Total operating expenses   |    | 693,792 |    | (308) |    | (308) |    | 693,484 |    | (54,536) |
| Operating income   |    | 9,297   |    | (96)  |    | (96)  |    | 9,201   |    | (1,288)  |
| Income from continuing operations before income taxes and equity in earnings of Affiliates Insurance Company |    | 6,823   |    | (96)  |    | (96)  |    | 6,727   |    | (1,288)  |
| Provision for income taxes   |    | (850)   |    | 72    |    | 72    |    | (778)   |    | 422      |
| Income from continuing operations  |    | 6,128   |    | 72    |    | (96)  |    | (24)    |    | 6,104    |
| Loss from discontinued operations  |    | (3,368) |    | 205   |    | (3)   |    | 202     |    | (3,166)  |
| Net income   | \$ | 2,760   | \$ | 277   | \$ | (99)  | \$ | 178     | \$ | 2,938    |

**Per Share Data:**

Basic income per share from:

|                              |    |        |  |  |    |        |  |    |        |
|------------------------------|----|--------|--|--|----|--------|--|----|--------|
| Continuing operations        | \$ | 0.13   |  |  | \$ | 0.13   |  | \$ | 0.11   |
| Discontinued operations      |    | (0.07) |  |  |    | (0.07) |  |    | (0.05) |
| Net income per share - basic | \$ | 0.06   |  |  | \$ | 0.06   |  | \$ | 0.06   |

Diluted income per share from:

|                         |    |        |  |  |    |        |  |    |        |
|-------------------------|----|--------|--|--|----|--------|--|----|--------|
| Continuing operations   | \$ | 0.13   |  |  | \$ | 0.14   |  | \$ | 0.11   |
| Discontinued operations |    | (0.07) |  |  |    | (0.08) |  |    | (0.05) |

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|                                   |    |      |    |      |    |      |
|-----------------------------------|----|------|----|------|----|------|
| Net income per share -<br>diluted | \$ | 0.06 | \$ | 0.06 | \$ | 0.06 |
|-----------------------------------|----|------|----|------|----|------|



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## For the Six Months Ended June 30, 2013

|  | As Reported | Error<br>Corrections | As Restated |
|--|-------------|----------------------|-------------|
| <b>Consolidated Statement of Comprehensive Income:</b>   |             |                      |             |
| Net income   | \$ 2,760    | \$ 178               | \$ 2,938    |
| Other comprehensive income (loss):   |             |                      |             |
| Unrealized gain on investments in available for sale securities, net of tax  | (289)       | 116                  | (173)       |
| Realized loss (gain) on investments in available for sale securities reclassified and included in net income, net of tax | 30          | (12)                 | 18          |
| Unrealized gains on equity investment in Affiliates Insurance Company  | (81)        |                      | (81)        |
| Other comprehensive income (loss)  | (340)       | 104                  | (236)       |
| Comprehensive income   | \$ 2,420    | \$ 282               | \$ 2,702    |

**Consolidated Statement of Cash Flows data:**

|  |          |       |       |       |          |          |          |          |
|--|----------|-------|-------|-------|----------|----------|----------|----------|
| Net income                               | 2,760    | 277   | (99)  | 178   | 2,938    | 2,938    |          |          |
| Depreciation and amortization            | 13,089   |       | (39)  | (39)  | 13,050   | (95)     | 12,955   |          |
| (Gain) loss from discontinued operations | 3,368    | 3     | 1,819 | 1,822 | 5,190    | (1,288)  | 3,902    |          |
| Provision for losses on receivables      | 2,842    |       | 683   | 683   | 3,525    | (785)    | 2,740    |          |
| Changes in assets and liabilities:       |          |       |       |       |          |          |          |          |
| Accounts receivable                      | (9,719)  |       | (269) | (221) | (490)    | (10,209) | 2,234    | (7,975)  |
| Prepaid expenses and other assets        | 9,377    | (544) |       | 636   | 92       | 9,469    | 91       | 9,560    |
| Accounts payable and accrued expenses    | (15,623) | 267   |       | (415) | (148)    | (15,771) | 21       | (15,750) |
| Accrued compensation and benefits        | 3,088    |       |       |       |          | 3,088    | (44)     | 3,044    |
| Due to related persons, net              | 1,315    |       |       | 62    | 62       | 1,377    |          | 1,377    |
| Other current and long term liabilities  | (1,473)  |       | 404   | (62)  | 342      | (1,131)  | (1)      | (1,132)  |
| Cash provided by operating activities    | 9,487    | 683   | 1,819 | 2,502 | 11,989   | 133      | 12,122   |          |
|  | (26,255) |       |       |       | (26,255) | 2,543    | (23,712) |          |

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|  |          |         |          |         |          |
|--|----------|---------|----------|---------|----------|
| Acquisition of property and equipment                                |          |         |          |         |          |
| Proceeds from disposition of property and equipment held for sale    | 15,901   |         | 15,901   | (2,567) | 13,334   |
| Cash used in investing activities                                    | (14,158) |         | (14,158) | (24)    | (14,182) |
| Repayments of mortgage notes payable                                 | (575)    | 37      | 37       | (538)   | (538)    |
| Cash used in financing activities                                    | (575)    | 37      | 37       | (538)   | (538)    |
| Net cash used in operating activities of discontinued operations     | (81)     | (3,608) | (3,608)  | (3,689) | (133)    |
| Net cash provided by investing activities of discontinued operations |          | 8,603   | 8,603    | 8,603   | 24       |
| Net cash used in financing activities of discontinued operations     |          | (7,534) | (7,534)  | (7,534) | (7,534)  |
| Net cash used in discontinued operations                             | (81)     | (2,539) | (2,539)  | (2,620) | (109)    |

**Consolidated  
Statement of  
Income data:**

|  |            |      |       |       |            |          |            |
|--|------------|------|-------|-------|------------|----------|------------|
| Senior living revenue  | \$ 269,040 | \$   | \$ 53 | \$ 53 | \$ 269,093 | \$       | \$ 269,093 |
| Rehabilitation hospital revenue  | 26,386     |      |       |       | 26,386     | (26,386) |            |
| Total revenues   | 322,826    |      | 53    | 53    | 322,879    | (26,386) | 296,493    |
| Senior living wages and benefits   | 130,240    |      | 12    | 12    | 130,252    |          | 130,252    |
| Rehabilitation hospital expense  | 23,872     |      |       |       | 23,872     | (23,872) |            |
| Rent expense   | 49,849     |      |       |       | 49,849     | (2,418)  | 47,431     |
| General and administrative   | 15,389     |      | 45    | 45    | 15,434     |          | 15,434     |
| Depreciation and amortization  | 6,276      |      | (20)  | (20)  | 6,256      | (53)     | 6,203      |
| Total operating expenses   | 312,156    |      | 37    | 37    | 312,193    | (26,343) | 285,850    |
| Operating income   | 10,670     |      | 16    | 16    | 10,686     | (43)     | 10,643     |
| Income from continuing operations before income taxes and equity in earnings of Affiliates |            |      |       |       |            |          |            |
| Insurance Company  | 9,344      |      | 16    | 16    | 9,360      | (43)     | 9,317      |
| Provision for income taxes   | (4,108)    | 274  |       |       | (3,834)    | 17       | (3,817)    |
| Income from continuing operations  | 5,312      | 274  | 16    | 290   | 5,602      | (26)     | 5,576      |
| Income from discontinued operations  | (674)      | (19) | 1     | (18)  | (692)      | 26       | (666)      |
| Net income   | 4,638      | 255  | 17    | 272   | 4,910      |          | 4,910      |

**Per Share Data:**
**Basic income per share from:**

|                              |         |  |  |  |         |  |         |
|------------------------------|---------|--|--|--|---------|--|---------|
| Continuing operations        | \$ 0.10 |  |  |  | \$ 0.12 |  | \$ 0.12 |
| Discontinued operations      | (0.01)  |  |  |  | (0.02)  |  | (0.02)  |
| Net income per share - basic | \$ 0.09 |  |  |  | \$ 0.10 |  | \$ 0.10 |

**Diluted income per share from:**

|                                |         |  |  |  |         |  |         |
|--------------------------------|---------|--|--|--|---------|--|---------|
| Continuing operations          | \$ 0.10 |  |  |  | \$ 0.12 |  | \$ 0.11 |
| Discontinued operations        | (0.01)  |  |  |  | (0.02)  |  | (0.01)  |
| Net income per share - diluted | \$ 0.09 |  |  |  | \$ 0.10 |  | \$ 0.10 |

