

Brookdale Senior Living Inc.  
Form 10-Q  
November 08, 2013

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2013

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-32641

BROOKDALE SENIOR LIVING INC.  
(Exact name of registrant as specified in its charter)

Delaware 20-3068069  
(State or other jurisdiction (I.R.S. Employer Identification No.)  
of incorporation or organization)

111 Westwood Place, Suite 400, Brentwood, Tennessee 37027  
(Address of principal executive offices) (Zip Code)

(615) 221-2250  
(Registrant's telephone number, including area code)

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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

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reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  T

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  T

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As of November 4, 2013, 124,285,473 shares of the registrant's common stock, \$0.01 par value, were outstanding (excluding unvested restricted shares).

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TABLE OF CONTENTS  
BROOKDALE SENIOR LIVING INC.

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2013

	<u>PAGE</u>
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets -</u> <u>As of September 30, 2013 (Unaudited) and December 31, 2012</u>	4
<u>Condensed Consolidated Statements of Operations -</u> <u>Three and nine months ended September 30, 2013 and 2012 (Unaudited)</u>	5
<u>Condensed Consolidated Statements of Comprehensive Income -</u> <u>Three and nine months ended September 30, 2013 and 2012 (Unaudited)</u>	6
<u>Condensed Consolidated Statement of Stockholders' Equity -</u> <u>Nine months ended September 30, 2013 (Unaudited)</u>	7
<u>Condensed Consolidated Statements of Cash Flows -</u> <u>Nine months ended September 30, 2013 and 2012 (Unaudited)</u>	8
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	9
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	45
<u>Item 4. Controls and Procedures</u>	46
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	46
<u>Item 1A. Risk Factors</u>	46
<u>Item 6. Exhibits</u>	46
<u>Signatures</u>	47

TABLE OF CONTENTS

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

BROOKDALE SENIOR LIVING INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (In thousands, except stock amounts)

	September 30, 2013 (Unaudited)	December 31, 2012
Assets		
Current assets		
Cash and cash equivalents	\$42,690	\$69,240
Cash and escrow deposits — restricted	43,231	43,096
Accounts receivable, net	108,720	100,401
Deferred tax asset	13,377	13,377
Prepaid expenses and other current assets, net	85,860	82,924
Total current assets	293,878	309,038
Property, plant and equipment and leasehold intangibles, net	3,845,741	3,879,977
Cash and escrow deposits — restricted	60,146	62,767
Investment in unconsolidated ventures	46,050	31,386
Goodwill	109,553	109,553
Other intangible assets, net	159,954	159,942
Other assets, net	128,909	113,315
Total assets	\$4,644,231	\$4,665,978
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt	\$72,172	\$509,543
Trade accounts payable	46,873	43,184
Accrued expenses	216,919	200,895
Refundable entrance fees and deferred revenue	376,161	370,755
Tenant security deposits	5,245	6,521
Total current liabilities	717,370	1,130,898
Long-term debt, less current portion	2,490,109	2,089,826
Line of credit	45,000	80,000
Deferred entrance fee revenue	85,507	79,010
Deferred liabilities	155,346	150,788
Deferred tax liability	96,187	96,187
Other liabilities	38,175	42,283
Total liabilities	3,627,694	3,668,992
Stockholders' Equity		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized at September 30, 2013 and December 31, 2012; no shares issued and outstanding	—	—
Common stock, \$0.01 par value, 200,000,000 shares authorized at September 30, 2013 and December 31, 2012; 130,135,841 and 129,117,946 shares issued and 127,707,440 and 126,689,545 shares outstanding (including 3,422,273 and 3,951,950 unvested restricted	1,277	1,267

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shares), respectively

Additional paid-in-capital	2,020,096	1,997,946
Treasury stock, at cost; 2,428,401 shares at September 30, 2013 and December 31, 2012	(46,800 )	(46,800 )
Accumulated deficit	(958,036 )	(955,427 )
Total stockholders' equity	1,016,537	996,986
Total liabilities and stockholders' equity	\$4,644,231	\$4,665,978

See accompanying notes to condensed consolidated financial statements.

4

---

TABLE OF CONTENTS

BROOKDALE SENIOR LIVING INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (Unaudited, in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Revenue				
Resident fees	\$631,144	\$605,530	\$1,876,452	\$1,804,129
Management fees	7,622	7,407	22,975	22,350
Reimbursed costs incurred on behalf of managed communities	90,233	83,208	258,306	242,847
Total revenue	728,999	696,145	2,157,733	2,069,326
Expense				
Facility operating expense (excluding depreciation and amortization of \$60,896, \$56,956, \$177,595 and \$172,982, respectively)	420,579	411,467	1,249,609	1,213,751
General and administrative expense (including non-cash stock-based compensation expense of \$6,894, \$6,021, \$20,776 and \$19,185, respectively)	45,824	43,158	138,470	134,202
Facility lease expense	69,232	71,167	207,028	213,240
Depreciation and amortization	68,644	62,876	200,557	189,781
Asset impairment	504	—	2,658	8,329
Loss on acquisition	—	—	—	636
Gain on facility lease termination	—	—	—	(2,780 )
Costs incurred on behalf of managed communities	90,233	83,208	258,306	242,847
Total operating expense	695,016	671,876	2,056,628	2,000,006
Income from operations	33,983	24,269	101,105	69,320
Interest income	472	676	1,027	2,220
Interest expense:				
Debt	(29,642 )	(32,262 )	(90,456 )	(96,743 )
Amortization of deferred financing costs and debt discount	(4,100 )	(4,543 )	(13,017 )	(13,602 )
Change in fair value of derivatives and amortization	(1,377 )	140	594	(371 )
Loss on extinguishment of debt	(53 )	—	(946 )	(221 )
Equity in earnings (loss) of unconsolidated ventures	431	(249 )	991	(211 )
Other non-operating income	279	500	1,365	392
(Loss) income before income taxes	(7 )	(11,469 )	663	(39,216 )
Provision for income taxes	(960 )	(747 )	(3,272 )	(2,559 )
Net loss	\$(967 )	\$(12,216 )	\$(2,609 )	\$(41,775 )
Basic and diluted net loss per share	\$(0.01 )	\$(0.10 )	\$(0.02 )	\$(0.34 )
Weighted average shares used in computing basic and diluted net loss per share	124,128	122,493	123,457	121,784

See accompanying notes to condensed consolidated financial statements.

5

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TABLE OF CONTENTS

BROOKDALE SENIOR LIVING INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (Unaudited, in thousands)

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	2012	2013	2012	2013
Net loss	\$(967)	\$(12,216)	\$(2,609)	\$(41,775)
Other comprehensive income:				
Unrealized gain on marketable securities - restricted	—	980	—	1,818
Other	—	—	—	61
Total other comprehensive income, net of tax	—	980	—	1,879
Comprehensive loss	\$(967)	\$(11,236)	\$(2,609)	\$(39,896)

See accompanying notes to condensed consolidated financial statements.

6

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TABLE OF CONTENTS

BROOKDALE SENIOR LIVING INC.  
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
 (Unaudited, in thousands)

	Common Stock		Additional Paid-In- Capital	Treasury Stock	Accumulated Deficit	Total
	Shares	Amount				
Balances at January 1, 2013 as previously reported	126,689	\$ 1,267	\$ 1,997,946	\$(46,800)	\$ (949,696 )	\$ 1,002,717
Retrospective adjustment for adoption of accounting policy					(5,731 )	(5,731 )
Balances at January 1, 2013 as adjusted	126,689	1,267	1,997,946	(46,800)	(955,427 )	996,986
Compensation expense related to restricted stock grants			20,776			20,776
Net loss					(2,609 )	(2,609 )
Issuance of common stock under Associate Stock Purchase Plan	47		1,135			1,135
Restricted stock, net	971	10				10
Other			239			239
Balances at September 30, 2013	127,707	\$ 1,277	\$ 2,020,096	\$(46,800)	\$ (958,036 )	\$ 1,016,537

See accompanying notes to condensed consolidated financial statements.

TABLE OF CONTENTS

BROOKDALE SENIOR LIVING INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited, in thousands)

	Nine Months Ended September 30,	
	2013	2012
<b>Cash Flows from Operating Activities</b>		
Net loss	\$(2,609 )	\$(41,775 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Loss on extinguishment of debt	946	221
Depreciation and amortization	213,574	203,383
Asset impairment	2,658	8,329
Equity in (earnings) loss of unconsolidated ventures	(991 )	211
Distributions from unconsolidated ventures from cumulative share of net earnings	2,089	1,435
Amortization of deferred gain	(3,279 )	(3,279 )
Amortization of entrance fees	(21,178 )	(18,835 )
Proceeds from deferred entrance fee revenue	30,584	30,303
Deferred income tax benefit		(435 )
Change in deferred lease liability	2,250	5,324
Change in fair value of derivatives and amortization	(594 )	371
(Gain) loss on sale of assets	(876 )	245
Loss on acquisition		636
Gain on facility lease termination		(2,780 )
Non-cash stock-based compensation	20,776	19,185
Other		(487 )
Changes in operating assets and liabilities:		
Accounts receivable, net	(9,482 )	(8,092 )
Prepaid expenses and other assets, net	(2,805 )	1,653
Accounts payable and accrued expenses	20,595	9,552
Tenant refundable fees and security deposits	(828 )	(1,556 )
Deferred revenue	(1,755 )	4,369
Net cash provided by operating activities	249,075	207,978
<b>Cash Flows from Investing Activities</b>		
Increase in lease security deposits and lease acquisition deposits, net	(2,046 )	(6,767 )
Decrease (increase) in cash and escrow deposits — restricted	2,484	(2,402 )
Purchase of marketable securities — restricted		(1,453 )
Additions to property, plant and equipment and leasehold intangibles, net	(161,522)	(151,381)
Acquisition of assets, net of related payables and cash received	(7,394 )	(111,308)
Payments on (issuance of) notes receivable, net	95	(591 )
Investment in unconsolidated ventures	(17,172 )	(571 )
Distributions received from unconsolidated ventures	100	256
Proceeds from sale of assets, net	7,554	325
Other		487
Net cash used in investing activities	(177,901)	(273,405)
<b>Cash Flows from Financing Activities</b>		
Proceeds from debt	597,852	193,607

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Repayment of debt and capital lease obligations	(651,741)	(136,957)
Proceeds from line of credit	320,000	280,000
Repayment of line of credit	(355,000)	(265,000)
Payment of financing costs, net of related payables	(11,194 )	(2,810 )
Refundable entrance fees:		
Proceeds from refundable entrance fees	29,265	29,512
Refunds of entrance fees	(24,504 )	(19,555 )
Cash portion of loss on extinguishment of debt	(502 )	(118 )
Purchase of derivatives and payment of swap termination	(2,863 )	(1,289 )
Other	963	(295 )
Net cash (used in) provided by financing activities	(97,724 )	77,095
Net (decrease) increase in cash and cash equivalents	(26,550 )	11,668
Cash and cash equivalents at beginning of period	69,240	30,836
Cash and cash equivalents at end of period	\$42,690	\$42,504

See accompanying notes to condensed consolidated financial statements.

TABLE OF CONTENTS

BROOKDALE SENIOR LIVING INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Description of Business

Brookdale Senior Living Inc. ("Brookdale" or the "Company") is a leading owner and operator of senior living communities throughout the United States. The Company provides an exceptional living experience through properties that are designed, purpose-built and operated to provide the highest quality service, care and living accommodations for residents. The Company owns, leases and operates retirement centers, assisted living and dementia-care communities and continuing care retirement centers ("CCRCs"). Through its Innovative Senior Care ("ISC") program, the Company also offers a range of outpatient therapy, home health and hospice services, primarily to residents of its communities.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for quarterly reports on Form 10-Q. In the opinion of management, these financial statements include all adjustments necessary to present fairly the financial position, results of operations and cash flows of the Company as of September 30, 2013, and for all periods presented. The condensed consolidated financial statements are prepared on the accrual basis of accounting. All adjustments made have been of a normal and recurring nature. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. The Company believes that the disclosures included are adequate and provide a fair presentation of interim period results. Interim financial statements are not necessarily indicative of the financial position or operating results for an entire year. It is suggested that these interim financial statements be read in conjunction with the audited financial statements and the notes thereto, together with management's discussion and analysis of financial condition and results of operations, included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the Securities and Exchange Commission.

Revenue Recognition

Resident Fees

Resident fee revenue is recorded when services are rendered and consists of fees for basic housing, support services and fees associated with additional services such as personalized health and assisted living care. Residency agreements are generally for a term of 30 days to one year, with resident fees billed monthly in advance. Revenue for certain skilled nursing services and ancillary charges is recognized as services are provided and is billed monthly in arrears.

