

FIVE STAR QUALITY CARE INC

Form 10-Q

July 31, 2013

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

- 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)

Maryland

(State or Other Jurisdiction of Incorporation or Organization)

04-3516029

(IRS Employer Identification No.)

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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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FIVE STAR QUALITY CARE, INC.

FORM 10-Q

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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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FIVE STAR QUALITY CARE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

(unaudited)

	June 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 19,311	\$ 24,638
Accounts receivable, net of allowance of \$4,396 and \$3,240 at June 30, 2013 and December 31, 2012, respectively	56,763	49,886
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	19,382	29,394
Assets of discontinued operations	4,978	16,285
Total current assets	133,798	146,552
Property and equipment, net	331,172	333,335
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	42,916	42,267
	\$ 558,886	\$ 578,237
LIABILITIES AND SHAREHOLDERS EQUITY		
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	23,553	36,450
Accrued expenses	20,792	23,518
Accrued compensation and benefits	43,059	39,971
Due to related persons	18,840	18,596
Mortgage notes payable	1,125	1,092
Accrued real estate taxes	11,175	11,631
Security deposit liability	8,997	9,704

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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	2,175	10,232
Total current liabilities	172,882	190,841
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	5,674	6,615
Total long term liabilities	76,191	80,591
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	354,671	354,083
Accumulated deficit	(46,877)	(49,637)
Accumulated other comprehensive income	1,537	1,877
Total shareholders' equity	309,813	306,805
	\$ 558,886	\$ 578,237

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
Revenues:				
Senior living revenue	\$ 269,081	\$ 269,040	\$ 538,471	\$ 535,776
Rehabilitation hospital revenue	28,343	26,386	55,824	53,173
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	351,858	322,826	703,089	640,842
Operating expenses:				
Senior living wages and benefits	130,466	130,240	263,086	262,026
Other senior living operating expenses	65,751	63,797	132,090	128,058
Costs incurred on behalf of managed communities	52,153	26,098	104,211	49,503
Rehabilitation hospital expenses	24,710	23,872	49,604	47,991
Rent expense	50,936	49,849	101,129	99,628
General and administrative	15,452	15,389	30,583	30,844
Depreciation and amortization	6,651	6,276	13,089	12,165
Total operating expenses	346,119	315,521	693,792	630,215
Operating income	5,739	7,305	9,297	10,627
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)	
Equity in earnings of Affiliates Insurance Company	79	76	155	121
Gain on settlement		3,365		3,365
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	4,516	9,420	6,978	11,565
Provision for income taxes	(1,854)	(4,108)	(850)	(5,063)
Income from continuing operations	2,662	5,312	6,128	6,502
Loss from discontinued operations	(1,837)	(674)	(3,368)	(1,495)
Net income	\$ 825	\$ 4,638	\$ 2,760	\$ 5,007
Weighted average shares outstanding - basic	48,253	47,914	48,244	47,906
Weighted average shares outstanding - diluted	48,253	49,953	48,244	50,360

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Basic income per share from:								
Continuing operations	\$	0.06	\$	0.10	\$	0.13	\$	0.14
Discontinued operations		(0.04)		(0.01)		(0.07)		(0.03)
Net income per share - basic	\$	0.02	\$	0.09	\$	0.06	\$	0.11
Diluted income per share from:								
Continuing operations	\$	0.06	\$	0.10	\$	0.13	\$	0.14
Discontinued operations		(0.04)		(0.01)		(0.07)		(0.03)
Net income per share - diluted	\$	0.02	\$	0.09	\$	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)

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Net income	\$ 825	\$ 4,638	\$ 2,760	\$ 5,007
Other comprehensive income				
Unrealized (loss) gain on investments in available for sale securities	(390)	94	(289)	281
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	117		30	1
Other comprehensive (loss) income	(346)	91	(340)	278
Comprehensive income	\$ 479	\$ 4,729	\$ 2,420	\$ 5,285

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	2012
Cash flows from operating activities:		
Net income	\$ 2,760	\$ 5,007
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	13,089	12,165
Gain on early extinguishment of debt		(45)
Loss from discontinued operations	3,368	1,495
Loss on sale of available for sale securities	30	1
Equity in earnings of Affiliates Insurance Company	(155)	(121)
Stock-based compensation	588	490
Provision for losses on receivables	2,842	2,153
Changes in assets and liabilities:		
Accounts receivable	(9,719)	(1,722)
Prepaid expenses and other assets	9,377	3,515
Accounts payable and accrued expenses	(15,623)	2,140
Accrued compensation and benefits	3,088	5,101
Due from (to) related persons, net	1,315	(2,703)
Other current and long term liabilities	(1,473)	984
Cash provided by operating activities	9,487	28,460
Net cash (used in) provided by discontinued operations	(81)	1,390
Cash flows from investing activities:		
Acquisition of property and equipment	(26,255)	(27,770)
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	15,901	13,967
Proceeds from sale of available for sale securities	5,213	772
Cash used in investing activities	(14,158)	(21,475)
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	(575)	(576)
Cash used in financing activities	(575)	(13,114)
Change in cash and cash equivalents during the period	(5,327)	(4,739)
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

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Cash paid for income taxes	\$	1,394	\$	1,235
Non-cash activities:				
Issuance of common stock	\$	182	\$	114

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

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 Annual Report on Form 10-K for the year ended December 31, 2012, or our 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.