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For the Three Months Ended June 30, 2012

|  | As Reported | Error<br>Corrections | As Restated |
|--|-------------|----------------------|-------------|
| <b>Consolidated Statement of Comprehensive Income:</b>   |             |                      |             |
| Net income   | 4,638       | 272                  | 4,910       |
| Other comprehensive income (loss):   |             |                      |             |
| Unrealized gain on investments in available for sale securities, net of tax  | 94          | (38)                 | 56          |
| Realized loss (gain) on investments in available for sale securities reclassified and included in net income, net of tax |             |                      |             |
| Unrealized gains on equity investment in Affiliates Insurance Company  | (3)         |                      | (3)         |
| Other comprehensive income (loss)  | 91          | (38)                 | 53          |
| Comprehensive income   | 4,729       | 234                  | 4,963       |

| <b>Consolidated Statement of Income data:</b>  |    |         |    |      |    |      |    |         |    |          |         |
|--|----|---------|----|------|----|------|----|---------|----|----------|---------|
| Senior living revenue  | \$ | 535,775 | \$ | 123  | \$ | 123  | \$ | 535,898 | \$ | 535,898  |         |
| Rehabilitation hospital revenue  |    | 53,173  |    |      |    |      |    | 53,173  |    | (53,173) |         |
| Total revenues   |    | 640,842 |    | 123  |    | 123  |    | 640,965 |    | (53,174) | 587,791 |
| Senior living wages and benefits   |    | 262,026 |    | 36   |    | 36   |    | 262,062 |    |          | 262,062 |
| General and administrative   |    | 30,844  |    | 89   |    | 89   |    | 30,933  |    |          | 30,933  |
| Rehabilitation hospital expense  |    | 47,991  |    |      |    |      |    | 47,991  |    | (47,991) |         |
| Rent expense   |    | 99,628  |    |      |    |      |    | 99,628  |    | (4,836)  | 94,792  |
| Depreciation and amortization  |    | 12,165  |    | (39) |    | (39) |    | 12,126  |    | (105)    | 12,021  |
| Total operating expenses   |    | 626,850 |    | 86   |    | 86   |    | 626,936 |    | (52,933) | 574,003 |
| Operating income   |    | 13,992  |    | 37   |    | 37   |    | 14,029  |    | (241)    | 13,788  |
| Income from continuing operations before income taxes and equity in earnings of Affiliates |    |         |    |      |    |      |    |         |    |          |         |
| Insurance Company  |    | 11,444  |    | 37   |    | 37   |    | 11,481  |    | (241)    | 11,240  |
| Provision for income taxes   |    | (5,063) |    | 347  |    | 347  |    | (4,716) |    | 98       | (4,618) |
| Income from continuing operations  |    | 6,502   |    | 347  |    | 384  |    | 6,886   |    | (143)    | 6,743   |
| Income from discontinued operations  |    | (1,495) |    | (11) |    | (9)  |    | (1,504) |    | 143      | (1,361) |
| Net income   |    | 5,007   |    | 336  |    | 375  |    | 5,382   |    |          | 5,382   |

**Per Share Data:**

|                                |    |        |  |  |  |  |  |        |      |  |        |      |
|--------------------------------|----|--------|--|--|--|--|--|--------|------|--|--------|------|
| Basic income per share from:   |    |        |  |  |  |  |  |        |      |  |        |      |
| Continuing operations          | \$ | 0.14   |  |  |  |  |  | \$     | 0.14 |  | \$     | 0.14 |
| Discontinued operations        |    | (0.03) |  |  |  |  |  | (0.03) |      |  | (0.03) |      |
| Net income per share - basic   | \$ | 0.11   |  |  |  |  |  | \$     | 0.11 |  | \$     | 0.11 |
| Diluted income per share from: |    |        |  |  |  |  |  |        |      |  |        |      |
| Continuing operations          | \$ | 0.14   |  |  |  |  |  | \$     | 0.14 |  | \$     | 0.14 |

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|                                |         |         |         |
|--------------------------------|---------|---------|---------|
| Discontinued operations        | (0.03)  | (0.03)  | (0.03)  |
| Net income per share - diluted | \$ 0.11 | \$ 0.11 | \$ 0.11 |

For the Six Months Ended June 30, 2012

|  | As Reported | Error<br>Corrections | As Restated |
|--|-------------|----------------------|-------------|
| <b>Consolidated Statement of Comprehensive Income:</b>   |             |                      |             |
| Net income   | 5,007       | 375                  | 5,382       |
| Other comprehensive income (loss):   |             |                      |             |
| Unrealized gain on investments in available for sale securities, net of tax  | 281         | (113)                | 168         |
| Realized loss (gain) on investments in available for sale securities reclassified and included in net income, net of tax | 1           |                      | 1           |
| Unrealized gains on equity investment in Affiliates Insurance Company  | (4)         |                      | (4)         |
| Other comprehensive income (loss)  | 278         | (113)                | 165         |
| Comprehensive income   | 5,285       | 262                  | 5,547       |

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| <b>Consolidated Statement of Cash Flows data:</b>                 |          |       |       |         |         |          |                |
|---|----------|-------|-------|---------|---------|----------|----------------|
| Net income  | 5,007    | 336   | 39    |         | 375     | 5,382    | 5,382          |
| Depreciation and amortization                                     | 12,165   |       | (39)  |         | (39)    | 12,126   | (105) 12,021   |
| Loss from discontinued operations                                 | 1,495    |       | (2)   | 1,159   | 1,157   | 2,652    | (241) 2,411    |
| Stock-based compensation  | 490      |       | 89    |         | 89      | 579      | 579            |
| Provision for losses on receivables                               | 2,153    |       |       |         |         | 2,153    | (325) 1,828    |
| <b>Changes in assets and liabilities:</b>                         |          |       |       |         |         |          |                |
| Accounts receivable   | (1,722)  |       | 36    | 90      | 126     | (1,596)  | (287) (1,883)  |
| Prepaid expenses and other assets                                 | 3,515    | (389) |       | 292     | (97)    | 3,418    | 25 3,443       |
| Accounts payable and accrued expenses                             | 2,140    | 53    |       | (1,433) | (1,380) | 760      | 1,105 1,865    |
| Accrued compensation and benefits                                 | 5,101    |       |       |         |         | 5,101    | (301) 4,800    |
| Due to related persons, net                                       | (2,703)  |       |       | 81      | 81      | (2,622)  | (2,622)        |
| Other current and long term liabilities                           | 984      |       | (123) | 970     | 847     | 1,831    | (1,056) 775    |
| Cash provided by operating activities                             | 28,460   |       |       | 1,159   | 1,159   | 29,619   | (1,185) 28,434 |
| Acquisition of property and equipment                             | (27,770) |       |       |         |         | (27,770) | 2,482 (25,288) |
| Proceeds from disposition of property and equipment held for sale | 13,967   |       |       |         |         | 13,967   | (2,900) 11,067 |
| Cash used in investing activities                                 | (21,475) |       |       |         |         | (21,475) | (418) (21,893) |
| Repayments of mortgage notes payable                              | (576)    |       |       | 70      | 70      | (506)    | (506)          |
| Cash used in financing activities                                 | (13,114) |       |       | 70      | 70      | (13,044) | (13,044)       |
| Net provided by operating activities of discontinued operations   | 1,390    |       |       | (450)   | (450)   | 940      | 1,185 2,125    |
|   |          |       |       | (709)   | (709)   | (709)    | 418 (291)      |

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|  |       |  |  |         |         |      |       |  |       |
|--|-------|--|--|---------|---------|------|-------|--|-------|
| Net cash used in investing activities of discontinued operations |       |  |  |         |         |      |       |  |       |
| Net cash used in financing activities of discontinued operations |       |  |  | (70)    | (70)    | (70) |       |  | (70)  |
| Net cash provided by discontinued operations                     | 1,390 |  |  | (1,229) | (1,229) | 161  | 1,603 |  | 1,764 |

**Consolidated Balance Sheet data:**

|  |           |         |         |          |       |          |          |           |             |           |
|--|-----------|---------|---------|----------|-------|----------|----------|-----------|-------------|-----------|
| Accounts receivable                    | \$ 53,134 | \$      | \$      | \$ (331) | \$    | \$ 1,391 | \$ 1,060 | \$ 54,194 | \$ (14,989) | \$ 39,205 |
| Due from related persons               |           |         |         |          |       | 6,881    | 6,881    | 6,881     |             | 6,881     |
| Prepaid and other current assets       | 29,644    | 9,507   | (1,763) |          | 1,681 | 9,425    | 39,069   | (751)     |             | 38,318    |
| Assets of discontinued operations      | 10,430    |         |         |          | 693   | 693      | 11,123   | 18,977    |             | 30,100    |
| Total current assets                   | 137,314   | 9,507   | (1,763) | (331)    | 693   | 9,953    | 18,059   | 155,373   | 3,237       | 158,610   |
| Property and equipment, net            | 335,612   |         |         | 110      | 4,929 |          | 5,039    | 340,651   | (3,157)     | 337,494   |
| Goodwill and other intangible assets   | 27,788    |         |         |          |       |          |          | 27,788    | (80)        | 27,708    |
| Other long term assets                 | 42,267    | (1,885) |         |          |       |          | (1,885)  | 40,382    |             | 40,382    |
| Total assets                           | 571,356   | 7,622   | (1,763) | (221)    | 5,622 | 9,953    | 21,213   | 592,569   |             | 592,569   |
| Accounts payable                       | 36,920    |         |         |          |       | 2,768    | 2,768    | 39,688    | (1,653)     | 38,035    |
| Accrued expenses                       | 22,996    | (544)   |         |          | 4,929 | 827      | 5,212    | 28,208    | (198)       | 28,010    |
| Accrued compensation and benefits      | 40,986    |         |         |          |       |          |          | 40,986    | (5,684)     | 35,302    |
| Due to related persons                 | 11,715    |         |         |          |       | 7,769    | 7,769    | 19,484    |             | 19,484    |
| Accrued real estate taxes              | 11,905    |         |         |          |       | (888)    | (888)    | 11,017    | (294)       | 10,723    |
| Security deposits                      | 9,727     |         |         | (647)    |       |          | (647)    | 9,080     | (23)        | 9,057     |
| Other current liabilities              | 15,299    |         |         |          |       | (523)    | (523)    | 14,776    | (1)         | 14,775    |
| Liabilities of discontinued operations | 8,448     |         |         | (21)     | 693   |          | 672      | 9,120     | 7,857       | 16,977    |
| Total current liabilities              | 183,960   | (544)   |         | (668)    | 5,622 | 9,953    | 14,363   | 198,323   | 4           | 198,327   |
| Other long term liabilities            | 6,615     | 101     |         |          |       |          | 101      | 6,716     | (4)         | 6,712     |
| Total long term liabilities            | 80,591    | 101     |         |          |       |          | 101      | 80,692    | (4)         | 80,688    |
|  | 354,083   |         |         | 81       |       |          | 81       | 354,164   |             | 354,164   |