Entrance Fees

Certain of the Company's communities have residency agreements which require the resident to pay an upfront entrance fee prior to occupying the community. In addition, in connection with the Company's MyChoice program, new and existing residents are allowed to pay additional entrance fee amounts in return for a reduced monthly service fee. The non-refundable portion of the entrance fee is recorded as deferred entrance fee revenue and amortized over

the estimated stay of the resident based on an actuarial valuation. The refundable portion of a resident's entrance fee is generally refundable within a certain number of months or days following contract termination or upon the sale of the unit, or in certain agreements, upon the resale of a comparable unit or 12 months after the resident vacates the unit. In such instances the refundable portion of the fee is not amortized and included in refundable entrance fees and deferred revenue. All refundable amounts due to residents at any time in the future are classified as current liabilities.

9

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## TABLE OF CONTENTS

### Management Fees

Management fee revenue is recorded as services are provided to the owners of the communities. Revenues are determined by an agreed upon percentage of gross revenues (as defined).

### Reimbursed Costs Incurred on Behalf of Managed Communities

The Company manages certain communities under contracts which provide for payment to the Company of a monthly management fee plus reimbursement of certain operating expenses. Where the Company is the primary obligor with respect to any such operating expenses, the Company recognizes revenue when the goods have been delivered or the service has been rendered and the Company is due reimbursement. Such revenue is included in "reimbursed costs incurred on behalf of managed communities" on the condensed consolidated statements of operations. The related costs are included in "costs incurred on behalf of managed communities" on the condensed consolidated statements of operations.

### Fair Value of Financial Instruments

The Financial Accounting Standards Board ("FASB") issued Accounting Standards Codification ("ASC") 820 – Fair Value Measurements ("ASC 820"), which establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels are defined as follows:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Cash and cash equivalents and cash and escrow deposits-restricted are reflected in the accompanying condensed consolidated balance sheets at amounts considered by management to reasonably approximate fair value due to the short maturity. Management estimates the fair value of its long-term debt using a discounted cash flow analysis based upon the Company's current borrowing rate for debt with similar maturities and collateral securing the indebtedness.

The Company had outstanding debt with a carrying value and estimated fair value of approximately \$2.6 billion and \$2.7 billion as of September 30, 2013 and December 31, 2012, respectively. The Company's fair value of debt disclosure is classified within Level 2 of the valuation hierarchy.

### Self-Insurance Liability Accruals

The Company is subject to various legal proceedings and claims that arise in the ordinary course of its business. Although the Company maintains general liability and professional liability insurance policies for its owned, leased and managed communities under a master insurance program, the Company's current policies provide for deductibles for each and every claim. As a result, the Company is, in effect, self-insured for claims that are less than the deductible amounts. In addition, the Company maintains a large-deductible workers compensation program and a self-insured employee medical program. The Company reviews the adequacy of its accruals related to these liabilities on an ongoing basis, using historical claims, actuarial valuations, third party administrator estimates, consultants,

advice from legal counsel and industry data, and adjusts accruals periodically. Estimated costs related to these self-insurance programs are accrued based on known claims and projected claims incurred but not yet reported. Subsequent changes in actual experience are monitored and estimates are updated as information is available.

10

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TABLE OF CONTENTS

## Cumulative Effect Adjustment

In July 2012, the FASB issued ASU 2012-01, Continuing Care Retirement Communities — Refundable Advance Fees ("ASU 2012-01"). ASU 2012-01 amends the situations in which recognition of deferred revenue for refundable advance fees is appropriate. Under this amendment, refundable advance fees that are contingent upon reoccupancy by a subsequent resident but are not limited to the proceeds of reoccupancy should be accounted for and reported as a liability. The guidance in ASU 2012-01 is effective for public companies for fiscal years, and interim periods within those years, beginning after December 15, 2012. The Company adopted the provisions of this update as of January 1, 2013 and incorporated the provisions of this update to its consolidated financial statements through retrospective application to all periods presented and a cumulative effect adjustment to the Company's accumulated deficit as of January 1, 2013.

The effect of this change in accounting was not material to the consolidated results of operations or financial position for any period, including the three and nine months ended September 30, 2013 and 2012, and did not impact cash flows from operations in any period. The Company increased its accumulated deficit by \$5.7 million to reflect the net cumulative effect of the adoption of ASU 2012-01.

The related adjustments will be made to the applicable prior periods as such financial information is included in future filings with the SEC, but no later than the filing of the Company's Annual Report on Form 10-K for the year ending December 31, 2013. The impact of all adjustments made to the prior annual consolidated financial statements is summarized as follows (dollars in thousands):

	As of and for the Year Ended December 31, 2012		
	As Reported	Adjustment	As Adjusted
<b>Consolidated Balance Sheets</b>			
Refundable entrance fees and deferred revenue	\$361,360	\$ 9,395	\$370,755
Deferred tax liability	99,851	(3,664 )	96,187
Accumulated deficit	(949,696 )	(5,731 )	(955,427 )
<b>Consolidated Statements of Operations</b>			
Resident fees	\$2,414,283	\$ (1,347 )	\$2,412,936
Total revenue	2,770,085	(1,347 )	2,768,738
Loss before income taxes	(63,601 )	(1,347 )	(64,948 )
Provision for income taxes	(2,044 )	525	(1,519 )
Net loss	(65,645 )	(822 )	(66,467 )
Basic and diluted net loss per share	(0.54 )	—	(0.54 )
<b>Consolidated Statements of Cash Flows</b>			
Net loss	\$(65,645)	\$(822 )	\$(66,467)
Amortization of entrance fees	(26,709)	1,347	(25,362)
Deferred income tax benefit	—	(525 )	(525 )

TABLE OF CONTENTS

	Year Ended December 31, 2011		
	As		As
	Reported	Adjustment	Adjusted
<b>Consolidated Statements of Operations</b>			
Resident fees	\$2,291,757	\$ (1,435 )	\$2,290,322
Total revenue	2,457,918	(1,435 )	2,456,483
Loss before income taxes	(65,835 )	(1,435 )	(67,270 )
Provision for income taxes	(2,340 )	560	(1,780 )
Net loss	(68,175 )	(875 )	(69,050 )
Basic and diluted net loss per share	(0.56 )	(0.01 )	(0.57 )
<b>Consolidated Statements of Cash Flows</b>			
Net loss	\$(68,175 )	\$ (875 )	\$(69,050 )
Amortization of entrance fees	(25,401 )	1,435	(23,966 )
Deferred income tax provision	943	(560 )	383

The prior period financial statements included in this filing have been revised to reflect this change in accounting, the effects of which have been summarized below (dollars in thousands):

	Three Months Ended September 30, 2012		
	As		As
	Reported	Adjustment	Adjusted
<b>Condensed Consolidated Statements of Operations</b>			
Resident fees	\$605,867	\$ (337 )	\$605,530
Total revenue	696,482	(337 )	696,145
Loss before income taxes	(11,132 )	(337 )	(11,469 )
Provision for income taxes	(878 )	131	(747 )
Net loss	(12,010 )	(206 )	(12,216 )
Basic and diluted net loss per share	(0.10 )	—	(0.10 )
<b>Condensed Consolidated Statements of Cash Flows</b>			
Net loss	\$(12,010 )	\$ (206 )	\$(12,216 )
Amortization of entrance fees	(19,846 )	1,011	(18,835 )
Deferred income tax benefit	(41 )	(394 )	(435 )

  

	Nine Months Ended September 30, 2012		
	As		As
	Reported	Adjustment	Adjusted
<b>Condensed Consolidated Statements of Operations</b>			
Resident fees	\$1,805,140	\$ (1,011 )	\$1,804,129
Total revenue	2,070,337	(1,011 )	2,069,326
Loss before income taxes	(38,205 )	(1,011 )	(39,216 )
Provision for income taxes	(2,953 )	394	(2,559 )
Net loss	(41,158 )	(617 )	(41,775 )
Basic and diluted net loss per share	(0.34 )	—	(0.34 )
<b>Condensed Consolidated Statements of Cash Flows</b>			
Net loss	\$(41,158 )	\$ (617 )	\$(41,775 )
Amortization of entrance fees	(19,846 )	1,011	(18,835 )
Deferred income tax benefit	(41 )	(394 )	(435 )



## TABLE OF CONTENTS

### New Accounting Pronouncements

In July 2013, the FASB issued ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ("ASU 2013-11"). ASU 2013-11 changes the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. These changes require an entity to present an unrecognized tax benefit as a liability in the financial statements if (i) a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position, or (ii) the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset to settle any additional income taxes that would result from the disallowance of a tax position. Otherwise, an unrecognized tax benefit is required to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The guidance in ASU 2013-11 is effective for public companies for fiscal years, and interim periods within those years, beginning after December 15, 2013. The Company does not believe that the adoption of ASU 2013-11 will have a material impact on the consolidated financial statements or disclosures.

### Reclassifications

Certain prior period amounts have been reclassified to conform to the current financial statement presentation, with no effect on the Company's consolidated financial position or results of operations.

### 3. Earnings Per Share

Basic earnings per share ("EPS") is calculated by dividing net income by the weighted average number of shares of common stock outstanding. Diluted EPS includes the components of basic EPS and also gives effect to dilutive common stock equivalents. For purposes of calculating basic and diluted earnings per share, vested restricted stock awards are considered outstanding. Under the treasury stock method, diluted EPS reflects the potential dilution that could occur if securities or other instruments that are convertible into common stock were exercised or could result in the issuance of common stock. Potentially dilutive common stock equivalents include unvested restricted stock, restricted stock units and convertible debt instruments and warrants.

During the three and nine months ended September 30, 2013 and 2012, the Company reported a consolidated net loss. As a result of the net loss, unvested restricted stock and restricted stock unit awards and convertible debt instruments and warrants were anti-dilutive for each period and were not included in the computation of diluted weighted average shares. The weighted average restricted stock and restricted stock unit awards excluded from the calculations of diluted net loss per share were 3.6 million and 4.2 million for the three months ended September 30, 2013 and 2012, respectively, and 4.1 million and 4.7 million for the nine months ended September 30, 2013 and 2012, respectively.

### 4. Acquisitions and Dispositions

Effective May 24, 2013, the Company acquired the underlying real estate interest in an entrance fee CCRC that the Company previously managed for an aggregate purchase price of \$15.4 million, which included the assumption of the existing mortgage debt and certain liabilities in addition to cash paid. The Company will continue to manage the CCRC and report the results of operations of such community in the Management Services segment until necessary license approvals are obtained.

Effective May 31, 2013, the Company purchased the underlying real estate in an assisted living community for an aggregate purchase price of \$2.4 million. The results of operations of the community are reported in the Assisted

Living segment.

During the nine months ended September 30, 2013, the Company purchased three home health agencies for an aggregate purchase price of approximately \$2.6 million. The purchase price of the acquisitions has been ascribed to an indefinite useful life intangible asset and recorded on the condensed consolidated balance sheet under other intangible assets, net.

13

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TABLE OF CONTENTS

During the nine months ended September 30, 2013, the Company sold two communities for an aggregate selling price of \$7.2 million. The results of operations of the communities were previously reported in the Assisted Living segment.

## 5. Stock-Based Compensation

The Company follows ASC 718 in accounting for its share-based payments. This guidance requires measurement of the cost of employee services received in exchange for stock compensation based on the grant-date fair value of the employee stock awards. This cost is recognized as compensation expense ratably over the employee's requisite service period. Incremental compensation costs arising from subsequent modifications of awards after the grant date must be recognized when incurred.

For all service awards, the Company records compensation expense for the entire award on a straight-line basis (or, if applicable, on the accelerated method) over the requisite service period. For awards with performance-based vesting conditions, total compensation expense is recognized over the requisite service period for each separately vesting tranche of the award as if the award is, in substance, multiple awards once the performance target is deemed probable of achievement. Performance goals are evaluated quarterly. If such goals are not ultimately met or it is not probable the goals will be achieved, no compensation expense is recognized and any previously recognized compensation expense is reversed.

The Company's compensation expense recorded in connection with grants of restricted stock for the three and nine months ended September 30, 2013 and 2012 reflects an initial estimated cumulative forfeiture rate from 0% to 10% over the requisite service period of the awards. That estimate is revised if subsequent information indicates that the actual number of awards expected to vest is likely to differ from previous estimates.

Current year grants of restricted shares under the Company's Omnibus Stock Incentive Plan were as follows (amounts in thousands except for value per share):

	Shares Granted	Value Per Share	Total Value
Three months ended March 31, 2013	1,036	\$25.32 – \$27.36	\$27,858
Three months ended June 30, 2013	156	\$26.85 – \$27.50	\$4,216
Three months ended September 30, 2013	50	\$26.84 – \$29.20	\$1,445

## 6. Goodwill and Other Intangible Assets, Net

The following is a summary of the carrying amount of goodwill for the nine months ended September 30, 2013 and the year ended December 31, 2012 presented on an operating segment basis (dollars in thousands):

	September 30, 2013			December 31, 2012		
	Gross Carrying Amount	Accumulated Impairment and Other Charges	Net	Gross Carrying Amount	Accumulated Impairment and Other Charges	Net
Retirement Centers	\$7,642	\$ (521 )	\$7,121	\$7,642	\$ (521 )	\$7,121
Assisted Living	102,680	(248 )	102,432	102,680	(248 )	102,432
CCRCs - Rental	56,281	(56,281 )	—	56,281	(56,281 )	—
CCRCs - Entry Fee	158,718	(158,718 )	—	158,718	(158,718 )	—

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Total                    \$325,321   \$ (215,768   )   \$109,553   \$325,321   \$ (215,768   )   \$109,553

Goodwill is tested for impairment annually with a test date of October 1 or sooner if indicators of impairment are present. No indicators of impairment were present during the nine months ended September 30, 2013.