We also lease and operate two rehabilitation hospitals with 321 beds that provide inpatient rehabilitation services to patients at the two hospitals and at three satellite locations. In addition, we lease and operate 13 outpatient clinics affiliated with these rehabilitation hospitals.

Note 2. Property and Equipment

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

June 30,
2013

December 31,
2012

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Land	\$	21,714	\$	21,714
Buildings and improvements		274,413		275,030
Furniture, fixtures and equipment		109,436		102,472
		405,563		399,216
Accumulated depreciation		(74,391)		(65,881)
	\$	331,172	\$	333,335

We recorded depreciation expense of \$6,365 and \$5,266 for the three months ended June 30, 2013 and 2012, respectively, and \$12,517 and \$11,139 for the six months ended June 30, 2013 and 2012, respectively, relating to our property and equipment.

As of June 30, 2013, we had \$5,679 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 in Affiliates Insurance Company		Investments in Available for Sale Securities		Accumulated Other Comprehensive Income
Balance at January 1, 2013	\$	99	\$	1,778	\$ 1,877
Unrealized loss on investments		(81)		(289)	(370)
Reclassification adjustment:					
Realized loss on investments				30	30
Balance at June 30, 2013	\$	18	\$	1,519	\$ 1,537

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. Financial Data by Segment

We have one reportable segment consisting of our senior living community business. In this 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 hospital operating business does not meet the quantitative thresholds of a reportable segment as prescribed under Financial Accounting Standards Board, or FASB, Codification Topic 280 and it is not considered a core component of our business. Therefore, we do not consider our rehabilitation hospital operations to be a material, separately reportable segment of our business and its operations are reported within our corporate and other activities. This represents a change from our segment reporting during the three and six months ended June 30, 2012 and the presentation of this period has been revised to conform to the current segment reporting presentation. 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.

We use segment operating profit as a means to evaluate our performance and for our business decision making purposes. Segment operating profit for our one reportable segment excludes general and administrative expenses, certain interest, dividend and other income, certain interest

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and other expense, acquisition related costs, provision for income taxes, equity in earnings of AIC, gain on settlement of litigation, gain on early extinguishment of debt, sales of available for sale securities, and corporate income and expenses.

Our revenues by segment and a reconciliation of segment operating profit (loss) to income (loss) from continuing operations for the three and six months ended June 30, 2013 and 2012 are as follows:

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FIVE STAR QUALITY CARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

	Senior Living Communities	Corporate and Other(1)	Total
Three months ended June 30, 2013			
Segment revenues:			
Senior living and rehabilitation hospital revenues	\$ 269,081	\$ 28,343	\$ 297,424
Management fee revenue	2,281		2,281
Reimbursed costs incurred on behalf of managed communities	52,153		52,153
Total segment revenues	323,515	28,343	351,858
Segment expenses:			
Operating expenses	196,217	24,710	220,927
Costs incurred on behalf of managed communities	52,153		52,153
Rent expense	48,208	2,728	50,936
Depreciation and amortization	6,200	451	6,651
Total segment expenses	302,778	27,889	330,667
Segment operating profit	20,737	454	21,191
General and administrative expenses(2)		(15,452)	(15,452)
Operating income (loss)	20,737	(14,998)	5,739
Interest, dividend and other income	19	192	211
Interest and other expense	(586)	(769)	(1,355)
Acquisition related costs		(41)	(41)
Equity in earnings of Affiliates Insurance Company		79	79
Loss on sale of available for sale securities		(117)	(117)
Provision for income taxes		(1,854)	(1,854)
Income (loss) from continuing operations	\$ 20,170	\$ (17,508)	\$ 2,662
Total Assets as of June 30, 2013	\$ 474,823	\$ 84,063	\$ 558,886

	Senior Living Communities	Corporate and Other(1)	Total
Three months ended June 30, 2012			
Segment revenues:			
Senior living and rehabilitation hospital revenues	\$ 269,040	\$ 26,386	\$ 295,426
Management fee revenue	1,302		1,302
Reimbursed costs incurred on behalf of managed communities	26,098		26,098
Total segment revenues	296,440	26,386	322,826
Segment expenses:			
Operating expenses	194,037	23,872	217,909
Costs incurred on behalf of managed communities	26,098		26,098

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Rent expense	47,193	2,656	49,849
Depreciation and amortization	5,698	578	6,276
Total segment expenses	273,026	27,106	300,132
Segment operating profit (loss)	23,414	(720)	22,694
General and administrative expenses(2)		(15,389)	(15,389)
Operating profit (loss)	23,414	(16,109)	7,305
Interest, dividend and other income	19	215	234
Interest and other expense	(599)	(1,006)	(1,605)
Equity in earnings of Affiliates Insurance Company		76	76
Gain on settlement		3,365	3,365
Gain on early extinguishment of debt		45	45
Provision for income taxes		(4,108)	(4,108)
Income (loss) from continuing operations	\$ 22,834	\$ (17,522)	\$ 5,312

(1) Corporate and Other includes operations that we do not consider a material, separately reportable segment of our business and income and expenses that are not attributable to a specific reportable segment.

(2) General and administrative expenses are not attributable to a specific reportable segment and include items such as corporate payroll and benefits and expenses of our home office activities.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

	Senior Living Communities	Corporate and Other(1)	Total
Six months ended June 30, 2013			