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|   |            |          |            |          |          |          |           |            |    |  |  |            |
|---|------------|----------|------------|----------|----------|----------|-----------|------------|----|--|--|------------|
| Additional paid<br>in capital                   |            |          |            |          |          |          |           |            |    |  |  |            |
| Accumulated<br>deficit                          | (49,637)   | 6,579    | (1,763)    | 366      |          |          | 5,182     | (44,455)   |    |  |  | (44,455)   |
| Cumulative<br>other<br>comprehensive<br>income  | 1,877      | 1,486    |            |          |          |          | 1,486     | 3,363      |    |  |  | 3,363      |
| Total<br>shareholders<br>equity                 | 306,805    | 8,065    | (1,763)    | 447      |          |          | 6,749     | 313,554    |    |  |  | 313,554    |
| Total liabilities<br>and shareholders<br>equity | \$ 571,356 | \$ 7,622 | \$ (1,763) | \$ (221) | \$ 5,622 | \$ 9,953 | \$ 21,213 | \$ 592,569 | \$ |  |  | \$ 592,569 |



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We have three operating segments: senior living communities, rehabilitation and wellness and rehabilitation hospitals. In the senior living community segment, we operate for our own account or manage for the account of SNH independent living communities, assisted living communities and SNFs that are subject to centralized oversight and provide housing and services to elderly residents. Our rehabilitation and wellness operating segment does not meet any of the quantitative thresholds of a reportable segment as prescribed under FASB ASC Topic 280, and as discussed further in Note 10 to the Notes to our Condensed Consolidated Financial Statements included in Item 1 of this Amended Quarterly Report, our rehabilitation hospital operating segment has been reclassified as discontinued operations. After the reclassification of our rehabilitation hospital business as discontinued operations, our business is comprised of one reportable segment, senior living. All of our operations and assets are located in the United States, except for the operations of our captive insurance company subsidiary, which participates in our workers' compensation, professional liability and automobile insurance programs and which is organized in the Cayman Islands.

As discussed further in Note 12, we are restating our condensed consolidated financial statements for the three and six month periods ended June 30, 2013 and 2012 contained within our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, or our Quarterly Report, to correct certain errors in the accounting for income taxes. In addition, as part of the restatement process we have corrected certain other errors related to insurance receivables, security deposits, accrual of fixed asset additions, classification of senior living operating expenses and certain other immaterial items. We corrected the presentation and disclosure of our consolidated statements of cash flows to separately identify the net cash flows from discontinued operations, by category and in total. Also, as described in Note 6, we have corrected the footnote presentation of certain of our available for sale debt securities from Level 1 assets to Level 2 assets as defined in the fair value hierarchy and corrected the disclosure of the fair market value of our mortgage notes payable.

**Key Statistical Data For the Three Months Ended June 30, 2013 and 2012:**

The following tables present a summary of our operations for the three months ended June 30, 2013 and 2012:

| (dollars in thousands, except average monthly rate)        | Three months ended June 30, |                    |           |              |
|--|-----------------------------|--------------------|-----------|--------------|
|  | 2013<br>(Restated)          | 2012<br>(Restated) | \$ Change | %/bps Change |
| Senior living revenue                                      | \$ 268,827                  | \$ 269,093         | \$ (266)  | (0.1)%       |
| Management fee revenue                                     | 2,281                       | 1,302              | 979       | 75.2%        |
| Reimbursed costs incurred on behalf of managed communities | 52,153                      | 26,098             | 26,055    | 99.8%        |
| Total revenue  | 323,261                     | 296,493            | 26,768    | 9.0%         |
| Senior living wages and benefits                           | (130,390)                   | (130,252)          | (138)     | (0.1)%       |
| Other senior living operating expenses                     | (65,752)                    | (63,797)           | (1,955)   | (3.1)%       |
| Costs incurred on behalf of managed communities            | (52,153)                    | (26,098)           | (26,055)  | (99.8)%      |
| Rent expense   | (48,279)                    | (47,431)           | (848)     | (1.8)%       |
| General and administrative expense                         | (15,451)                    | (15,434)           | (17)      | (0.1)%       |
| Depreciation and amortization expense                      | (6,585)                     | (6,203)            | (382)     | (6.2)%       |
| Gain on settlement   |                             | 3,365              | (3,365)   | (100.0)%     |
| Interest, dividend and other income                        | 211                         | 234                | (23)      | (9.8)%       |

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|  |          |          |            |          |
|--|----------|----------|------------|----------|
| Interest and other expense                         | (1,355)  | (1,605)  | 250        | 15.6%    |
| Acquisition related costs                          | (41)     |          | (41)       | (100.0)% |
| Gain on early extinguishment of debt               |          | 45       | (45)       | (100.0)% |
| Loss on sale of available for sale securities      | (117)    |          | (117)      | (100.0)% |
| Provision for income taxes                         | (1,131)  | (3,817)  | 2,686      | 70.4%    |
| Equity in earnings of Affiliates Insurance Company | 79       | 76       | 3          | 3.9%     |
| Income from continuing operations                  | \$ 2,297 | \$ 5,576 | \$ (3,279) | (58.8)%  |

Total number of communities (end of period):

|                                 |     |     |    |       |
|---------------------------------|-----|-----|----|-------|
| Owned and leased communities    | 211 | 211 |    |       |
| Managed communities             | 39  | 25  | 14 | 56.0% |
| Number of total communities (1) | 250 | 236 | 14 | 5.9%  |

Total number of living units (end of period):

|                                  |        |        |       |       |
|----------------------------------|--------|--------|-------|-------|
| Owned and leased living units    | 23,020 | 23,020 |       |       |
| Managed living units             | 6,678  | 3,735  | 2,943 | 78.8% |
| Number of total living units (1) | 29,698 | 26,755 | 2,943 | 11.0% |

Owned and leased communities:

|   |          |          |       |         |
|---|----------|----------|-------|---------|
| Occupancy %   | 85.5%    | 86.0%    | n/a   | (50)bps |
| Average monthly rate(2)   | \$ 4,438 | \$ 4,406 | \$ 32 | 0.7%    |
| Percent of senior living revenue from Medicaid                  | 10.7%    | 11.4%    | n/a   | (70)bps |
| Percent of senior living revenue from Medicare                  | 12.6%    | 12.8%    | n/a   | (20)bps |
| Percent of senior living revenue from private and other sources | 76.7%    | 75.8%    | n/a   | 90bps   |

(1) Excludes those senior living communities we have classified as discontinued operations.

(2) Average monthly rate is calculated by taking the average daily rate, which is defined as total operating revenue divided by occupied units, during the period and multiplying it by 30 days.

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Comparable senior living communities (senior living communities that we have owned, leased or managed and operated continuously since April 1, 2012):

| (dollars in thousands, except average monthly rate)             | Three months ended June 30, |                    |           |              |
|---|-----------------------------|--------------------|-----------|--------------|
|   | 2013<br>(Restated)          | 2012<br>(Restated) | \$ Change | %/bps Change |
| Senior living revenue   | \$ 268,827                  | \$ 269,093         | \$ (266)  | (0.1)%       |
| Management fee revenue  | 1,246                       | 1,302              | (56)      | (4.3)%       |
| Senior living wages and benefits                                | (130,390)                   | (130,252)          | (138)     | (0.1)%       |
| Other senior living operating expenses                          | (65,752)                    | (63,797)           | (1,955)   | (3.1)%       |
| <b>Total number of communities (end of period):</b>             |                             |                    |           |              |
| Owned and leased communities                                    | 211                         | 211                |           |              |
| Managed communities   | 25                          | 25                 |           |              |
| Number of total communities (1)                                 | 236                         | 236                |           |              |
| <b>Total number of living units (end of period):</b>            |                             |                    |           |              |
| Owned and leased living units                                   | 23,020                      | 23,020             |           |              |
| Managed living units  | 3,735                       | 3,735              |           |              |
| Number of total living units (1)                                | 26,755                      | 26,755             |           |              |
| <b>Owned and leased communities:</b>                            |                             |                    |           |              |
| Occupancy %   | 85.5%                       | 86.0%              | n/a       | (50)bps      |
| Average monthly rate(2)   | \$ 4,438                    | \$ 4,406           | \$ 32     | 0.7%         |
| Percent of senior living revenue from Medicaid                  | 10.7%                       | 11.4%              | n/a       | (70)bps      |
| Percent of senior living revenue from Medicare                  | 12.6%                       | 12.8%              | n/a       | (20)bps      |
| Percent of senior living revenue from private and other sources | 76.7%                       | 75.8%              | n/a       | 90bps        |

(1) Excludes those senior living communities we have classified as discontinued operations.

(2) Average monthly rate is calculated by taking the average daily rate, which is defined as total operating revenue divided by occupied units, during the period and multiplying it by 30 days.

### Three Months Ended June 30, 2013 Compared to Three Months Ended June 30, 2012

Our senior living revenue was almost unchanged for the three months ended June 30, 2013 compared to the same period in 2012, with increased per diem charges to residents offset by a decrease in occupancy during the second quarter 2013 compared to the same period in 2012.

Our management fee revenue and reimbursed costs at our managed communities increased significantly during the three months ended June 30, 2013 compared to the same period in 2012 due to an increase in the number of communities we managed from 25 to 39 during the respective periods.