Community purchase options are amortized over their estimated lives and are tested for impairment whenever indicators of impairment arise. No indicators of impairment were present during the nine months ended September

14

---

TABLE OF CONTENTS

30, 2013. The following is a summary of other intangible assets at September 30, 2013 and December 31, 2012 (dollars in thousands):

	September 30, 2013			December 31, 2012		
	Gross		Net	Gross		Net
	Carrying Amount	Accumulated Amortization		Carrying Amount	Accumulated Amortization	
Community purchase options	\$ 147,610	\$ (24,037 )	\$ 123,573	\$ 147,610	\$ (21,263 )	\$ 126,347
Health care licenses	33,850	—	33,850	31,082	—	31,082
Other	3,331	(800 )	2,531	2,585	(72 )	2,513
Total	\$ 184,791	\$ (24,837 )	\$ 159,954	\$ 181,277	\$ (21,335 )	\$ 159,942

Amortization expense related to definite-lived intangible assets for the three months ended September 30, 2013 and 2012 was \$1.2 million and \$1.0 million, respectively, and for the nine months ended September 30, 2013 and 2012 was \$3.5 million and \$2.8 million, respectively. Health care licenses were determined to be indefinite-lived intangible assets and are not subject to amortization.

#### 7. Property, Plant and Equipment and Leasehold Intangibles, Net

Property, plant and equipment and leasehold intangibles, net, which include assets under capital leases, consist of the following (dollars in thousands):

	September 30, 2013	December 31, 2012
Land	\$ 297,992	\$ 296,314
Buildings and improvements	3,454,304	3,391,667
Leasehold improvements	73,832	60,186
Furniture and equipment	608,728	541,585
Resident and leasehold operating intangibles	441,657	441,603
Construction in progress	75,678	75,419
Assets under capital and financing leases	687,698	674,492
	5,639,889	5,481,266
Accumulated depreciation and amortization	(1,794,148)	(1,601,289)
Property, plant and equipment and leasehold intangibles, net	\$ 3,845,741	\$ 3,879,977

Long-lived assets with definite useful lives are depreciated or amortized on a straight-line basis over their estimated useful lives (or, in certain cases, the shorter of their estimated useful lives or the lease term) and are tested for impairment whenever indicators of impairment arise.

During the nine months ended September 30, 2013, there were indicators of impairment on certain long-lived assets. The Company compared the estimated fair value of the assets to their carrying values and recorded an impairment charge for the excess of carrying value over fair value. Non-cash charges of \$2.7 million related to certain communities within the CCRCs - Rental and Assisted Living segments were recorded in the Company's operating results and reflected as asset impairment in the accompanying condensed consolidated statement of operations. The impairment charges are primarily due to the amount by which the carrying values of the assets exceeded the estimated selling price.



8. Debt

Long-Term Debt, Capital Leases and Financing Obligations

Long-term debt, capital leases and financing obligations consist of the following (dollars in thousands):

15

---

TABLE OF CONTENTS

	September 30, 2013	December 31, 2012
Mortgage notes payable due 2014 through 2023; weighted average interest rate of 4.09% for the nine months ended September 30, 2013, net of debt discount of \$0.2 million (weighted average interest rate of 4.62% in 2012)	\$1,996,204	\$1,701,515
\$150,000 Series A notes payable, secured by five communities and by a \$3.0 million cash collateral deposit, bearing interest at LIBOR plus 0.88%, payable in monthly installments of principal and interest through maturity in August 2013	—	144,384
Discount mortgage note payable due June 2013, net of debt discount of \$1.0 million in 2012 (weighted average interest rate of 2.56% in 2012)	—	80,533
Variable rate tax-exempt bonds credit-enhanced by Fannie Mae; (weighted average interest rate of 1.65% in 2012), due 2032, payable in monthly installments of principal and interest through maturity, secured by the underlying assets of the portfolio	—	99,847
Capital and financing lease obligations payable through 2026; weighted average interest rate of 8.15% for the nine months ended September 30, 2013 (weighted average interest rate of 8.16% in 2012)	299,319	319,745
Convertible notes payable in aggregate principal amount of \$316.3 million, less debt discount of \$57.4 million and \$65.0 million in 2013 and 2012, respectively, interest at 2.75% per annum, due June 2018	258,840	251,312
Construction financing due 2017 through 2027; weighted average interest rate of 4.37% for the nine months ended September 30, 2013 (weighted average interest rate of 8.0% in 2012)	438	1,280
Notes payable issued to finance insurance premiums, weighted average interest rate of 2.65% for the nine months ended September 30, 2013 (weighted average interest rate of 2.81% in 2012), due 2014	7,480	753
Total debt	2,562,281	2,599,369
Less current portion	72,172	509,543
Total long-term debt	\$2,490,109	\$2,089,826

## Credit Facilities

On March 28, 2013, the Company entered into a second amended and restated credit agreement with General Electric Capital Corporation, as administrative agent and lender, and the other lenders from time to time parties thereto. The amended credit agreement extended the maturity date of the facility to March 31, 2018 and decreased the interest rate payable on advances and the fee payable on the unused portion of the facility. The amended credit agreement provided an option to increase the committed amount initially from \$230.0 million to \$250.0 million, which the

Company exercised on June 28, 2013, and provides an additional option to increase the committed amount from \$250.0 million to up to \$350.0 million, subject to obtaining commitments for the amount of such increase from acceptable lenders. The amended credit agreement also permits reduction of the committed amount or termination of the facility during the last two years of the five year term without payment of a premium or penalty. The amended credit agreement was further amended and restated effective September 20, 2013 to, among other things, incorporate a \$25.0 million swingline feature to permit same-day borrowing.

Amounts drawn under the facility bear interest at 90-day LIBOR plus an applicable margin. The applicable margin varies with the percentage of the total commitment drawn, with a 3.25% margin at 25% or lower utilization, a 3.75% margin at utilization greater than 25% but less than or equal to 50%, and a 4.25% margin at greater than 50% utilization. For purposes of determining the interest rate, in no event will LIBOR be less than 0.5% per annum. The

16

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TABLE OF CONTENTS

Company is also required to pay a quarterly commitment fee of 0.5% per annum on the unused portion of the facility.

The revolving line of credit can be used to finance acquisitions and fund working capital and capital expenditures and for other general corporate purposes.

The facility is secured by a first priority mortgage on certain of the Company's communities. The availability under the line will vary from time to time as it is based on borrowing base calculations related to the appraised value and performance of the communities securing the facility.

The amended credit agreement contains typical affirmative and negative covenants, including financial covenants with respect to minimum consolidated fixed charge coverage and minimum consolidated tangible net worth. A violation of any of these covenants could result in a default under the amended credit agreement, which would result in termination of all commitments under the amended credit agreement and all amounts owing under the amended credit agreement and certain other loan agreements becoming immediately due and payable.

As of September 30, 2013, the Company had an available secured line of credit with a \$250.0 million commitment and \$238.6 million of availability (of which \$45.0 million had been drawn as of such date). The Company also had secured and unsecured letter of credit facilities of up to \$92.5 million in the aggregate as of September 30, 2013. Letters of credit totaling \$71.8 million had been issued under these facilities as of that date.

Financings

On April 3, 2013, the Company obtained a \$25.0 million first mortgage loan, secured by the underlying community. The loan bears interest at a variable rate equal to 30-day LIBOR plus a margin of 275 basis points and matures in April 2018. In connection with the transaction, the Company repaid \$29.0 million of existing variable rate debt.

On April 12, 2013, the Company obtained \$259.0 million in loans secured by first mortgages on 23 communities. The loans bear interest at a variable rate equal to 30-day LIBOR plus a margin of 246 basis points. Concurrent with the closing of the loans, the Company entered into a five-year interest rate cap agreement that caps the interest rate on the loans at 5.03%. The loans mature in May 2023 and require amortization of principal over a 30 year period. Proceeds of the loans, together with cash on hand, were used to refinance or repay a total of \$275.2 million of mortgage debt which was scheduled to mature in May 2013 and July 2013 and variable rate tax-exempt bonds scheduled to mature in 2032.

On April 22, 2013, the Company obtained a \$28.0 million first mortgage loan, secured by two communities. The loan bears interest at a variable rate equal to 30-day LIBOR plus a margin of 275 basis points and matures in April 2018. In connection with the transaction, the Company repaid \$35.1 million of existing variable rate debt.

On May 30, 2013, the Company obtained an \$84.1 million first mortgage loan secured by eight of the Company's communities. The loan has a ten-year term and bears interest at a variable rate equal to 30-day LIBOR plus a margin of 289 basis points. Concurrent with the closing of the loan, the Company entered into a five-year interest rate cap agreement that caps the interest rate on the loan at 4.68%. Proceeds of the loan, together with cash on hand, were used to refinance or repay \$100.9 million of mortgage debt that was scheduled to mature between 2013 and 2017.

On August 1, 2013, the Company obtained \$172.1 million in loans secured by first mortgages on four communities. The loans bear interest at a variable rate equal to 30-day LIBOR plus a margin ranging from 226 to 288 basis points. The loans mature in August 2020 (\$75.0 million) and August 2023 (\$97.1 million) and require amortization of principal over a 30 year period. Proceeds of the loans were used to refinance a total of \$142.0 million of Series A notes payable which were scheduled to mature on August 1, 2013.

As of September 30, 2013, the Company is in compliance with the financial covenants of its outstanding debt and lease agreements.

17

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TABLE OF CONTENTS

## 9. Litigation

The Company has been and is currently involved in litigation and claims incidental to the conduct of its business which are comparable to other companies in the senior living industry. Certain claims and lawsuits allege large damage amounts and may require significant costs to defend and resolve. Similarly, the senior living industry is continuously subject to scrutiny by governmental regulators, which could result in litigation related to regulatory compliance matters. As a result, the Company maintains general liability and professional liability insurance policies in amounts and with coverage and deductibles the Company believes are adequate, based on the nature and risks of its business, historical experience and industry standards. The Company's current policies provide for deductibles for each claim. Accordingly, the Company is, in effect, self-insured for claims that are less than the deductible amounts.

## 10. Supplemental Disclosure of Cash Flow Information

(dollars in thousands):	Nine Months Ended September 30,	
	2013	2012
Supplemental Disclosure of Cash Flow Information:		
Interest paid	\$90,167	\$95,795
Income taxes paid	\$2,089	\$1,954
Write-off of deferred costs	\$444	\$744
Supplemental Schedule of Non-cash Operating, Investing and Financing Activities:		
Acquisition of assets, net of related payables and cash received:		
Cash and escrow deposits-restricted	\$—	\$3,313
Prepaid expenses and other current assets	(1,326 )	(2,817 )
Property, plant and equipment and leasehold intangibles, net	17,157	123,450
Other intangible assets, net	3,514	6,641
Other assets, net	1,760	(7,327 )
Accrued expenses	(3,866 )	(580 )
Other liabilities	—	3,628
Long-term debt	(9,845 )	(15,000 )
Net	\$7,394	\$111,308
Capital leases:		
Property, plant and equipment and leasehold intangibles, net	\$—	\$13,852
Long-term debt	—	(13,852 )
Net	\$—	\$—

## 11. Facility Operating Leases

The following table provides a summary of facility lease expense and the impact of straight-line adjustment and amortization of deferred gains (dollars in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Cash basis payment	\$69,507	\$70,142	\$208,057	\$211,195
Straight-line expense	818	2,118	2,250	5,324

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Amortization of deferred gain	(1,093 )	(1,093 )	(3,279 )	(3,279 )
Facility lease expense	\$69,232	\$71,167	\$207,028	\$213,240

---

18

TABLE OF CONTENTS

12. Income Taxes

The difference in the Company's effective tax rates for both the three months and nine months ended September 30, 2013 and 2012 was due to the impact of the Company's improved financial results under generally accepted accounting principles. The Company's tax expense mainly reflects its cash tax position for states that do not allow for or have suspended the use of net operating losses for the period.

The Company recorded additional interest charges related to its tax contingency reserve as well as an additional reserve for an uncertain tax position for the nine months ended September 30, 2013. Tax returns for years 2009 through 2012 are subject to future examination by tax authorities. In addition, certain tax returns are open from 2002 through 2008 to the extent of the net operating losses generated during those periods.

13. Segment Information

The Company currently has six reportable segments: retirement centers; assisted living; CCRCs – rental; CCRCs – entry fee; ISC; and management services. Operating segments are defined as components of an enterprise that engage in business activities from which it may earn revenues and incur expenses; for which separate financial information is available; and whose operating results are regularly reviewed by the chief operating decision maker to assess the performance of the individual segment and make decisions about resources to be allocated to the segment.

**Retirement Centers.** The Company's Retirement Centers segment includes owned or leased communities that are primarily designed for middle to upper income senior citizens age 75 and older who desire an upscale residential environment providing the highest quality of service. The majority of the Company's retirement center communities consist of both independent living and assisted living units in a single community, which allows residents to "age-in-place" by providing them with a continuum of senior independent and assisted living services.

**Assisted Living.** The Company's Assisted Living segment includes owned or leased communities that offer housing and 24-hour assistance with activities of daily life to mid-acuity frail and elderly residents. Assisted living communities include both freestanding, multi-story communities and freestanding single story communities. The Company also operates memory care communities, which are freestanding assisted living communities specially designed for residents with Alzheimer's disease and other dementias.

**CCRCs - Rental.** The Company's CCRCs - Rental segment includes large owned or leased communities that offer a variety of living arrangements and services to accommodate all levels of physical ability and health. Most of the Company's CCRCs have independent living, assisted living and skilled nursing available on one campus or within the immediate market, and some also include memory care/Alzheimer's units.

**CCRCs - Entry Fee.** The communities in the Company's CCRCs - Entry Fee segment are similar to those in the Company's CCRCs - Rental segment but allow for residents in the independent living apartment units to pay a one-time upfront entrance fee, which is partially refundable in certain circumstances. The amount of the entrance fee varies depending upon the type and size of the dwelling unit, the type of contract plan selected, whether the contract contains a lifecare benefit for the resident, the amount and timing of refund, and other variables. In addition to the initial entrance fee, residents under all entrance fee agreements also pay a monthly service fee, which entitles them to the use of certain amenities and services. Since entrance fees are received upon initial occupancy, the monthly fees are generally less than fees at a comparable rental community.

**ISC.** The Company's ISC segment includes the outpatient therapy, home health and hospice services provided to residents of many of the Company's communities, to other senior living communities that the Company does not own



or operate and to seniors living outside of the Company's communities. The ISC segment does not include the therapy services provided in the Company's skilled nursing units, which are included in the Company's CCRCs - Rental and CCRCs - Entry Fee segments.

Management Services. The Company's management services segment includes communities operated by the Company pursuant to management agreements. In some of the cases, the controlling financial interest in the community is held by third parties and, in other cases, the community is owned in a joint venture structure in which

19

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TABLE OF CONTENTS

the Company has an ownership interest. Under the management agreements for these communities, the Company receives management fees as well as reimbursed expenses, which represent the reimbursement of expenses it incurs on behalf of the owners.

The accounting policies of the Company's reportable segments are the same as those described in the summary of significant accounting policies.

The following table sets forth certain segment financial and operating data (dollars in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2013	2012	September 30, 2013	2012
Revenue <sup>(1)</sup>				
Retirement Centers	\$ 133,272	\$ 126,401	\$ 392,364	\$ 376,726
Assisted Living	262,524	254,179	783,636	757,930
CCRCs - Rental	100,076	96,681	297,965	287,051
CCRCs - Entry Fee	74,110	71,413	222,434	213,990
ISC	61,162	56,856	180,053	168,432
Management Services <sup>(2)</sup>	97,855	90,615	281,281	265,197
	\$ 728,999	\$ 696,145	\$ 2,157,733	\$ 2,069,326
Segment operating income <sup>(3)</sup>				
Retirement Centers	\$ 56,820	\$ 50,722	\$ 164,331	\$ 154,388
Assisted Living	96,750	91,162	289,216	271,891
CCRCs - Rental	27,013	25,100	81,657	79,883
CCRCs - Entry Fee	18,218	15,164	55,561	47,486
ISC	11,764	11,915	36,078	36,730
Management Services	7,622	7,407	22,975	22,350
	218,187	201,470	649,818	612,728
General and administrative (including non-cash stock-based compensation expense)	45,824	43,158	138,470	134,202
Facility lease expense	69,232	71,167	207,028	213,240
Depreciation and amortization	68,644	62,876	200,557	189,781
Asset impairment	504	—	2,658	8,329
Loss on acquisition	—	—	—	636
Gain on facility lease termination	—	—	—	(2,780)
Income from operations	\$ 33,983	\$ 24,269	\$ 101,105	\$ 69,320

	As of September 30, 2013	December 31, 2012
Total assets		
Retirement Centers	\$ 1,245,316	\$ 1,256,497
Assisted Living	1,426,868	1,438,934
CCRCs - Rental	524,875	534,220
CCRCs - Entry Fee	951,475	951,584
ISC	95,906	90,357

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Corporate and Management Services	399,791	394,386
Total assets	\$4,644,231	\$4,665,978

(1) All revenue is earned from external third parties in the United States.

20

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TABLE OF CONTENTS

(2) Management services segment revenue includes reimbursements for which the Company is the primary obligor of costs incurred on behalf of managed communities.

(3) Segment operating income is defined as segment revenues less segment operating expenses (excluding depreciation and amortization).

14. Subsequent Events

Effective October 1, 2013, the Company acquired seven communities for an aggregate purchase price of \$80.9 million. The Company financed the transaction with \$60.8 million of first mortgage financing (substantially through the assumption of existing debt), with the balance of the purchase price paid from cash on hand. The Company had been managing six of the communities since the acquisition of Horizon Bay in September 2011. The results of operations of the seven communities will be reported in the Assisted Living segment.

21

---

TABLE OF CONTENTS

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

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements in this Quarterly Report on Form 10-Q and other information we provide from time to time may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Those forward-looking statements include all statements that are not historical statements of fact and those regarding our intent, belief or expectations, including, but not limited to, statements relating to the consummation of the restructuring of the management agreements with Chartwell Retirement Residences ("Chartwell"); statements relating to our operational initiatives and our expectations regarding their effect on our results; our expectations regarding the economy, the senior living industry, occupancy, revenue, cash flow, operating income, expenses, capital expenditures, Program Max opportunities, cost savings, the demand for senior housing, the home resale market, expansion, development and construction activity, acquisition opportunities, asset dispositions, our share repurchase program, capital deployment, returns on invested capital and taxes; our expectations regarding returns to shareholders and our growth prospects; our expectations concerning the future performance of recently acquired communities and the effects of acquisitions (including the Chartwell portfolio acquisition) on our financial results; our ability to secure financing or repay, replace or extend existing debt at or prior to maturity; our ability to remain in compliance with all of our debt and lease agreements (including the financial covenants contained therein); our expectations regarding liquidity and leverage; our expectations regarding financings and refinancings of assets (including the timing thereof) and their effect on our results; our expectations regarding changes in government reimbursement programs and their effect on our results; our plans to generate growth organically through occupancy improvements, increases in annual rental rates and the achievement of operating efficiencies and cost savings; our plans to expand our offering of ancillary services (therapy, home health and hospice); our plans to expand, renovate, redevelop and reposition existing communities; our plans to acquire additional communities, asset portfolios, operating companies and home health agencies; the expected project costs for our expansion, redevelopment and repositioning program; our expected levels of expenditures and reimbursements (and the timing thereof); our expectations regarding our sales, marketing and branding initiatives and their impact on our results; our expectations for the performance of our entrance fee communities; our ability to anticipate, manage and address industry trends and their effect on our business; our expectations regarding the payment of dividends; and our ability to increase revenues, earnings, Adjusted EBITDA, Cash From Facility Operations, and/or Facility Operating Income (as such terms are defined herein). Words such as "anticipate(s)", "expect(s)", "intend(s)", "plan(s)", "target(s)", "project(s)", "predict(s)", "believe(s)", "may", "will", "would", "could", "should", "seek(s)", "estimate(s)" and similar expressions are intended to identify such forward-looking statements. These statements are based on management's current expectations and beliefs and are subject to a number of risks and uncertainties that could lead to actual results differing materially from those projected, forecasted or expected. Although we believe that the assumptions underlying the forward-looking statements are reasonable, we can give no assurance that our expectations will be attained. Factors which could have a material adverse effect on our operations and future prospects or which could cause actual results to differ materially from our expectations include, but are not limited to, the risk that we may not be able to satisfy the conditions and successfully complete the Chartwell management agreement restructuring; the risk associated with the current global economic situation and its impact upon capital markets and liquidity; changes in governmental reimbursement programs; our inability to extend (or refinance) debt (including our credit and letter of credit facilities) as it matures; the risk that we may not be able to satisfy the conditions precedent to exercising the extension options associated with certain of our debt agreements; events which adversely affect the ability of seniors to afford our monthly resident fees or entrance fees; the conditions of housing markets in certain geographic areas; our ability to generate sufficient cash flow to cover required interest and long-term operating lease payments; the effect of our indebtedness and long-term operating leases on our liquidity; the risk of loss of property pursuant to our mortgage debt and long-term lease obligations; the possibilities that changes in the capital markets, including changes in interest rates and/or credit spreads, or other factors could make financing more expensive or unavailable to us; our determination from time to

time to purchase any shares under the repurchase program; our ability to fund any repurchases; our ability to effectively manage our growth; our ability to maintain consistent quality control; delays in obtaining regulatory approvals; the risk that we may not be able to expand, redevelop and reposition our communities in accordance with our plans; our ability to complete acquisitions and integrate them into our operations; competition for the acquisition of assets; our ability to obtain additional capital on terms acceptable to us; a decrease in the overall demand for senior housing; our vulnerability to economic downturns; acts of nature in certain geographic areas; terminations of our resident agreements and vacancies in the living spaces we lease; early

22

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TABLE OF CONTENTS

terminations or non-renewal of management agreements; increased competition for skilled personnel; increased union activity; departure of our key officers; increases in market interest rates; environmental contamination at any of our facilities; failure to comply with existing environmental laws; an adverse determination or resolution of complaints filed against us; the cost and difficulty of complying with increasing and evolving regulation; and other risks detailed from time to time in our filings with the Securities and Exchange Commission, press releases and other communications, including those set forth under "Risk Factors" included in our Annual Report on Form 10-K for the year ended December 31, 2012 and in this Quarterly Report. Such forward-looking statements speak only as of the date of this Quarterly Report. We expressly disclaim any obligation to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or change in events, conditions or circumstances on which any statement is based.

## Executive Overview

Our primary long-term growth objectives are to grow our revenues, Adjusted EBITDA, Cash From Facility Operations and Facility Operating Income primarily through a combination of: (i) organic growth in our core business, including expense control and the realization of economies of scale; (ii) expansion, redevelopment and repositioning of existing communities; (iii) acquisition and consolidation of asset portfolios and other senior living companies; and (iv) continued expansion of our ancillary services programs (including therapy, home health and hospice services).

The tables below present a summary of our operating results and certain other financial metrics for the three and nine months ended September 30, 2013 and 2012 and the amount and percentage of increase or decrease of each applicable item (dollars in millions).

	Three Months Ended		Increase (Decrease)		
	September 30, 2013	2012	Amount	Percent	
Total revenues	\$729.0	\$696.1	\$32.9	4.7	%
Net loss	\$(1.0 )	\$(12.2 )	\$(11.2)	(92.1)	%
Adjusted EBITDA	\$114.1	\$106.8	\$7.3	6.8	%
Cash From Facility Operations	\$70.6	\$61.5	\$9.1	14.8	%
Facility Operating Income	\$203.6	\$187.6	\$16.0	8.5	%

  

	Nine Months Ended		Increase (Decrease)		
	September 30, 2013	2012	Amount	Percent	
Total revenues	\$2,157.7	\$2,069.3	\$88.4	4.3	%
Net loss	\$(2.6 )	\$(41.8 )	\$(39.2)	(93.8)	%
Adjusted EBITDA	\$338.2	\$307.9	\$30.3	9.8	%
Cash From Facility Operations	\$209.6	\$177.5	\$32.1	18.0	%
Facility Operating Income	\$605.7	\$571.5	\$34.2	6.0	%

Adjusted EBITDA and Facility Operating Income are non-GAAP financial measures we use in evaluating our operating performance. Cash From Facility Operations is a non-GAAP financial measure we use in evaluating our liquidity. See "Non-GAAP Financial Measures" below for an explanation of how we define each of these measures, a detailed description of why we believe such measures are useful and the limitations of each measure, a reconciliation of net income (loss) to each of Adjusted EBITDA and Facility Operating Income and a reconciliation of net cash provided by operating activities to Cash From Facility Operations.

During the nine months ended September 30, 2013, we experienced an increase in our total revenues, primarily due to increases in occupancy and average monthly revenue per unit, including an increase in our ancillary services revenue.

Total revenues for the nine months ended September 30, 2013 increased to \$2.2 billion, an increase of \$88.4 million, or 4.3%, over our total revenues for the nine months ended September 30, 2012. Resident fees for the nine months ended September 30, 2013 increased \$72.3 million, or 4.0%, from the prior year period. Management

23

---



TABLE OF CONTENTS

fees increased \$0.6 million, or 2.8%, from the prior year period, and reimbursed costs incurred on behalf of managed communities increased \$15.5 million, or 6.4%.