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Our senior living wages and benefits increased 0.1% for the three months ended June 30, 2013 compared to the same period in 2012 primarily due to increased employee health insurance costs partially offset by certain lower wage costs. Our other senior living operating expenses, which include utilities, housekeeping, dietary, maintenance, insurance and community level administrative costs, increased 3.1% due to increased charges from various service providers and general maintenance expenses. Our rent expense increased 1.8% compared to the same period in 2012 primarily due to our payment of additional rent for senior living community capital improvements purchased by SNH since April 1, 2012.

Our depreciation and amortization expense increased 6.2% for the three months ended June 30, 2013 compared to the same period in 2012 primarily due to capital expenditures (net of our sales of capital improvements to SNH), including depreciation costs arising from our purchase of furniture and fixtures for our owned communities.

General and administrative expenses increased 0.1% for the three months ended June 30, 2013 compared to the same period in 2012 primarily due to increased business management fees resulting from the increased size of our business, partially offset by lower costs associated with certain third party services.

Our interest, dividend and other income decreased 9.8% for the three months ended June 30, 2013 compared to the same period in 2012 due to lower investable cash balances and lower yields realized on our investments.

Our interest and other expense decreased 15.6% for the three months ended June 30, 2013 compared to the same period in 2012 primarily due to our purchase and retirement of \$12.4 million par value of the outstanding Notes since April 1, 2012 and our repayment and subsequent termination of the Bridge Loan in April 2012.

For the three months ended June 30, 2013, we recognized a tax expense from continuing operations of \$1.1 million. During this period, we also recognized a tax benefit from discontinued operations of \$941,000. As of December 31, 2012, our federal net operating loss carry forward, which begins to expire in 2026 if unused, was approximately \$70.8 million, and our tax credit carry forward, which begins to expire in 2022 if unused, was approximately \$11.7 million. For more information about our taxes, see Note 4 to our condensed consolidated financial statements included in Part I, Item 1 of this Amended Quarterly Report.

Discontinued operations:

Loss from discontinued operations for the three months ended June 30, 2013 increased \$833,000 to \$1.5 million, compared to a loss of \$666,000 for the three months ended June 30, 2012. The losses in both years are primarily due to losses incurred at assisted living communities, SNFs and rehabilitation hospitals and affiliated clinics that we have sold or expect to sell, which includes an impairment of long-lived assets during the three months ended June 30, 2013 of \$1.2 million. The loss for the three months ended June 30, 2013 is after giving effect to a tax benefit of \$941,000 that we recognized in that period relating to our discontinued operations.



Table of Contents**Key Statistical Data For the Six Months Ended June 30, 2013 and 2012:**

The following tables present a summary of our operations for the six months ended June 30, 2013 and 2012:

| (dollars in thousands, except average monthly rate)             | Six months ended June 30, |                    | \$ Change  | %/bps Change |
|---|---------------------------|--------------------|------------|--------------|
|   | 2013<br>(Restated)        | 2012<br>(Restated) |            |              |
| Senior living revenue   | \$ 538,067                | \$ 535,898         | \$ 2,169   | 0.4%         |
| Management fee revenue  | 4,583                     | 2,390              | 2,193      | 91.8%        |
| Reimbursed costs incurred on behalf of managed communities      | 104,211                   | 49,503             | 54,708     | 110.5%       |
| Total revenue   | 646,861                   | 587,791            | 59,070     | 10.0%        |
| Senior living wages and benefits                                | (262,817)                 | (262,062)          | (755)      | (0.3)%       |
| Other senior living operating expenses                          | (132,090)                 | (128,057)          | (4,033)    | (3.1)%       |
| Costs incurred on behalf of managed communities                 | (104,211)                 | (49,503)           | (54,708)   | (110.5)%     |
| Rent expense  | (96,292)                  | (94,792)           | (1,500)    | (1.6)%       |
| General and administrative                                      | (30,583)                  | (30,933)           | 350        | 1.1%         |
| Depreciation and amortization expense                           | (12,955)                  | (12,021)           | (934)      | (7.8)%       |
| Gain on settlement  |                           | 3,365              | (3,365)    | (100.0)%     |
| Interest, dividend and other income                             | 408                       | 439                | (31)       | (7.1)%       |
| Interest and other expense                                      | (2,811)                   | (3,031)            | 220        | 7.3%         |
| Acquisition related costs                                       | (41)                      |                    | (41)       | (100.0)%     |
| Gain on early extinguishment of debt                            |                           | 45                 | (45)       | (100.0)%     |
| Loss on sale of available for sale securities                   | (30)                      | (1)                | (29)       | (2,900.0)%   |
| Provision for income taxes                                      | (356)                     | (4,618)            | 4,262      | 92.3%        |
| Equity in earnings of Affiliates Insurance Company              | 155                       | 121                | 34         | 28.1%        |
| Income from continuing operations                               | \$ 5,238                  | \$ 6,743           | \$ (1,505) | (22.3)%      |
| <b>Total number of communities (end of period):</b>             |                           |                    |            |              |
| Owned and leased communities                                    | 211                       | 211                |            |              |
| Managed communities   | 39                        | 25                 | 14         | 56.0%        |
| Number of total communities (1)                                 | 250                       | 236                | 14         | 5.9%         |
| <b>Number of living units:</b>                                  |                           |                    |            |              |
| Owned and leased living units                                   | 23,020                    | 23,020             |            |              |
| Managed living units  | 6,678                     | 3,735              | 2,943      | 78.8%        |
| Number of total living units (1)                                | 29,698                    | 26,755             | 2,943      | 11.0%        |
| <b>Owned and leased communities:</b>                            |                           |                    |            |              |
| Occupancy %   | 85.8%                     | 86.2%              | n/a        | (40)bps      |
| Average monthly rate(2)   | \$ 4,455                  | \$ 4,384           | \$ 71      | 1.6%         |
| Percent of senior living revenue from Medicaid                  | 10.8%                     | 11.2%              | n/a        | (40)bps      |
| Percent of senior living revenue from Medicare                  | 12.9%                     | 12.9%              | n/a        |              |
| Percent of senior living revenue from private and other sources | 76.3%                     | 75.9%              | n/a        | 40bps        |

(1) Excludes those senior living communities we have classified as discontinued operations.

(2) Average monthly rate is calculated by taking the average daily rate, which is defined as total operating revenue divided by occupied units, during the period and multiplying it by 30 days.





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Comparable senior living communities (senior living communities that we have owned, leased or managed and operated continuously since January 1, 2012):

| (dollars in thousands, except average monthly rate)             | 2013<br>(Restated) | Six months ended June 30,<br>2012<br>(Restated) | \$ Change | %/bps Change |
|---|--------------------|---|-----------|--------------|
| Senior living revenue   | \$ 538,067         | \$ 535,898                                      | \$ 2,169  | 0.4%         |
| Management fee revenue  | 2,224              | 2,155   | 69        | 3.2%         |
| Senior living wages and benefits                                | (262,817)          | (262,062)                                       | (755)     | (0.3)%       |
| Other senior living operating expenses                          | (132,090)          | (128,057)                                       | (4,033)   | (3.1)%       |
| <b>Total number of communities (end of period):</b>             |                    |   |           |              |
| Owned and leased communities                                    | 211                | 211   |           |              |
| Managed communities   | 23                 | 23  |           |              |
| Number of total communities (1)                                 | 234                | 234   |           |              |
| <b>Number of living units:</b>                                  |                    |   |           |              |
| Owned and leased living units                                   | 23,020             | 23,020  |           |              |
| Managed living units  | 3,390              | 3,390   |           |              |
| Number of total living units (1)                                | 26,410             | 26,410  |           |              |
| <b>Owned and leased communities:</b>                            |                    |   |           |              |
| Occupancy %   | 85.8%              | 86.2%   | n/a       | (40)bps      |
| Average monthly rate(2)   | \$ 4,455           | \$ 4,384  | \$ 71     | 1.6%         |
| Percent of senior living revenue from Medicaid                  | 10.8%              | 11.2%   | n/a       | (40)bps      |
| Percent of senior living revenue from Medicare                  | 12.9%              | 12.9%   | n/a       |              |
| Percent of senior living revenue from private and other sources | 76.3%              | 75.9%   | n/a       | 40bps        |

(1) Excludes those senior living communities we have classified as discontinued operations.

(2) Average monthly rate is calculated by taking the average daily rate, which is defined as total operating revenue divided by occupied units, during the period and multiplying it by 30 days.

### Six Months Ended June 30, 2013 Compared to Six Months Ended June 30, 2012

Our senior living revenue increased 0.4% for the six months ended June 30, 2013 compared to the same period in 2012 primarily due to increased per diem charges to residents partially offset by a decrease in occupancy.

Our management fee revenue and reimbursed costs at our managed communities increased significantly during the six months ended June 30, 2013 compared to the same period in 2012 due to an increase in the number of communities we managed from 25 to 39 beginning in the second half of 2012 and increases in our management fee revenues and reimbursed costs at our same store comparable managed communities, which was primarily due to increases in occupancy.

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Our senior living wages and benefits increased 0.3% for the six months ended June 30, 2013 compared to the same period in 2012 primarily due to increased employee health insurance costs, partially offset by certain lower wage costs. Our other senior living operating expenses, which include utilities, housekeeping, dietary, maintenance, insurance and community level administrative costs, increased 3.1% due to increased charges from various service providers and general maintenance expenses. Our rent expense increased 1.6% compared to the same period in 2012 primarily due to our payment of additional rent for senior living community capital improvements purchased by SNH since January 1, 2012.

Our depreciation and amortization expense increased 7.8% for the six months ended June 30, 2013 compared to the same period in 2012 primarily due to capital expenditures (net of our sales of capital improvements to SNH), including depreciation costs arising from our purchase of furniture and fixtures for our owned communities.