The increase in resident fees during the nine months ended September 30, 2013 was primarily a result of a 2.7% increase in senior housing average monthly revenue per unit compared to the prior year period, an 80 basis points increase in average occupancy and an increase in revenues from our ancillary services programs. Our weighted average occupancy rate for the nine months ended September 30, 2013 and 2012 was 88.6% and 87.8%, respectively. The increase in our average occupancy rate was a result of improving fundamentals, execution by our field organization and sales and marketing team and the benefit of the capital we have invested and continue to spend on our communities.

During the nine months ended September 30, 2013, we also made progress in controlling our cost growth. Facility operating expenses for the nine months ended September 30, 2013 were \$1.2 billion, an increase of \$35.9 million, or 3.0%, as compared to the nine months ended September 30, 2012.

Net loss for the nine months ended September 30, 2013 was \$2.6 million, or \$(0.02) per basic and diluted common share, compared to a net loss of \$41.8 million, or \$(0.34) per basic and diluted common share, for the nine months ended September 30, 2012.

During the nine months ended September 30, 2013, our Adjusted EBITDA, Cash From Facility Operations and Facility Operating Income increased by 9.8%, 18.0% and 6.0%, respectively, when compared to the nine months ended September 30, 2012.

During the first nine months of 2013, we continued to expand our ancillary services offerings. As of September 30, 2013, we offered therapy services to approximately 53,000 of our units and home health services to approximately 48,000 of our units (approximately 38,000 and 34,000 of these units, respectively, are in our consolidated portfolio). As of that date we also had ten hospice agencies in operation. We expect to continue to expand our ancillary services programs to additional units and to open or acquire additional home health agencies. We also expect to expand our ancillary services programs by opening additional hospice agencies.

Effective October 1, 2013, we acquired seven communities from Chartwell for an aggregate purchase price of \$80.9 million. We financed the transaction with \$60.8 million of first mortgage financing (substantially through the assumption of existing debt), with the balance of the purchase price paid from cash on hand. We had been managing six of the communities since the acquisition of Horizon Bay in September 2011.

Consolidated Results of Operations

Three Months Ended September 30, 2013 and 2012

The following table sets forth, for the periods indicated, statement of operations items and the amount and percentage of increase or decrease of these items. The results of operations for any particular period are not necessarily indicative of results for any future period. The following data should be read in conjunction with our condensed consolidated financial statements and the related notes, which are included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Certain prior period amounts have been reclassified to conform to the current year presentation.

TABLE OF CONTENTS

(dollars in thousands, except average monthly revenue per unit)	Three Months Ended		Increase (Decrease)	% Increase (Decrease)	
	2013	2012			
Statement of Operations Data:					
Revenue					
Resident fees					
Retirement Centers	\$ 133,272	\$ 126,401	\$ 6,871	5.4	%
Assisted Living	262,524	254,179	8,345	3.3	%
CCRCs – Rental	100,076	96,681	3,395	3.5	%
CCRCs – Entry Fee	74,110	71,413	2,697	3.8	%
ISC	61,162	56,856	4,306	7.6	%
Total resident fees	631,144	605,530	25,614	4.2	%
Management services <sup>(1)</sup>	97,855	90,615	7,240	8.0	%
Total revenue	728,999	696,145	32,854	4.7	%
Expense					
Facility operating expense					
Retirement Centers	76,452	75,679	773	1.0	%
Assisted Living	165,774	163,017	2,757	1.7	%
CCRCs – Rental	73,063	71,581	1,482	2.1	%
CCRCs – Entry Fee	55,892	56,249	(357)	(0.6)	%
ISC	49,398	44,941	4,457	9.9	%
Total facility operating expense	420,579	411,467	9,112	2.2	%
General and administrative expenses	45,824	43,158	2,666	6.2	%
Facility lease expense	69,232	71,167	(1,935)	(2.7)	%
Depreciation and amortization	68,644	62,876	5,768	9.2	%
Asset impairment	504	¾	504	100.0	%
Costs incurred on behalf of managed communities	90,233	83,208	7,025	8.4	%
Total operating expense	695,016	671,876	23,140	3.4	%
Income from operations	33,983	24,269	9,714	40.0	%
Interest income	472	676	(204)	(30.2)	%
Interest expense					
Debt	(29,642)	(32,262)	(2,620)	(8.1)	%
Amortization of deferred financing costs and debt discounts	(4,100)	(4,543)	(443)	(9.8)	%
Change in fair value of derivatives and amortization	(1,377)	140	1,517	NM	
Loss on extinguishment of debt	(53)	¾	53	100.0	%
Equity in earnings (loss) of unconsolidated ventures	431	(249)	680	273.1	%
Other non-operating income	279	500	(221)	(44.2)	%
Loss before income taxes	(7)	(11,469)	(11,462)	(99.9)	%
Provision for income taxes	(960)	(747)	213	28.5	%
Net loss	\$(967)	\$(12,216)	\$(11,249)	(92.1)	%

TABLE OF CONTENTS

	Three Months Ended September 30,		Increase (Decrease)	% Increase (Decrease)	
	2013	2012			
Selected Operating and Other Data:					
Total number of communities (period end)	651	648	3	0.5	%
Total units operated <sup>(2)</sup>					
Period end	66,311	66,110	201	0.3	%
Weighted average	66,243	66,090	153	0.2	%
Owned/leased communities units <sup>(2)</sup>					
Period end	47,983	48,013	(30)	(0.1)	%
Weighted average	47,952	48,009	(57)	(0.1)	%
Owned/leased communities occupancy rate (weighted average)	89.0 %	88.0 %	1.0 %	1.1 %	%
Senior Housing average monthly revenue per unit <sup>(3)</sup>	\$4,397	\$4,279	\$ 118	2.8	%
Selected Segment Operating and Other Data:					
Retirement Centers					
Number of communities (period end)	76	76	—	—	
Total units <sup>(2)</sup>					
Period end	14,453	14,438	15	0.1	%
Weighted average	14,444	14,445	(1)	—	
Occupancy rate (weighted average)	90.2 %	89.1 %	1.1 %	1.2 %	%
Senior Housing average monthly revenue per unit <sup>(3)</sup>	\$3,408	\$3,275	\$ 133	4.1	%
Assisted Living					
Number of communities (period end)	432	434	(2)	(0.5)	%
Total units <sup>(2)</sup>					
Period end	21,519	21,655	(136)	(0.6)	%
Weighted average	21,513	21,652	(139)	(0.6)	%
Occupancy rate (weighted average)	90.0 %	89.1 %	0.9 %	1.0 %	%
Senior Housing average monthly revenue per unit <sup>(3)</sup>	\$4,518	\$4,393	\$ 125	2.8	%
CCRCs - Rental					
Number of communities (period end)	27	27	—	—	
Total units <sup>(2)</sup>					
Period end	6,687	6,691	(4)	(0.1)	%
Weighted average	6,687	6,691	(4)	(0.1)	%
Occupancy rate (weighted average)	86.7 %	85.8 %	0.9 %	1.0 %	%
Senior Housing average monthly revenue per unit <sup>(3)</sup>	\$5,759	\$5,619	\$ 140	2.5	%
CCRCs - Entry Fee					
Number of communities (period end)	14	14	—	—	
Total units <sup>(2)</sup>					
Period end	5,324	5,229	95	1.8	%
Weighted average	5,308	5,221	87	1.7	%
Occupancy rate (weighted average)	84.1 %	83.4 %	0.7 %	0.8 %	%
Senior Housing average monthly revenue per unit <sup>(3)</sup>	\$4,994	\$4,975	\$ 19	0.4	%
Other Entry Fee Data					
Non-refundable entrance fees sales	\$9,223	\$12,926	\$ (3,703)	(28.6)	%

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Refundable entrance fees sales <sup>(4)</sup>	9,875	12,206	(2,331 )	(19.1 %)
Total entrance fee receipts	19,098	25,132	(6,034 )	(24.0 %)

26

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TABLE OF CONTENTS

	Three Months Ended September 30,				Increase (Decrease)	% Increase (Decrease)
	2013	2012				
Refunds	(7,728 )	(6,024 )	1,704		28.3	%
Net entrance fees	\$11,370	\$19,108	\$(7,738 )		(40.5	%)
Management Services						
Number of communities (period end)	102	97	5		5.2	%
Total units <sup>(2)</sup>						
Period end	18,328	18,097	231		1.3	%
Weighted average	18,291	18,081	210		1.2	%
Occupancy rate (weighted average)	85.7 %	84.3 %	1.4	%	1.7	%
ISC						
Outpatient Therapy treatment codes	818,758	939,241	(120,483 )		(12.8	%)
Home Health average census	4,574	3,651	923		25.3	%

- (1) Management services segment revenue includes reimbursements for which we are the primary obligor of costs incurred on behalf of managed communities.
- (2) Period end units operated excludes equity homes. Weighted average units operated represents the average units operated during the period, excluding equity homes.
- (3) Senior Housing average monthly revenue per unit represents the average of the total monthly resident fee revenues, excluding amortization of entrance fees and ISC segment revenue, divided by average occupied units. Refundable entrance fee sales for the three months ended September 30, 2013 and 2012 include amounts received from residents participating in the MyChoice program, which allows new and existing residents the option to pay additional refundable entrance fee amounts in return for a reduced monthly service fee. MyChoice amounts received from residents totaled \$3.2 million and \$2.4 million for the three months ended September 30, 2013 and 2012, respectively.

As of September 30, 2013, our total operations included 651 communities with a capacity to serve 67,069 residents.

## Resident Fees

Resident fees increased over the prior year period primarily as a result of an increase in the average monthly revenue per unit compared to the prior year period, including an increase in revenue from our ancillary services programs, and an increase in occupancy. During the current period, revenues grew 3.8% at the 541 communities we operated during both periods with a 2.5% increase in the average monthly revenue per unit (excluding amortization of entrance fees in both instances). Occupancy increased 1.1% in these communities period over period.

Retirement Centers revenue increased \$6.9 million, or 5.4%, primarily due to increases in average monthly revenue per unit and occupancy at the communities we operated during both periods.

Assisted Living revenue increased \$8.3 million, or 3.3%, primarily due to increases in average monthly revenue per unit and occupancy at the communities we operated during both periods. The increase was partially offset by the impact of the disposition of three communities subsequent to the prior year period.

CCRCs - Rental revenue increased \$3.4 million, or 3.5%, primarily due to increases in average monthly revenue per unit and occupancy at the communities we operated during both periods.

CCRCs - Entry Fee revenue increased \$2.7 million, or 3.8%, primarily due to an increase in the number of units operated and an increase in occupancy at the communities we operated during both periods.

27

---

TABLE OF CONTENTS

ISC revenue increased \$4.3 million, or 7.6%, primarily due to the roll-out of our ancillary services programs to additional units subsequent to the prior year period. The increase was partially offset by a decrease in therapy service volume and by the impact of reimbursement changes.

Management Services

Management services revenue, including reimbursed costs incurred on behalf of managed communities, increased \$7.2 million, or 8.0%, primarily due to additional costs incurred on behalf of managed communities resulting from an increase in the number of managed communities from the prior year period.

Facility Operating Expense

Facility operating expense increased over the prior-year period primarily due to increases in salaries and wages and additional expenses incurred in connection with the expansion of our ancillary services programs. These increases were partially offset by a decrease in insurance expense.

Retirement Centers operating expenses increased \$0.8 million, or 1.0%, primarily due to an increase in salaries and wages due to wage rate increases and an increase in food and supplies expense due to an increase in occupancy. These increases were partially offset by a decrease in insurance expense.

Assisted Living operating expenses increased \$2.8 million, or 1.7%, primarily due to an increase in salaries and wages due to wage rate increases and expenses incurred for grounds maintenance services. These increases were partially offset by a decrease in insurance expense and by the impact of the disposition of three communities subsequent to the prior year period.

CCRCs - Rental operating expenses increased \$1.5 million, or 2.1%, primarily driven by an increase in salaries and wages due to wage rate increases and increased hours worked period over period, an increase in food and supplies expense due to an increase in occupancy and an increase in bad debt expense period over period. These increases were partially offset by a decrease in insurance expense.

CCRCs - Entry Fee operating expenses decreased \$0.4 million, or 0.6%, primarily driven by a decrease in insurance expense.

ISC operating expenses increased \$4.5 million, or 9.9%, primarily due to an increase in expenses incurred in connection with the continued expansion of our ancillary services programs, an increase in therapy labor expense and an increase in bad debt expense.