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General and administrative expenses decreased 1.1% for the six months ended June 30, 2013 compared to the same period in 2012 primarily due to lower costs associated with certain third party services, partially offset by increased business management fees resulting from the increased size of our business.

Our interest, dividend and other income decreased 7.1% for the six months ended June 30, 2013 compared to the same period in 2012 due to lower investable cash balances and lower yields realized on our investments.

Our interest and other expense decreased 7.3% for the three months ended June 30, 2013 compared to the same period in 2012 primarily due to our purchase and retirement of \$12.4 million par value of the outstanding Notes since January 1, 2012 and our repayment and subsequent termination of the Bridge Loan in April 2012.

For the six months ended June 30, 2013, we recognized a tax expense from continuing operations of \$356,000, which includes a tax benefit of \$1.5 million relating to a work opportunity tax credit program that expired in 2012 and which was retroactively reinstated on January 3, 2013 and extended by the American Taxpayer Relief Act of 2012, which was enacted on January 2, 2013. As prescribed by FASB ASC Topic 740, Accounting for Income Taxes, the effects of tax law changes are recognized in the period in which new legislation is enacted; and the total effect of the reinstatement of the work opportunity tax credit program relating to 2012 employee wages is recorded as a component of income tax expense in continuing operations during the first quarter of 2013. We also recognized in the six months ended June 30, 2013 a tax benefit from discontinued operations of \$1.6 million. As of December 31, 2012, our federal net operating loss carry forward, which begins to expire in 2026 if unused, was approximately \$70.8 million, and our tax credit carry forward, which begins to expire in 2022 if unused, was approximately \$11.7 million. For more information relating to our taxes, see Note 4 to our condensed consolidated financial statements included in Part I, Item I of this Amended Quarterly Report.

Discontinued operations:

Loss from discontinued operations for the six months ended June 30, 2013 increased \$939,000 to \$2.3 million, compared to a loss of \$1.4 million for the six months ended June 30, 2012. The losses in both years are primarily due to losses incurred at assisted living communities, SNFs and rehabilitation hospitals and affiliated clinics that we have sold or expect to sell, which includes an impairment of long-lived assets during the six months ended June 30, 2013 of \$1.2 million. The loss for the six months ended June 30, 2013 is after giving effect to a tax benefit of \$1.6 million that we recognized in that period relating to our discontinued operations.

**LIQUIDITY AND CAPITAL RESOURCES**

As of June 30, 2013, we had \$19.3 million of unrestricted cash and cash equivalents and \$35.0 million and \$149.4 million available to borrow under our Credit Agreement and our Credit Facility, respectively. We expect to use the cash flow from our operations, our cash balances, borrowings under our Credit Agreement and our Credit Facility and proceeds from our sales to SNH of capital improvements we may make to our properties that we lease from SNH for increased rent pursuant to our leases with SNH to fund our operations, debt repayments, investments in and maintenance of our properties, including those which are not improvements that we may sell to SNH, future property acquisitions and other general business purposes. We believe such amounts will be sufficient to fund these activities for the next 12 months and for the foreseeable future thereafter. If, however, our occupancies decline from historic levels, the non-government rates we receive for our services

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decline or government reimbursement rates are reduced and we are unable to generate positive cash flow for an extended period, we expect that we would explore alternatives to fund our operations. Such alternatives may include reducing our costs, incurring debt under, and perhaps in addition to, our Credit Agreement and our Credit Facility, engaging in sale leaseback transactions of our owned communities, mortgage financing our communities that we own and that are not subject to existing mortgages and issuing new equity or debt securities. We have an effective shelf registration statement that allows us to issue public securities on an expedited basis, but this registration statement does not assure that there will be buyers for such securities.

### **Assets and Liabilities**

Our total current assets at June 30, 2013 were \$145.8 million, compared to \$158.6 million at December 31, 2012. At June 30, 2013, we had cash and cash equivalents of \$19.3 million compared to \$24.6 million at December 31, 2012. The

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decrease in our cash and cash equivalents primarily results from using excess cash balances in our captive insurance program to invest in available for sale securities. Our current liabilities were \$175.1 million at June 30, 2013 compared to \$198.3 million at December 31, 2012.

We had net cash flows from continuing operations of \$12.1 million for the six months ended June 30, 2013 compared to \$28.4 million for the same period in 2012. Acquisitions of property, plant and equipment in our continuing operations on a net basis after considering the proceeds from sales of fixed assets to SNH, were \$10.4 million and \$14.2 million for the six months ended June 30, 2013 and 2012, respectively.

**Our Leases and Management Agreements with SNH**

As of June 30, 2013, we leased 177 senior living communities, which are included in our continuing operations and 11 senior living communities and two rehabilitation hospitals which we have classified as discontinued operations, from SNH under four leases. Our total annual rent payable to SNH as of June 30, 2013 was \$199.0 million, excluding percentage rent based on increases in gross revenues at certain properties. Our total rent expense with SNH was \$50.9 million and \$49.9 million for the three months ended June 30, 2013 and 2012, respectively, and \$101.5 million and \$99.7 million for the six months ended June 30, 2013 and 2012, respectively, which included approximately \$1.5 million and \$1.2 million in percentage rent paid to SNH for the three months ended June 30, 2013 and 2012, respectively, and \$2.9 million and \$2.4 million for the six months ended June 30, 2013 and 2012, respectively.

Upon our request, SNH may purchase capital improvements made at the properties we lease from SNH and increase our rent pursuant to contractual formulas; however, SNH is not obligated to purchase these improvements from us and we are not obligated to sell them to SNH. During the six months ended June 30, 2013, SNH purchased from us \$15.9 million for capital expenditures made at the properties leased from SNH and these purchases resulted in our annual rent being increased by approximately \$1.3 million.

During 2012, we entered into several management agreements, pooling agreements and lease amendments with SNH and its affiliates. For more information regarding these 2012 activities and our leases and management agreements with SNH, see Note 9 to our condensed consolidated financial statements included in Part I, Item 1 of this Amended Quarterly Report and Note 15 to our consolidated financial statements included in Item 15 of our Amended 2012 Annual Report.

**Litigation Settlement**

On May 29, 2012, we entered into the Settlement Agreement with Sunrise pursuant to which we agreed to settle our long running litigation with Sunrise involving amounts charged by Sunrise to us for certain insurance programs for senior living communities previously managed by Sunrise for us. Pursuant to the Settlement Agreement, Sunrise paid us \$4.0 million in cash and we recorded a gain of \$3.4 million, net of legal fees, in our condensed consolidated statements of income.

**Our Revenues**

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Our revenues from services to residents at our senior living communities and patients of our rehabilitation hospitals and affiliated clinics are our primary source of cash to fund our operating expenses, including rent, capital expenditures and principal and interest payments on our debt.

During the past several years, weak economic conditions throughout the country have negatively affected many entities both within and outside of our industry. These conditions have resulted in, among other things, a decrease in our communities' occupancy, and it is unclear when these conditions, especially in the housing market, may materially improve. Although many of the services that we provide are needs-driven, some of our prospective residents may be deferring their decisions to relocate to senior living communities in light of current economic circumstances. Recently, economic indicators reflect an improving housing market; however, even with those improvements, housing activity remains below pre-recession levels and it is unclear how sustainable the improvements will be and whether any such improvements will result in any increased demand for our services.

At some of our senior living communities (principally our SNFs) and our rehabilitation and wellness clinics, Medicare and Medicaid programs provide operating revenues for skilled nursing and rehabilitation services. These programs are discussed in Part I, Item 1 of our Amended 2012 Annual Report under the caption "Government Regulation and

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Reimbursement . We derived approximately 23.8% and 24.1% of our senior living community revenues from continuing operations from these programs during the six months ended June 30, 2013 and 2012, respectively.

Our net Medicare revenues from services to senior living community residents from continuing operations totaled \$68.7 million and \$67.9 million during the six months ended June 30, 2013 and 2012, respectively. Our net Medicaid revenues from services to senior living community residents from continuing operations totaled \$57.4 million and \$59.2 million during the six months ended June 30, 2013 and 2012, respectively. Our net Medicare revenues from our rehabilitation hospital business, which we have classified as discontinued operations, totaled \$36.1 million and \$34.7 million during the six months ended June 30, 2013 and 2012, respectively. Our net Medicaid revenues from our rehabilitation hospital business, which we have classified as discontinued operations, totaled \$1.6 million and \$1.7 million during the six months ended June 30, 2013 and 2012, respectively. Our Medicare net revenue is heavily influenced by adjustments to the Prospective Payment System, or PPS, by the Centers for Medicare & Medicaid Services, or CMS. PPS is a method of reimbursement by which CMS makes Medicare payments for services based on a predetermined, fixed payment amount based on the classification system of that service, in contrast to a traditional fee-for-service model. CMS updates PPS rates by facility type annually. For federal fiscal year 2012, CMS adopted a final rule that reduced aggregate Medicare PPS rates for SNFs by approximately 11.1%. For federal fiscal year 2013, CMS increased Medicare PPS rates for SNFs by 1.8%. Due to the prior reduction of approximately 11.1%, however, Medicare payment rates will be lower for federal fiscal year 2013 than they were in federal fiscal year 2011. In addition, the Middle Class Tax Relief and Job Creation Act of 2012, which was enacted in February 2012, gradually reduces the reimbursement rate for Medicare bad debt from 100% to 65% in federal fiscal year 2015 for beneficiaries dually-eligible for Medicare and Medicaid. Because nearly 90% of SNF bad debt has historically been related to dual-eligible beneficiaries, this rule has a substantial adverse effect on SNFs. The Middle Class Tax Relief and Job Creation Act of 2012 also reduced the Medicare bad debt reimbursement rate for Medicare beneficiaries not eligible for Medicaid from 70% to 65%. Additionally, the Budget Control Act of 2011 allows for automatic reductions in federal spending by means of a process called sequestration, which has reduced Medicare payments by 2% since April 1, 2013. Sequestration could result in reductions to our revenues from Medicare and certain other federal health programs over the next decade. Any future reductions in Medicare payment rates could be adverse and material to our operations and to our future financial results of operations.