General and Administrative Expense

General and administrative expense increased \$2.7 million, or 6.2%, primarily as a result of increased employee benefits, travel, professional fees and repairs and maintenance expenses. General and administrative expense as a percentage of total revenue, including revenue generated by the communities we manage and excluding non-cash stock-based compensation expense and integration, transaction-related and electronic medical records ("EMR") roll-out costs, was 4.3% for both the three months ended September 30, 2013 and 2012, calculated as follows (dollars in thousands):

TABLE OF CONTENTS

	Three Months Ended September 30,			
	2013		2012	
Resident fee revenues	\$631,144	78.8 %	\$605,530	79.2 %
Resident fee revenues under management	169,373	21.2 %	158,600	20.8 %
Total	\$800,517	100.0 %	\$764,130	100.0 %
General and administrative expenses (excluding non-cash stock-based compensation expense and integration, transaction-related and EMR roll-out costs)	\$34,269	4.3 %	\$32,513	4.3 %
Non-cash stock-based compensation expense	6,894	0.9 %	6,021	0.8 %
Integration, transaction-related and EMR roll-out costs	4,661	0.6 %	4,624	0.6 %
General and administrative expenses (including non-cash stock-based compensation expense and integration, transaction-related and EMR roll-out costs)	\$45,824	5.7 %	\$43,158	5.6 %

## Facility Lease Expense

Facility lease expense decreased \$1.9 million, or 2.7%, primarily as a result of the purchase of 12 previously leased communities in the prior year.

## Depreciation and Amortization

Depreciation and amortization expense increased \$5.8 million, or 9.2%, primarily as a result of the purchase of 12 previously leased communities in the prior year.

## Asset Impairment

During the three months ended September 30, 2013, we recognized \$0.5 million of impairment charges related to asset impairments for property, plant, and equipment for a community within the Assisted Living segment. We compared the estimated fair value of the assets to the carrying value and recorded an impairment charge for the excess of carrying value over estimated fair value.

## Costs Incurred on Behalf of Managed Communities

Costs incurred on behalf of managed communities increased \$7.0 million, or 8.4%, primarily due to additional costs resulting from an increase in the number of managed communities from the prior year period.

## Interest Expense

Interest expense decreased \$1.5 million, or 4.2%, primarily due to decreased interest expense related to our mortgage debt, which had lower interest rates period over period, and a decrease in amortization of deferred financing costs and debt discount. These decreases were partially offset by a change in the fair value of interest rate swaps and caps due to a decrease in interest rates during the current period.

## Income Taxes



The difference in our effective tax rates for the three months ended September 30, 2013 and 2012 was due to the impact of our improved financial results under generally accepted accounting principles. Tax expense mainly reflects our cash tax position for states that do not allow for or have suspended the use of net operating losses for the period.

29

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TABLE OF CONTENTS

Additional interest charges related to our tax contingency reserve as well as an additional reserve for an uncertain tax position were recorded during the three months ended September 30, 2013. Tax returns for years 2009 through 2012 are subject to future examination by tax authorities. In addition, certain tax returns are open from 2002 through 2008 to the extent of the net operating losses generated during those periods.

## Nine Months Ended September 30, 2013 and 2012

The following table sets forth, for the periods indicated, statement of operations items and the amount and percentage of increase or decrease of these items. The results of operations for any particular period are not necessarily indicative of results for any future period. The following data should be read in conjunction with our condensed consolidated financial statements and the related notes, which are included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Certain prior period amounts have been reclassified to conform to the current year presentation.

	Nine Months Ended		Increase (Decrease)	% Increase (Decrease)	
	2013	2012			
(dollars in thousands, except average monthly revenue per unit) September 30,					
Statement of Operations Data:					
Revenue					
Resident fees					
Retirement Centers	\$392,364	\$376,726	\$ 15,638	4.2	%
Assisted Living	783,636	757,930	25,706	3.4	%
CCRCs - Rental	297,965	287,051	10,914	3.8	%
CCRCs - Entry Fee	222,434	213,990	8,444	3.9	%
ISC	180,053	168,432	11,621	6.9	%
Total resident fees	1,876,452	1,804,129	72,323	4.0	%
Management services <sup>(1)</sup>	281,281	265,197	16,084	6.1	%
Total revenue	2,157,733	2,069,326	88,407	4.3	%
Expense					
Facility operating expense					
Retirement Centers	228,033	222,338	5,695	2.6	%
Assisted Living	494,420	486,039	8,381	1.7	%
CCRCs - Rental	216,308	207,168	9,140	4.4	%
CCRCs - Entry Fee	166,873	166,504	369	0.2	%
ISC	143,975	131,702	12,273	9.3	%
Total facility operating expense	1,249,609	1,213,751	35,858	3.0	%
General and administrative expense	138,470	134,202	4,268	3.2	%
Facility lease expense	207,028	213,240	(6,212 )	(2.9	%)
Depreciation and amortization	200,557	189,781	10,776	5.7	%
Asset impairment	2,658	8,329	(5,671 )	(68.1	%)
Loss on acquisition	¾	636	(636 )	(100.0	%)
Gain on facility lease termination	¾	(2,780 )	(2,780 )	(100.0	%)
Costs incurred on behalf of managed communities	258,306	242,847	15,459	6.4	%
Total operating expense	2,056,628	2,000,006	56,622	2.8	%
Income from operations	101,105	69,320	31,785	45.9	%
Interest income	1,027	2,220	(1,193 )	(53.7	%)

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Interest expense					
Debt	(90,456 )	(96,743 )	(6,287 )	(6.5	%)
Amortization of deferred financing costs and debt discount	(13,017 )	(13,602 )	(585 )	(4.3	%)
Change in fair value of derivatives and amortization	594	(371 )	(965 )	(260.1	%)

30

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Period end	5,324	5,229	95	1.8	%
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31

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TABLE OF CONTENTS

(dollars in thousands, except average monthly revenue per unit)	Nine Months Ended September 30,				
	2013	2012	Increase (Decrease)	Increase (Decrease)	%
Weighted average	5,295	5,197	98	1.9	%
Occupancy rate (weighted average)	84.2	% 83.5	% 0.7	% 0.8	%
Senior Housing average monthly revenue per unit <sup>(3)</sup>	\$5,010	\$4,998	\$12	0.2	%
<b>Other Entry Fee Data</b>					
Non-refundable entrance fees sales	\$30,584	\$30,303	\$281	0.9	%
Refundable entrance fees sales <sup>(4)</sup>	29,265	29,512	(247 )	(0.8	%)
Total entrance fee receipts	59,849	59,815	34	0.1	%
Refunds	(24,504 )	(19,555 )	4,949	25.3	%
Net entrance fees	\$35,345	\$40,260	\$(4,915 )	(12.2	%)
<b>Management Services</b>					
Number of communities (period end)	102	97	5	5.2	%
Total units <sup>(2)</sup>					
Period end	18,328	18,097	231	1.3	%
Weighted average	18,238	18,159	79	0.4	%
Occupancy rate (weighted average)	85.1	% 84.2	% 0.9	% 1.1	%
<b>ISC</b>					
Outpatient Therapy treatment codes	2,480,142	2,804,421	(324,279 )	(11.6	%)
Home Health average census	4,410	3,551	859	24.2	%

(1) Management services segment revenue includes reimbursements for which we are the primary obligor of costs incurred on behalf of managed communities.

(2) Period end units operated excludes equity homes. Weighted average units operated represents the average units operated during the period, excluding equity homes.

(3) Senior Housing average monthly revenue per unit represents the average of the total monthly resident fee revenues, excluding amortization of entrance fees and ISC segment revenue, divided by average occupied units.

Refundable entrance fee sales for the nine months ended September 30, 2013 and 2012 include amounts received from residents participating in the MyChoice program, which allows new and existing residents the option to pay (4) additional refundable entrance fee amounts in return for a reduced monthly service fee. MyChoice amounts received from residents totaled \$9.0 million and \$8.4 million for the nine months ended September 30, 2013 and 2012, respectively.

**Resident Fees**

Resident fees increased over the prior year period primarily as a result of an increase in the average monthly revenue per unit compared to the prior year period, including an increase in revenue from our ancillary services programs, and an increase in occupancy. During the current year period, revenues grew 3.5% at the 540 communities we operated during both periods with a 2.5% increase in the average monthly revenue per unit (excluding amortization of entrance fees in both instances). Occupancy increased 0.9% in these communities period over period.

Retirement Centers revenue increased \$15.6 million, or 4.2%, primarily due to increases in average monthly revenue per unit and occupancy at the communities we operated during both periods.

32

---

TABLE OF CONTENTS

Assisted Living revenue increased \$25.7 million, or 3.4%, primarily due to increases in average monthly revenue per unit and occupancy at the communities we operated during both periods. The increase was partially offset by the impact of the disposition of three communities subsequent to the prior year period.

CCRCs - Rental revenue increased \$10.9 million, or 3.8%, primarily due to increases in average monthly revenue per unit and occupancy at the communities we operated during both periods.

CCRCs - Entry Fee revenue increased \$8.4 million, or 3.9%, primarily due to an increase in occupancy at the communities we operated during both periods and an increase in the number of units operated. This increase was partially offset by a decrease in skilled therapy revenue due to lower Medicare reimbursement.

ISC revenue increased \$11.6 million, or 6.9%, primarily due to the roll-out of our ancillary services programs to additional units subsequent to the prior year period. The increase was partially offset by a decrease in therapy service volume and by the impact of reimbursement changes.

Management Services

Management services revenue, including reimbursed costs incurred on behalf of managed communities, increased \$16.1 million, or 6.1%, primarily due to additional costs incurred on behalf of managed communities resulting from an increase in the number of managed communities from the prior year period.

Facility Operating Expense

Facility operating expense increased over the prior-year period primarily due to increased marketing and advertising expenses, as well as increases in salaries and wages and additional expenses incurred in connection with the expansion of our ancillary services programs. These increases were partially offset by a decrease in insurance expense.

Retirement Centers operating expenses increased \$5.7 million, or 2.6%, primarily due to an increase in marketing and advertising expense and an increase in salaries and wages due to wage rate increases. There was also an increase in real estate tax expense period over period and an increase in food expense driven by higher occupancy compared to the prior year period. These increases were partially offset by a decrease in insurance expense.

Assisted Living operating expenses increased \$8.4 million, or 1.7%, primarily due to an increase in marketing and advertising expense and an increase in salaries and wages due to wage rate increases. There was also an increase in grounds maintenance and repair expense period over period. These increases were partially offset by a decrease in insurance expense.

CCRCs - Rental operating expenses increased \$9.1 million, or 4.4%, primarily driven by an increase in salaries and wages due to wage rate increases and an increase in hours worked period over period, an increase in healthcare supplies expense due to an increase in occupancy and residents with higher acuity needs, and an increase in marketing and advertising expense. There was also an increase in bad debt expense compared to the prior year period. These increases were partially offset by a decrease in insurance expense.

CCRCs - Entry Fee operating expenses increased \$0.4 million, or 0.2%, primarily driven by an increase in marketing and advertising expense, an increase in salaries and wages due to wage rate increases, and an increase in bad debt expense. These increases were partially offset by a decrease in skilled therapy service expense due to a decrease in hours worked in the current year period and a decrease in insurance expense.



ISC operating expenses increased \$12.3 million, or 9.3%, primarily due to an increase in expenses incurred in connection with the continued expansion of our ancillary services programs, an increase in therapy labor expense and an increase in bad debt expense.

33

---

TABLE OF CONTENTS

## General and Administrative Expense

General and administrative expense increased \$4.3 million, or 3.2%, primarily as a result of increases in salaries and wage expense and employee benefits expense primarily due to increased employee headcount and increases in travel, repairs and maintenance, and marketing and advertising expenses. These increases were partially offset by a decrease in integration, transaction-related and EMR roll-out costs compared to the prior year period. General and administrative expense as a percentage of total revenue, including revenue generated by the communities we manage and excluding non-cash stock-based compensation expense and integration, transaction-related and EMR roll-out costs, was 4.5% and 4.3% for the nine months ended September 30, 2013 and 2012, respectively, calculated as follows (dollars in thousands):

	Nine Months Ended September 30,			
	2013		2012	
Resident fee revenues	\$1,876,452	79.0 %	\$1,804,129	79.1 %
Resident fee revenues under management	500,238	21.0 %	475,522	20.9 %
Total	\$2,376,690	100.0 %	\$2,279,651	100.0 %
General and administrative expenses (excluding non-cash stock-based compensation expense and integration, transaction-related and EMR roll-out costs)	\$107,302	4.5 %	\$98,801	4.3 %
Non-cash stock-based compensation expense	20,776	0.9 %	19,185	0.8 %
Integration, transaction-related and EMR roll-out costs	10,392	0.4 %	16,216	0.7 %
General and administrative expenses (including non-cash stock-based compensation expense and integration, transaction-related and EMR roll-out costs)	\$138,470	5.8 %	\$134,202	5.9 %

## Facility Lease Expense

Facility lease expense decreased \$6.2 million, or 2.9%, primarily as a result of the purchase of 12 previously leased communities in the prior year.

## Depreciation and Amortization

Depreciation and amortization expense increased \$10.8 million, or 5.7%, primarily as a result of the purchase of 12 previously leased communities in the prior year.