Although Medicaid is exempt from the sequestration process, some of the states in which we operate either have not raised Medicaid rates by amounts sufficient to offset increasing costs or have frozen or reduced, or are expected to freeze or reduce, Medicaid rates. In addition, certain temporary increases in federal payments to states for Medicaid programs that had been in effect since October 1, 2008 ended as of June 30, 2011. Despite these freezes and reduced payments to states, according to the 2012 Actuarial Report on the Financial Outlook for Medicaid, Medicaid enrollment is projected to increase at an average annual rate of 3.4% through 2021, due in part to the expansion in Medicaid eligibility under the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, or collectively the ACA, beginning in 2014. Under the ACA, the federal government would pay for 100% of a state's expansion in the Medicaid program to groups not currently covered by Medicaid for the first three years and gradually reduce its subsidy to 90% by 2020. As of June 30, 2013, however, more than 20 states elected not to broaden Medicaid eligibility and, instead, to forgo the federal funds that would otherwise be available for Medicaid expansion. We expect the ending of temporary federal payments, combined with the anticipated slow recovery of state revenues from the recent economic recession, as well as other costs and budgetary constraints for state governments, to result in continued challenging state fiscal conditions. Some state budget deficits may increase, and certain states may reduce Medicaid payments to healthcare services providers like us as part of an effort to balance their budgets.

Medicare and Medicaid programs provided approximately 67.6% and 68.6% of our revenues from our rehabilitation hospital business, which we have classified as discontinued operations, for the six months ended June 30, 2013 and 2012, respectively. For federal fiscal year 2012, CMS adopted a final rule that updated Medicare PPS rates for inpatient rehabilitation facilities, or IRFs, which includes our rehabilitation hospitals. The updates included an aggregate net increase of 2.2% in IRF PPS rates. This 2.2% increase is the net effect of the rate adjustments due to a rebased market basket update of approximately 2.9% to account for inflation, reduced by an automatic 0.1% and by a productivity adjustment of 1.0%, both pursuant to the ACA, and increased by 0.4% in estimated outlier payments. CMS subsequently adopted updated Medicare PPS rates for federal fiscal year 2013 which CMS estimates will increase aggregate Medicare payment rates for IRFs by 2.1%. The aggregate effect on our former IRF Medicare payments for federal fiscal year 2013 may vary from CMS's estimate based on wage indexes and low income patient percentages contained in the final rule.

In addition, our two rehabilitation hospitals were required to satisfy the so-called "60% Rule" in order to be classified as an IRF by the Medicare program. Pursuant to the 60% Rule, at least 60% of a facility's inpatient population during each



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12-month cost-reporting period must require intensive rehabilitation services for one of CMS's 13 designated medical conditions. An IRF that fails to meet the requirements of the 60% Rule is subject to reclassification as a different type of healthcare provider, the effect of which would be to lower that IRF's Medicare payment rates. Although we believe that our former IRFs operated in compliance with the 60% Rule during the time we operated them, the actual percentage of patients at our IRFs who received services for a designated condition may not be as high as we believed. Our failure to have complied, or a CMS finding of noncompliance, could result in our retroactively receiving lower Medicare rates and require us to refund prior amounts we may have received in excess of the assessed payment rate for services we previously provided at our former IRFs and could materially and adversely affect our future financial results.

We cannot currently predict the type and magnitude of the potential Medicare and Medicaid policy changes, rate reductions or other changes and the impact on us of the possible failure of these programs to increase rates to match our increasing expenses, but they may be adverse and material to our operations and to our future financial results of operations. Similarly, we are unable to predict the impact on us of the insurance changes, payment changes, and healthcare delivery systems changes contained in and to be developed pursuant to the ACA or the impact the various remaining challenges and potential changes to the ACA may have on its implementation. If the changes to be implemented under the ACA result in reduced payments for our services, or the failure of Medicare, Medicaid or insurance payment rates to cover our costs of providing required services to residents, our future financial results could be materially and adversely affected.

## **Debt Financings and Covenants**

As of June 30, 2013, we had no outstanding borrowings under either of our Credit Agreement or our Credit Facility. As of June 30, 2013, we had \$24.9 million aggregate principal amount of Notes outstanding and \$38.2 million aggregate principal amount of mortgage notes outstanding. On July 8, 2013, we redeemed our entire \$24.9 million aggregate principal amount outstanding Notes at a redemption price equal to the principal amount, plus accrued and unpaid interest. We funded this redemption with cash on hand and borrowings under our Credit Facility. As of June 30, 2013, we believe we were in compliance with all applicable covenants under those debt agreements and instruments. As of July 30, 2013, we had \$0 and \$10,000, respectively, outstanding under our Credit Agreement and Credit Facility. For more information regarding our debt financings and covenants, including terms governing those debt financings and their maturities, and the Bridge Loan we repaid in full in April 2012, please see Note 7 to our condensed consolidated financial statements in Part I, Item 1 of this Amended Quarterly Report, which is incorporated herein by reference.

## **Off Balance Sheet Arrangements**

We have pledged our accounts receivable and certain other assets, with a carrying value, as of June 30, 2013, of \$12.7 million arising from our operation of 26 properties owned by SNH and leased to us to secure SNH's borrowings from its lender, FNMA. As of June 30, 2013, we had no other off balance sheet arrangements that have had or that we expect would be reasonably likely to have a future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

## **Related Person Transactions**

We have relationships and historical and continuing transactions with our Directors, our executive officers, SNH, RMR, AIC and other companies to which RMR provides management services and others affiliated with them. For example: SNH is our former parent, our largest

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landlord and our largest stockholder and RMR provides management services to both us and SNH; we provide management services to D&R Yonkers LLC which is owned by SNH's executive officers and we manage a portion of a senior living community which D&R Yonkers LLC subleases from SNH in order to accommodate certain requirements of New York healthcare licensing laws; we, RMR, SNH and five other companies to which RMR provides management services each currently own 12.5% of AIC, and we and the other shareholders of AIC have property insurance in place providing \$500.0 million of coverage pursuant to an insurance program arranged by AIC and with respect to which AIC is a reinsurer of certain coverage amounts; and RMR, a company that employs our President and Chief Executive Officer, our Treasurer and Chief Financial Officer, and one of our Managing Directors and which is majority owned by one of our Managing Directors, assists us with various aspects of our business pursuant to a business management and shared services agreement. For further information about these and other such relationships and related person transactions, please see Note 9 to our condensed consolidated financial statements included in Part I, Item 1 of this Amended Quarterly Report, which is incorporated herein by reference. In addition, for more information about these transactions and relationships, please see elsewhere in this Amended Quarterly Report,

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including Warning Concerning Forward Looking Statements in Part I, and our Annual Report, our definitive Proxy Statement for the Annual Meeting of Stockholders held on May 16, 2013, or our Proxy Statement, and our other filings with the SEC, including Note 15 to our consolidated financial statements included in our Amended 2012 Annual Report, the sections captioned Business, Management's Discussion and Analysis of Financial Condition and Results of Operations Related Person Transactions and Warning Concerning Forward Looking Statements of our Amended 2012 Annual Report and the section captioned Related Person Transactions and Company Review of Such Transactions and the information regarding our Directors and executive officers in our Proxy Statement. In addition, please see the section captioned Risk Factors of our Amended 2012 Annual Report for a description of risks that may arise as a result of these and other related person transactions and relationships. Our filings with the SEC, including our Amended 2012 Annual Report and our Proxy Statement, are available at the SEC's website at [www.sec.gov](http://www.sec.gov). Copies of certain of our agreements with these related parties, including our leases, forms of management agreements and related pooling agreements and former Bridge Loan agreement with SNH, our management agreement with D&R Yonkers LLC, our business management agreement with RMR, our headquarters lease with an affiliate of RMR and our shareholders agreement with AIC and its shareholders, are also publicly available as exhibits to our public filings with the SEC and accessible at the SEC's website.

We believe that our agreements with SNH, RMR, D&R Yonkers LLC and AIC are on commercially reasonable terms. We also believe that our relationships with SNH, RMR, D&R Yonkers LLC and AIC and their affiliated and related persons and entities benefit us and, in fact, provide us with competitive advantages in operating and growing our business.

**Seasonality**

Our senior living business is subject to modest effects of seasonality. During the calendar fourth quarter holiday periods, nursing home and assisted living residents are sometimes discharged to join family celebrations and relocations and admission decisions are often deferred. The first quarter of each calendar year usually coincides with increased illness among nursing home and assisted living residents which can result in increased costs or discharges to hospitals. As a result of these factors, nursing home and assisted living operations sometimes produce greater earnings in the second and third quarters of a calendar year and lesser earnings in the first and fourth quarters. We do not believe that this seasonality will cause fluctuations in our revenues or operating cash flow to such an extent that we will have difficulty paying our expenses, including rent, which do not fluctuate seasonally.

**Item 4. Controls and Procedures**

Our management carried out an evaluation, under the supervision and with the participation of our President and Chief Executive Officer and our Treasurer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15 as of June 30, 2013. Based on that evaluation, at the time our Quarterly Report was filed with the SEC, our President and Chief Executive Officer and our Treasurer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2013. Subsequently, as a result of the errors described in Note 12 to the Notes to our Condensed Consolidated Financial Statements included in Item 1 of this Amended Quarterly Report, our management, including our President and Chief Executive Officer and our Treasurer and Chief Financial Officer, identified material weaknesses, described below, in our internal control over financial reporting as of December 31, 2012. As a result, our management reevaluated our disclosure controls and procedures and concluded that our disclosure controls and procedures were not effective as of June 30, 2013 because of the material weaknesses described below.

As more fully described in Note 12 to the Notes to our Condensed Consolidated Financial Statements included in Item 1 of this Amended Quarterly Report, subsequent to the filing of our Quarterly Report our management and our Audit Committee concluded that our condensed consolidated financial statements for the quarter ended June 30, 2013 contained within our Quarterly Report should be restated and that those

financial statements should no longer be relied upon.

We determined that we had material weaknesses in our internal controls over accounting for income taxes, lacked sufficient personnel with requisite technical accounting competencies and had an insufficient level of oversight in the financial statement close process. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our financial statements will not be prevented or detected on a timely basis.

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**Remediation of Material Weaknesses in Internal Control Over Financial Reporting**

We are developing our remediation plan for the material weaknesses described above, which, at a minimum, will include:

- Enhancing internal control around the accounting for income taxes to include additional layers of review by qualified persons, whether sourced internally or externally; and
- Recruiting additional experienced personnel for certain accounting roles.

We have begun to implement the remediation plan while we continue to develop it. Successful remediation of the material weaknesses described above will require review and evidence of the effectiveness of the related internal control processes as part of our periodic assessments of our internal controls over financial reporting. As we continue to evaluate and work to enhance our internal control over financial reporting, we may determine that additional measures should be taken to address the material weaknesses described above or other control deficiencies, or that we should modify the remediation plan. We expect that the remediation of the material weaknesses described above will be completed before December 31, 2014.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**WARNING CONCERNING FORWARD LOOKING STATEMENTS**

THIS QUARTERLY REPORT ON FORM 10-Q CONTAINS STATEMENTS THAT CONSTITUTE FORWARD LOOKING STATEMENTS WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 AND OTHER SECURITIES LAWS. ALSO, WHENEVER WE USE WORDS SUCH AS BELIEVE , EXPECT , ANTICIPATE , INTEND , PLAN , ESTIMATE OR SIMILAR EXPRESSIONS, WE ARE MAKING FORWARD LOOKING STATEMENTS. THESE FORWARD LOOKING STATEMENTS ARE BASED UPON OUR PRESENT INTENT, BELIEFS OR EXPECTATIONS, BUT FORWARD LOOKING STATEMENTS ARE NOT GUARANTEED TO OCCUR AND MAY NOT OCCUR. FORWARD LOOKING STATEMENTS IN THIS REPORT RELATE TO VARIOUS ASPECTS OF OUR BUSINESS, INCLUDING:

- OUR ABILITY TO OPERATE OUR SENIOR LIVING COMMUNITIES AND REHABILITATION HOSPITALS PROFITABLY,
  
- OUR ABILITY TO COMPLY AND TO REMAIN IN COMPLIANCE WITH APPLICABLE MEDICARE, MEDICAID AND OTHER FEDERAL AND STATE REGULATORY, RULE MAKING AND RATE SETTING REQUIREMENTS,
  
- OUR ABILITY TO MEET OUR RENT AND DEBT OBLIGATIONS,
  
- OUR ABILITY TO RAISE EQUITY OR DEBT CAPITAL,
  
- OUR ABILITY TO COMPETE FOR ACQUISITIONS EFFECTIVELY AND TO SELL PROPERTIES WE OFFER FOR SALE,
  
- THE FUTURE AVAILABILITY OF BORROWINGS UNDER OUR CREDIT FACILITIES,
  
- OUR EXPECTATION THAT WE WILL BENEFIT FINANCIALLY BY PARTICIPATING IN AIC WITH RMR AND COMPANIES TO WHICH RMR PROVIDES MANAGEMENT SERVICES, AND
  
- OTHER MATTERS.

OUR ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE CONTAINED IN OR IMPLIED BY OUR FORWARD LOOKING STATEMENTS AS A RESULT OF VARIOUS FACTORS. FACTORS THAT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR

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FORWARD LOOKING STATEMENTS AND UPON OUR BUSINESS, RESULTS OF OPERATIONS, FINANCIAL CONDITION, CASH FLOWS, LIQUIDITY AND PROSPECTS INCLUDE, BUT ARE NOT LIMITED TO:

- CHANGES IN MEDICARE AND MEDICAID POLICIES WHICH COULD RESULT IN REDUCED RATES OF PAYMENT TO US,
- THE IMPACT OF CHANGES IN THE ECONOMY AND THE CAPITAL MARKETS ON US AND OUR RESIDENTS AND OTHER CUSTOMERS,
- COMPETITION WITHIN THE SENIOR LIVING SERVICES AND REHABILITATION HOSPITAL BUSINESSES,
- INCREASES IN INSURANCE AND TORT LIABILITY COSTS,
- INCREASES IN OUR LABOR COSTS OR IN COSTS WE PAY FOR GOODS AND SERVICES,
- ACTUAL AND POTENTIAL CONFLICTS OF INTEREST WITH OUR MANAGING DIRECTORS, SNH, RMR, AIC AND THEIR RELATED PERSONS AND ENTITIES,
- COMPLIANCE WITH, AND CHANGES TO FEDERAL, STATE AND LOCAL LAWS AND REGULATIONS THAT COULD AFFECT OUR SERVICES OR IMPOSE REQUIREMENTS, COSTS AND

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ADMINISTRATIVE BURDENS THAT MAY REDUCE OUR ABILITY TO PROFITABLY OPERATE OUR BUSINESS, AND

- ACTS OF TERRORISM, OUTBREAKS OF SO CALLED PANDEMICS OR OTHER MANMADE OR NATURAL DISASTERS BEYOND OUR CONTROL.

FOR EXAMPLE:

- THE VARIOUS GOVERNMENTS WHICH PAY US FOR THE SERVICES WE PROVIDE TO OUR RESIDENTS AND PATIENTS ARE CURRENTLY EXPERIENCING, AND ARE EXPECTED TO CONTINUE TO EXPERIENCE, BUDGETARY PRESSURES AND CONSTRAINTS AND MAY LOWER THE MEDICARE, MEDICAID AND OTHER RATES THEY PAY US. BECAUSE WE OFTEN CANNOT ETHICALLY LOWER THE QUALITY OF THE SERVICES WE PROVIDE TO MATCH THE AVAILABLE MEDICARE, MEDICAID AND OTHER RATES WE ARE PAID, WE MAY EXPERIENCE LOSSES AND SUCH LOSSES MAY BE MATERIAL;
- THIS QUARTERLY REPORT ON FORM 10-Q STATES THAT WE EXPECT THAT WE MAY ENTER INTO ADDITIONAL MANAGEMENT ARRANGEMENTS WITH SNH SIMILAR TO THOSE CURRENTLY IN EFFECT FOR US TO MANAGE ADDITIONAL SENIOR LIVING COMMUNITIES SNH MAY ACQUIRE IN THE FUTURE, INCLUDING WITH RESPECT TO THOSE SENIOR LIVING COMMUNITIES SNH CURRENTLY HAS UNDER AGREEMENT TO PURCHASE. HOWEVER, THERE CAN BE NO ASSURANCE THAT SNH WILL ACQUIRE OTHER COMMUNITIES OR THAT WE AND SNH WILL ENTER INTO ANY ADDITIONAL MANAGEMENT ARRANGEMENTS;
- OUR ABILITY TO OPERATE AND MANAGE NEW SENIOR LIVING COMMUNITIES PROFITABLY DEPENDS UPON MANY FACTORS, INCLUDING OUR ABILITY TO INTEGRATE NEW COMMUNITIES INTO OUR EXISTING OPERATIONS AND SOME FACTORS WHICH ARE BEYOND OUR CONTROL SUCH AS THE DEMAND FOR OUR SERVICES ARISING FROM ECONOMIC CONDITIONS GENERALLY. WE MAY NOT BE ABLE TO SUCCESSFULLY INTEGRATE NEW COMMUNITIES OR OPERATE AND MANAGE NEW COMMUNITIES PROFITABLY;
- THIS QUARTERLY REPORT ON FORM 10-Q STATES THAT AT JUNE 30, 2013, WE HAD \$19.3 MILLION OF CASH AND CASH EQUIVALENTS, THAT AT JULY 30, 2013, WE HAD \$10.0 MILLION OF BORROWINGS OUTSTANDING UNDER OUR CREDIT FACILITIES, LEAVING \$175.0 MILLION OF AVAILABILITY, AND THAT WE HAVE IN THE PAST SOLD IMPROVEMENTS TO SNH AND EXPECT TO REQUEST TO SELL ADDITIONAL IMPROVEMENTS TO SNH FOR INCREASED RENT PURSUANT TO OUR LEASES WITH SNH; ALL OF WHICH MAY IMPLY THAT WE HAVE ABUNDANT CASH LIQUIDITY. HOWEVER, OUR OPERATIONS AND BUSINESS REQUIRE SIGNIFICANT AMOUNTS OF WORKING CASH AND REQUIRE US TO MAKE SIGNIFICANT CAPITAL EXPENDITURES TO MAINTAIN OUR COMPETITIVENESS. ACCORDINGLY, WE MAY NOT HAVE SUFFICIENT CASH LIQUIDITY;
- THIS QUARTERLY REPORT STATES THAT DURING THE PAST SEVERAL YEARS, WEAK ECONOMIC CONDITIONS THROUGHOUT THE COUNTRY HAVE NEGATIVELY AFFECTED ENTITIES BOTH WITHIN AND OUTSIDE OF OUR INDUSTRY,