## Asset Impairment

During the nine months ended September 30, 2013, we recognized \$2.7 million of impairment charges related to asset impairments for property, plant, and equipment for certain communities within the CCRCs – Rental and Assisted Living segments. During the nine months ended September 30, 2012, we recognized \$8.3 million of impairment charges related to asset impairments for property, plant, and equipment for certain communities within the Assisted Living and CCRCs – Entry Fee segments. We compared the estimated fair value of the assets to the carrying value and recorded an impairment charge for the excess of carrying value over estimated fair value.

## Loss on Acquisition

The loss on acquisition recognized during the nine months ended September 30, 2012 relates to the reduction of a prior-year gain for adjustments to pre-acquisition self-insurance reserves and the related tax impact.

34

---

TABLE OF CONTENTS

## Gain on Facility Lease Termination

During the nine months ended September 30, 2012, we recognized a \$2.8 million net gain on facility lease termination from the reversal of deferred lease liabilities associated with nine previously-leased communities that were acquired during the prior year period, partially offset by the write-off of deferred lease costs.

## Costs Incurred on Behalf of Managed Communities

Costs incurred on behalf of managed communities increased \$15.5 million, or 6.4%, primarily due to additional costs resulting from an increase in the number of managed communities from the prior year period.

## Interest Expense

Interest expense decreased \$7.8 million, or 7.1%, primarily due to decreased interest expense related to our mortgage debt, which had lower interest rates period over period, and a gain recorded from the change in the fair value of interest rate swaps and caps due to an increase in interest rates since the purchase of the instruments.

## Income Taxes

The difference in our effective tax rates for the nine months ended September 30, 2013 and 2012 was due to the impact of our improved financial results under generally accepted accounting principles. Tax expense mainly reflects our cash tax position for states that do not allow for or have suspended the use of net operating losses for the period.

Additional interest charges related to our tax contingency reserve as well as an additional reserve for an uncertain tax position were recorded during the nine months ended September 30, 2013. Tax returns for years 2009 through 2012 are subject to future examination by tax authorities. In addition, certain tax returns are open from 2002 through 2008 to the extent of the net operating losses generated during those periods.

## Liquidity and Capital Resources

The following is a summary of cash flows from operating, investing and financing activities, as reflected in the condensed consolidated statements of cash flows (dollars in thousands):

	Nine Months Ended	
	September 30,	
	2013	2012
Cash provided by operating activities	\$249,075	\$207,978
Cash used in investing activities	(177,901)	(273,405)
Cash (used in) provided by financing activities	(97,724 )	77,095
Net (decrease) increase in cash and cash equivalents	(26,550 )	11,668
Cash and cash equivalents at beginning of period	69,240	30,836
Cash and cash equivalents at end of period	\$42,690	\$42,504

The increase in cash provided by operating activities was attributable primarily to improved operating results.

The decrease in cash used in investing activities was primarily attributable to a decrease in cash paid for acquisitions. The decrease was partially offset by an increase in spending on property, plant, equipment, and leasehold intangibles and by additional investments in unconsolidated ventures. The current year period also includes cash received from the sale of two communities.

The change in cash related to financing activities period over period was primarily attributable to net repayment of debt, including our line of credit, and related financing costs in connection with refinancing transactions during the current period.

35

---

## TABLE OF CONTENTS

Our principal sources of liquidity have historically been from:

- cash balances on hand;
- cash flows from operations;
- proceeds from our credit facilities;
- proceeds from mortgage financing or refinancing of various assets;
- funds generated through joint venture arrangements or sale-leaseback transactions; and with somewhat lesser frequency, funds raised in the debt or equity markets and proceeds from the selective disposition of underperforming and/or non-core assets.

Over the longer-term, we expect to continue to fund our business through these principal sources of liquidity.

Our liquidity requirements have historically arisen from:

- working capital;
- operating costs such as employee compensation and related benefits, general and administrative expense and supply costs;
- debt service and lease payments;
- acquisition consideration and transaction costs;
- cash collateral required to be posted in connection with our interest rate swaps and related financial instruments;
- capital expenditures and improvements, including the expansion of our current communities and the development of new communities;
- dividend payments;
- purchases of common stock under our share repurchase authorizations; and
- other corporate initiatives (including integration and branding).

Over the near-term, we expect that our liquidity requirements will primarily arise from:

- working capital;
- operating costs such as employee compensation and related benefits, general and administrative expense and supply costs;
- debt service and lease payments;
- capital expenditures and improvements, including the expansion, renovation, redevelopment and repositioning of our current communities and the development of new communities;
- other corporate initiatives (including information systems and branding); and
- acquisition consideration and transaction costs.

We are highly leveraged and have significant debt and lease obligations. As of September 30, 2013, we have three principal corporate-level debt obligations: our \$250.0 million revolving credit facility, our \$316.3 million convertible senior notes due 2018 and separate secured and unsecured letter of credit facilities providing for up to \$92.5 million of letters of credit in the aggregate. The remainder of our indebtedness is generally comprised of non-recourse property-level mortgage financings.

At September 30, 2013, we had \$2.3 billion of debt outstanding, excluding capital lease obligations and our line of credit, at a weighted-average interest rate of 4.5% (calculated using an imputed interest rate of 7.5% for our \$316.3 million convertible senior notes due 2018). At September 30, 2013, we had \$299.3 million of capital and financing lease obligations, \$45.0 million was drawn on our revolving loan facility, and \$71.8 million of letters of credit had

been issued under our letter of credit facilities. Approximately \$72.2 million of our debt and capital lease obligations are due on or before September 30, 2014. We also have substantial operating lease obligations and capital expenditure requirements. For the year ending September 30, 2014, we will be required to make approximately \$281.0 million of payments in connection with our existing operating leases.

36

---

TABLE OF CONTENTS

We had \$42.7 million of cash and cash equivalents at September 30, 2013, excluding cash and escrow deposits-restricted and lease security deposits of \$144.0 million in the aggregate. As of that date, we also had \$238.6 million of availability on our revolving credit facility (of which \$45.0 million had been drawn as of September 30, 2013).

At September 30, 2013, we had \$423.5 million of negative working capital, which includes the classification of \$268.7 million of refundable entrance fees as current liabilities. Based upon our historical operating experience, we anticipate that only 9.0% to 12.0% of the refundable entrance fee liabilities will actually come due, and be required to be settled in cash, during the next 12 months. We expect that any entrance fee liabilities due within the next 12 months will be fully offset by the proceeds generated by subsequent entrance fee sales. Entrance fee sales, net of refunds paid, provided \$35.3 million of cash for the nine months ended September 30, 2013.

For the year ending December 31, 2013, we anticipate that we will make investments of approximately \$180.0 million to \$195.0 million for net capital expenditures (excluding expenditures related to our Program Max initiative discussed below), comprised of approximately \$40.0 million to \$45.0 million of net recurring capital expenditures and approximately \$140.0 million to \$150.0 million of expenditures relating to other major projects (including corporate initiatives). These major projects include unusual or non-recurring capital projects, projects which create new or enhanced economics, such as major renovations or repositioning projects at our communities, integration related expenditures (including the cost of developing information systems), and expenditures supporting the expansion of our ancillary services programs. For the nine months ended September 30, 2013, we spent approximately \$32.1 million for net recurring capital expenditures and approximately \$89.8 million for expenditures relating to other major projects and corporate initiatives.

In addition, we have increased our efforts with respect to the expansion, redevelopment and repositioning of our communities through our Program Max initiative. We anticipate making net investments of approximately \$40.0 million to \$50.0 million during 2013 in connection with recently initiated or currently planned projects. For the nine months ended September 30, 2013, we spent approximately \$38.1 million in connection with our Program Max initiative.

During 2013, we anticipate that our capital expenditures will be funded from cash on hand, cash flows from operations, lessor reimbursement and amounts drawn on our credit facility.

As opportunities arise, we plan to continue to take advantage of the fragmented senior housing and care sectors by selectively purchasing existing operating companies, asset portfolios, home health agencies and communities. We may also seek to acquire the fee interest in communities that we currently lease or manage. We expect to continue to assess our financing alternatives periodically and access the capital markets opportunistically. If our existing resources are insufficient to satisfy our liquidity requirements, or if we enter into an acquisition or strategic arrangement with another company, we may need to sell additional equity or debt securities. Any such sale of additional equity securities will dilute the interests of our existing stockholders, and we cannot be certain that additional public or private financing will be available in amounts or on terms acceptable to us, if at all. If we are unable to obtain this additional financing, we may be required to delay, reduce the scope of, or eliminate one or more aspects of our business development activities, any of which could reduce the growth of our business.

We currently estimate that our existing cash flows from operations, together with existing working capital, amounts available under our credit facility and, to a lesser extent, proceeds from anticipated financings, will be sufficient to fund our liquidity needs for at least the next 12 months, assuming that the overall economy does not substantially deteriorate.



Our actual liquidity and capital funding requirements depend on numerous factors, including our operating results, the actual level of capital expenditures, our expansion, development and acquisition activity, general economic conditions and the cost of capital. Shortfalls in cash flows from operating results or other principal sources of liquidity may have an adverse impact on our ability to execute our business and growth strategies. Volatility in the credit and financial markets may also have an adverse impact on our liquidity by making it more difficult for us to obtain financing or refinancing. As a result, this may impact our ability to grow our business, maintain capital spending levels, expand certain communities, or execute other aspects of our business strategy. In order to continue some of these activities at historical or planned levels, we may incur additional indebtedness or lease financing to

37

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## TABLE OF CONTENTS

provide additional funding. There can be no assurance that any such additional financing will be available or on terms that are acceptable to us.

As of September 30, 2013, we are in compliance with the financial covenants of our outstanding debt and lease agreements.

### Credit Facilities

On March 28, 2013, we entered into a second amended and restated credit agreement with General Electric Capital Corporation, as administrative agent and lender, and the other lenders from time to time parties thereto. The amended credit agreement extended the maturity date of the facility to March 31, 2018 and decreased the interest rate payable on advances and the fee payable on the unused portion of the facility. The amended credit agreement provided an option to increase the committed amount initially from \$230.0 million to \$250.0 million, which we exercised on June 28, 2013, and provides an additional option to increase the committed amount from \$250.0 million to up to \$350.0 million, subject to obtaining commitments for the amount of such increase from acceptable lenders. The amended credit agreement also permits reduction of the committed amount or termination of the facility during the last two years of the five year term without payment of a premium or penalty. The amended credit agreement was further amended and restated effective September 20, 2013 to, among other things, incorporate a \$25.0 million swingline feature to permit same-day borrowing.

Amounts drawn under the facility bear interest at 90-day LIBOR plus an applicable margin. The applicable margin varies with the percentage of the total commitment drawn, with a 3.25% margin at 25% or lower utilization, a 3.75% margin at utilization greater than 25% but less than or equal to 50%, and a 4.25% margin at greater than 50% utilization. For purposes of determining the interest rate, in no event will LIBOR be less than 0.5% per annum. We are also required to pay a quarterly commitment fee of 0.5% per annum on the unused portion of the facility.

The revolving line of credit can be used to finance acquisitions and fund working capital and capital expenditures and for other general corporate purposes.

The facility is secured by a first priority mortgage on certain of our communities. The availability under the line will vary from time to time as it is based on borrowing base calculations related to the appraised value and performance of the communities securing the facility.

The amended credit agreement contains typical affirmative and negative covenants, including financial covenants with respect to minimum consolidated fixed charge coverage and minimum consolidated tangible net worth. A violation of any of these covenants could result in a default under the amended credit agreement, which would result in termination of all commitments under the amended credit agreement and all amounts owing under the amended credit agreement and certain other loan agreements becoming immediately due and payable.

As of September 30, 2013, we had an available secured line of credit with a \$250.0 million commitment and \$238.6 million of availability (of which \$45.0 million had been drawn as of such date). We also had secured and unsecured letter of credit facilities of up to \$92.5 million in the aggregate as of September 30, 2013. Letters of credit totaling \$71.8 million had been issued under these facilities as of that date.

### Contractual Commitments

Significant ongoing commitments consist primarily of leases, debt, purchase commitments and certain other long-term liabilities. For a summary and complete presentation and description of our ongoing commitments and contractual

obligations, see the "Contractual Commitments" section of Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

There have been no material changes outside the ordinary course of business in our contractual commitments during the nine months ended September 30, 2013. See Note 8 for financing transactions that were completed during the period.

38

---

TABLE OF CONTENTS

Off-Balance Sheet Arrangements

The equity method of accounting has been applied in the accompanying financial statements with respect to our investment in unconsolidated ventures that are not considered variable interest entities as we do not possess a controlling financial interest. We do not believe these off-balance sheet arrangements have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Non-GAAP Financial Measures

A non-GAAP financial measure is generally defined as one that purports to measure historical or future financial performance, financial position or cash flows, but excludes or includes amounts that would not be so adjusted in the most comparable GAAP measure. In this report, we define and use the non-GAAP financial measures Adjusted EBITDA, Cash From Facility Operations and Facility Operating Income, as set forth below.