THAT THESE CONDITIONS HAVE RESULTED IN, AMONG OTHER THINGS, A DECREASE IN OUR COMMUNITIES OCCUPANCIES AND THAT IT IS UNCLEAR WHEN THESE CONDITIONS MAY MATERIALLY IMPROVE. THESE STATEMENTS MAY IMPLY THAT OUR BUSINESS AND RESULTS OF OPERATIONS WILL IMPROVE AS THESE CONDITIONS IMPROVE BUT THERE CAN BE NO ASSURANCE THAT OUR BUSINESS AND RESULTS OF OPERATIONS WILL IMPROVE AS THESE CONDITIONS IMPROVE;

- OUR RESIDENTS AND PATIENTS WHO PAY FOR OUR SERVICES WITH THEIR PRIVATE RESOURCES MAY BECOME UNABLE TO AFFORD OUR SERVICES WHICH COULD RESULT IN DECREASED OCCUPANCY AND DECREASED REVENUES AT OUR SENIOR LIVING COMMUNITIES AND REHABILITATION HOSPITALS AND INCREASED RELIANCE ON LOWER RATES FROM GOVERNMENT AND OTHER PAYERS;

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- WE INTEND TO OPERATE OUR REHABILITATION HOSPITALS PROFITABLY. HOWEVER, WE HAVE HISTORICALLY EXPERIENCED LOSSES FROM OUR REHABILITATION HOSPITALS AND WE MAY BE UNABLE TO OPERATE OUR REHABILITATION HOSPITALS PROFITABLY;
  
- WE MAY BE UNABLE TO REPAY OUR DEBT OBLIGATIONS WHEN THEY BECOME DUE;
  
- THE AMOUNT OF AVAILABLE BORROWINGS UNDER OUR CREDIT FACILITIES IS SUBJECT TO OUR HAVING QUALIFIED COLLATERAL, WHICH IS PRIMARILY BASED ON THE VALUE OF OUR ACCOUNTS RECEIVABLE SECURING OUR \$35.0 MILLION CREDIT AGREEMENT AND THE VALUE OF THE PROPERTIES SECURING OUR \$150.0 MILLION CREDIT FACILITY. ACCORDINGLY, THE AVAILABILITY OF BORROWINGS UNDER OUR CREDIT FACILITIES AT ANY TIME MAY BE LESS THAN \$35.0 MILLION AND \$150.0 MILLION, RESPECTIVELY. ADDITIONALLY, THE AVAILABILITY OF BORROWINGS UNDER OUR CREDIT FACILITIES IS SUBJECT TO OUR SATISFYING CERTAIN FINANCIAL COVENANTS AND MEETING OTHER CUSTOMARY CONDITIONS;
  
- ACTUAL COSTS UNDER OUR CREDIT FACILITIES WILL BE HIGHER THAN LIBOR PLUS A PREMIUM BECAUSE OF OTHER FEES AND EXPENSES ASSOCIATED WITH OUR CREDIT FACILITIES;
  
- THIS QUARTERLY REPORT ON FORM 10-Q REPORTS OUR CASH RECEIPTS RESULTING FROM THE SALE OF OUR PHARMACY BUSINESS TO BE \$34.3 MILLION, BEFORE TAXES AND TRANSACTION COSTS. HOWEVER, THE PURCHASE AGREEMENT INCLUDED CUSTOMARY INDEMNIFICATION OBLIGATIONS AND REQUIRED US TO ESCROW A PORTION OF THE PURCHASE PRICE AT CLOSING IN CONNECTION WITH THE INDEMNIFICATION OBLIGATIONS. IF WE ARE REQUIRED TO PAY AMOUNTS (INCLUDING WITH ESCROWED PROCEEDS) TO SATISFY INDEMNIFICATION OBLIGATIONS IN THE FUTURE, THE ACTUAL CASH RECEIPTS WE MAY REALIZE FROM THIS SALE, AND ANY CORRESPONDING CAPITAL GAIN, MAY BE REDUCED;
  
- THIS QUARTERLY REPORT ON FORM 10-Q STATES THAT WE AND SNH HAVE ENTERED AN AGREEMENT TO SELL ONE SNF THAT WE LEASE FROM SNH. THIS SALE IS SUBJECT TO VARIOUS TERMS AND CONDITIONS TYPICAL OF SUCH TRANSACTIONS. THESE TERMS AND CONDITIONS MAY NOT BE MET. AS A RESULT, THIS TRANSACTION MAY BE DELAYED OR MAY NOT OCCUR OR ITS TERMS MAY CHANGE;
  
- THIS QUARTERLY REPORT ON FORM 10-Q STATES THAT WE AND SNH HAVE DECIDED TO OFFER FOR SALE NINE OTHER SENIOR LIVING COMMUNITIES THAT WE LEASE FROM SNH AND THAT WE HAVE DECIDED TO OFFER FOR SALE ONE COMMUNITY WHICH WE OWN. HOWEVER, WE CAN PROVIDE NO ASSURANCE THAT WE WILL BE ABLE TO SELL THESE COMMUNITIES ON TERMS ACCEPTABLE TO US OR OTHERWISE; AND
  
- THIS QUARTERLY REPORT ON FORM 10-Q STATES THAT WE BELIEVE THAT OUR CONTINUING RELATIONSHIPS WITH SNH, RMR AND AIC AND THEIR AFFILIATED AND RELATED PERSONS AND ENTITIES MAY BENEFIT US AND PROVIDE US WITH COMPETITIVE ADVANTAGES IN OPERATING AND GROWING OUR BUSINESS. IN FACT, THE ADVANTAGES WE

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BELIEVE WE MAY REALIZE FROM THESE RELATIONSHIPS MAY NOT MATERIALIZE.

THESE RESULTS COULD OCCUR DUE TO MANY DIFFERENT CIRCUMSTANCES, SOME OF WHICH ARE BEYOND OUR CONTROL, SUCH AS NATURAL DISASTERS, CHANGED MEDICARE AND MEDICAID RATES, NEW LEGISLATION, REGULATIONS OR RULE MAKING AFFECTING OUR BUSINESS, CHANGES IN OUR REVENUES OR COSTS, OR CHANGES IN CAPITAL MARKETS OR THE ECONOMY GENERALLY.

THE INFORMATION CONTAINED ELSEWHERE IN THIS QUARTERLY REPORT ON FORM 10-Q OR IN OUR FILINGS WITH THE SEC INCLUDING UNDER THE CAPTION RISK FACTORS , OR INCORPORATED HEREIN OR THEREIN, IDENTIFIES OTHER IMPORTANT FACTORS THAT COULD CAUSE DIFFERENCES FROM OUR FORWARD LOOKING STATEMENTS. OUR FILINGS WITH THE SEC ARE AVAILABLE ON THE SEC S WEBSITE AT WWW.SEC.GOV.

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YOU SHOULD NOT PLACE UNDUE RELIANCE UPON OUR FORWARD LOOKING STATEMENTS.

EXCEPT AS REQUIRED BY LAW, WE DO NOT INTEND TO UPDATE OR CHANGE ANY FORWARD LOOKING STATEMENTS AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE.

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**Part II. Other Information**

**Item 6. Exhibits**

| <b>Exhibit<br/>Number</b> | <b>Description</b>  |
|---------------------------|---|
| 3.1                       | Composite Copy of Articles of Amendment and Restatement, dated December 5, 2001, as amended to date. (Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011.)  |
| 3.2                       | Articles Supplementary, as corrected by Certificate of Correction, dated March 19, 2004. (Incorporated by reference to the Company's registration statement on Form 8-A dated March 19, 2004 and the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2004, respectively.)   |
| 3.3                       | Amended and Restated Bylaws of the Company, adopted February 14, 2012. (Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2011.)  |
| 4.1                       | Form of Common Share Certificate. (Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012.)  |
| 4.2                       | Rights Agreement, dated March 10, 2004, between the Company and EquiServe Trust Company, N.A. (Incorporated by reference to the Company's Current Report on Form 8-K dated March 10, 2004.)   |
| 4.3                       | Appointment of Successor Rights Agent, dated December 13, 2004, between the Company and Wells Fargo Bank, National Association. (Incorporated by reference to the Company's Current Report on Form 8-K dated December 13, 2004.)  |
| 4.4                       | Indenture related to 3.75% Convertible Senior Notes due 2026, dated as of October 18, 2006, among the Company, each of the guarantors named therein and U.S. Bank National Association, as Trustee. (Incorporated by reference to the Company's Current Report on Form 8-K dated October 24, 2006.)   |
| 10.1                      | Summary of Director Compensation. (Incorporated by reference to the Company's Current Report on Form 8-K dated May 16, 2013.)   |
| 31.1                      | Rule 13a-14(a) Certification of Chief Executive Officer. (Filed herewith.)  |
| 31.2                      | Rule 13a-14(a) Certification of Chief Financial Officer. (Filed herewith.)  |
| 32.1                      | Section 1350 Certification of Chief Executive Officer and Chief Financial Officer. (Furnished herewith.)  |
| 101.1                     | The following materials from the Company's Quarterly Report on Form 10-Q/A for the quarter ended June 30, 2013 formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Income, (iii) the Condensed Consolidated Statements of Comprehensive Income, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) related notes to these financial statements, tagged as blocks of text and in detail. (Filed herewith.) |

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**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.

FIVE STAR QUALITY CARE, INC.

/s/ Bruce J. Mackey Jr.  
Bruce J. Mackey Jr.  
President and Chief Executive Officer  
Dated: April 15, 2014

/s/ Paul V. Hoagland  
Paul V. Hoagland  
Treasurer and Chief Financial Officer  
(Principal Financial and Accounting Officer)  
Dated: April 15, 2014