Adjusted EBITDA

Definition of Adjusted EBITDA

We define Adjusted EBITDA as follows:

Net income (loss) before:

- provision (benefit) for income taxes;
- non-operating (income) expense items;
- (gain) loss on sale or acquisition of communities (including gain (loss) on facility lease termination);
- depreciation and amortization (including non-cash impairment charges);
- straight-line lease expense (income);
- amortization of deferred gain;
- amortization of deferred entrance fees;
- non-cash stock-based compensation expense; and
- change in future service obligation;

and including:

entrance fee receipts and refunds (excluding (i) first generation entrance fee receipts from the sale of units at a recently opened entrance fee CCRC prior to stabilization and (ii) first generation entrance fee refunds not replaced by second generation entrance fee receipts at the recently opened community prior to stabilization).

Management's Use of Adjusted EBITDA

We use Adjusted EBITDA to assess our overall financial and operating performance. We believe this non-GAAP measure, as we have defined it, is helpful in identifying trends in our day-to-day performance because the items excluded have little or no significance on our day-to-day operations. This measure provides an assessment of controllable expenses and affords management the ability to make decisions which are expected to facilitate meeting

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TABLE OF CONTENTS

current financial goals as well as achieve optimal financial performance. It provides an indicator for management to determine if adjustments to current spending decisions are needed.

Adjusted EBITDA provides us with a measure of financial performance, independent of items that are beyond the control of management in the short-term, such as the change in the liability for the obligation to provide future services under existing lifecare contracts, depreciation and amortization (including non-cash impairment charges), straight-line lease expense (income), taxation and interest expense associated with our capital structure. This metric measures our financial performance based on operational factors that management can impact in the short-term, namely the cost structure or expenses of the organization. Adjusted EBITDA is one of the metrics used by senior management and the board of directors to review the financial performance of the business on a monthly basis.

Adjusted EBITDA is also used by research analysts and investors to evaluate the performance of and value companies in our industry.

Limitations of Adjusted EBITDA

Adjusted EBITDA has limitations as an analytical tool. It should not be viewed in isolation or as a substitute for GAAP measures of earnings. Material limitations in making the adjustments to our earnings to calculate Adjusted EBITDA, and using this non-GAAP financial measure as compared to GAAP net income (loss), include:

the cash portion of interest expense, income tax (benefit) provision and non-recurring charges related to gain (loss) on sale of communities and extinguishment of debt activities generally represent charges (gains), which may significantly affect our financial results; and

depreciation and amortization, though not directly affecting our current cash position, represent the wear and tear and/or reduction in value of our communities, which affects the services we provide to our residents and may be indicative of future needs for capital expenditures.

An investor or potential investor may find this item important in evaluating our performance, results of operations and financial position. We use non-GAAP financial measures to supplement our GAAP results in order to provide a more complete understanding of the factors and trends affecting our business.

Adjusted EBITDA is not an alternative to net income, income from operations or cash flows provided by or used in operations as calculated and presented in accordance with GAAP. You should not rely on Adjusted EBITDA as a substitute for any such GAAP financial measure. We strongly urge you to review the reconciliation of Adjusted EBITDA to GAAP net income (loss), along with our condensed consolidated financial statements included herein.

We also strongly urge you to not rely on any single financial measure to evaluate our business. In addition, because Adjusted EBITDA is not a measure of financial performance under GAAP and is susceptible to varying calculations, the Adjusted EBITDA measure, as presented in this report, may differ from and may not be comparable to similarly titled measures used by other companies.

The table below shows the reconciliation of net loss to Adjusted EBITDA for the three and nine months ended September 30, 2013 and 2012 (dollars in thousands):

	Three Months Ended September 30, 2013 <sup>(1)</sup>		Nine Months Ended September 30, 2013 <sup>(1)</sup>	
	2012 <sup>(1)</sup>	2012 <sup>(1)</sup>	2012 <sup>(1)</sup>	2012 <sup>(1)</sup>
Net loss	\$(967 )	\$(12,216)	\$(2,609 )	\$(41,775)

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Provision for income taxes	960	747	3,272	2,559
Equity in (earnings) loss of unconsolidated ventures	(431 )	249	(991 )	211
Loss on extinguishment of debt	53	—	946	221
Other non-operating income	(279 )	(500 )	(1,365 )	(392 )
Interest expense:				
Debt	23,467	24,615	71,291	73,691
Capitalized lease obligation	6,175	7,647	19,165	23,052

40

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TABLE OF CONTENTS

Amortization of deferred financing costs and debt discount	4,100	4,543	13,017	13,602
Change in fair value of derivatives and amortization	1,377	(140 )	(594 )	371
Interest income	(472 )	(676 )	(1,027 )	(2,220 )
Income from operations	33,983	24,269	101,105	69,320
Gain on facility lease termination	—	—	—	(2,780 )
Loss on acquisition	—	—	—	636
Depreciation and amortization	68,644	62,876	200,557	189,781
Asset impairment	504	—	2,658	8,329
Straight-line lease expense	818	2,118	2,250	5,324
Amortization of deferred gain	(1,093 )	(1,093 )	(3,279 )	(3,279 )
Amortization of entrance fees	(7,013 )	(6,459 )	(21,178 )	(18,835 )
Non-cash stock-based compensation expense	6,894	6,021	20,776	19,185
Entrance fee receipts <sup>(2)</sup>	19,098	25,132	59,849	59,815
Entrance fee disbursements	(7,728 )	(6,024 )	(24,504 )	(19,555 )
Adjusted EBITDA	\$ 114,107	\$ 106,840	\$ 338,234	\$ 307,941

The calculation of Adjusted EBITDA includes integration, transaction-related and EMR roll-out costs of \$4.7 million and \$10.4 million for the three and nine months ended September 30, 2013, respectively. The calculation of (1) Adjusted EBITDA includes integration, transaction-related and EMR roll-out costs of \$4.6 million and \$16.2 million for the three and nine months ended September 30, 2012, respectively.

(2) Includes the receipt of refundable and non-refundable entrance fees.

## Cash From Facility Operations

## Definition of Cash From Facility Operations

We define Cash From Facility Operations (CFFO) as follows:

Net cash provided by (used in) operating activities adjusted for:

- changes in operating assets and liabilities;
- deferred interest and fees added to principal;
- refundable entrance fees received;
- first generation entrance fee receipts at a recently opened entrance fee CCRC prior to stabilization;
- entrance fee refunds disbursed adjusted for first generation entrance fee refunds not replaced by second generation entrance fee receipts at the recently opened community prior to stabilization;
- lease financing debt amortization with fair market value or no purchase options;
- gain (loss) on facility lease termination;
- recurring capital expenditures, net;
- distributions from unconsolidated ventures from cumulative share of net earnings;
- CFFO from unconsolidated ventures; and
- other.



## TABLE OF CONTENTS

Recurring capital expenditures include routine expenditures capitalized in accordance with GAAP that are funded from current operations. Amounts excluded from recurring capital expenditures consist primarily of major projects, renovations, community repositionings, expansions, systems projects or other non-recurring or unusual capital items (including integration capital expenditures) or community purchases that are funded using lease or financing proceeds, available cash and/or proceeds from the sale of communities that are held for sale.

### Management's Use of Cash From Facility Operations

We use CFFO to assess our overall liquidity. This measure provides an assessment of controllable expenses and affords management the ability to make decisions which are expected to facilitate meeting current financial and liquidity goals as well as to achieve optimal financial performance. It provides an indicator for management to determine if adjustments to current spending decisions are needed.

This metric measures our liquidity based on operational factors that management can impact in the short-term, namely the cost structure or expenses of the organization. CFFO is one of the metrics used by our senior management and board of directors (i) to review our ability to service our outstanding indebtedness (including our credit facilities and long-term leases), (ii) to review our ability to pay dividends to stockholders, (iii) to review our ability to make regular recurring capital expenditures to maintain and improve our communities on a period-to-period basis, (iv) for planning purposes, including preparation of our annual budget, (v) in making compensation determinations for certain of our associates (including our named executive officers) and (vi) in setting various covenants in our credit agreements.

These agreements generally require us to escrow or spend a minimum of between \$250 and \$450 per unit per year. Historically, we have spent in excess of these per unit amounts; however, there is no assurance that we will have funds available to escrow or spend these per unit amounts in the future. If we do not escrow or spend the required minimum annual amounts, we would be in default of the applicable debt or lease agreement which could trigger cross default provisions in our outstanding indebtedness and lease arrangements.

### Limitations of Cash From Facility Operations

CFFO has limitations as an analytical tool. It should not be viewed in isolation or as a substitute for GAAP measures of cash flow from operations. CFFO does not represent cash available for dividends or discretionary expenditures, since we may have mandatory debt service requirements or other non-discretionary expenditures not reflected in the measure. Material limitations in making the adjustment to our cash flow from operations to calculate CFFO, and using this non-GAAP financial measure as compared to GAAP operating cash flows, include:

the cash portion of interest expense, income tax (benefit) provision and non-recurring charges related to gain (loss) on sale of communities and extinguishment of debt activities generally represent charges (gains), which may significantly affect our financial results; and

depreciation and amortization, though not directly affecting our current cash position, represent the wear and tear and/or reduction in value of our communities, which affects the services we provide to our residents and may be indicative of future needs for capital expenditures.

We believe CFFO is useful to investors because it assists their ability to meaningfully evaluate (1) our ability to service our outstanding indebtedness, including our credit facilities and capital and financing leases, (2) our ability to pay dividends to stockholders and (3) our ability to make regular recurring capital expenditures to maintain and improve our communities.

FFO is not an alternative to cash flows provided by or used in operations as calculated and presented in accordance with GAAP. You should not rely on FFO as a substitute for any such GAAP financial measure. We strongly urge you to review the reconciliation of FFO to GAAP net cash provided by (used in) operating activities, along with our condensed consolidated financial statements included herein. We also strongly urge you to not rely on any single financial measure to evaluate our business. In addition, because FFO is not a measure of financial performance under GAAP and is susceptible to varying calculations, the FFO measure, as presented in this report, may differ from and may not be comparable to similarly titled measures used by other companies.

42

---

TABLE OF CONTENTS

The table below shows the reconciliation of net cash provided by operating activities to CFFO for the three and nine months ended September 30, 2013 and 2012 (dollars in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2013 <sup>(1)</sup>	2012 <sup>(1)</sup>	September 30, 2013 <sup>(1)</sup>	2012 <sup>(1)</sup>
Net cash provided by operating activities	\$ 104,247	\$ 79,431	\$ 249,075	\$ 207,978
Changes in operating assets and liabilities	(21,464 )	(10,731 )	(5,725 )	(5,926 )
Refundable entrance fees received <sup>(2)(3)</sup>	9,875	12,206	29,265	29,512
Entrance fee refunds disbursed	(7,728 )	(6,024 )	(24,504 )	(19,555 )
Recurring capital expenditures, net	(12,127 )	(11,475 )	(32,115 )	(28,138 )
Lease financing debt amortization with fair market value or no purchase options	(3,518 )	(3,066 )	(10,333 )	(8,988 )
Distributions from unconsolidated ventures from cumulative share of net earnings	(648 )	(420 )	(2,089 )	(1,435 )
CFFO from unconsolidated ventures	1,922	1,559	5,979	4,097
Cash From Facility Operations	\$ 70,559	\$ 61,480	\$ 209,553	\$ 177,545

The calculation of Cash From Facility Operations includes integration, transaction-related and EMR roll-out costs of \$4.7 million and \$10.4 million for the three and nine months ended September 30, 2013, respectively. The calculation of Cash From Facility Operations includes integration, transaction-related and EMR roll-out costs of \$4.6 million and \$16.2 million for the three and nine months ended September 30, 2012, respectively.

Entrance fee receipts include promissory notes issued to the Company by the resident in lieu of a portion of the entrance fees due. Notes issued (net of collections) for the three months ended September 30, 2013 and 2012 were \$0.3 million and \$4.6 million, respectively, and for the nine months ended September 30, 2013 and 2012 were (\$0.1) million and \$2.9 million, respectively.

Total entrance fee receipts for the three months ended September 30, 2013 and 2012 were \$19.1 million and \$25.1 million, respectively, including \$9.2 million and \$12.9 million, respectively, of non-refundable entrance fee receipts included in net cash provided by operating activities. Total entrance fee receipts for both the nine months ended September 30, 2013 and 2012 were \$59.8 million, including \$30.6 million and \$30.3 million, respectively, of non-refundable entrance fee receipts included in net cash provided by operating activities.

## Facility Operating Income

## Definition of Facility Operating Income

We define Facility Operating Income as follows:

Net income (loss) before:

- provision (benefit) for income taxes;
- non-operating (income) expense items;
- (gain) loss on sale or acquisition of communities (including gain (loss) on facility lease termination);
- depreciation and amortization (including non-cash impairment charges);

·facility lease expense;

·general and administrative expense, including non-cash stock-based compensation expense;

43

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## TABLE OF CONTENTS

- change in future service obligation;
- amortization of deferred entrance fee revenue; and

- management fees.

### Management's Use of Facility Operating Income

We use Facility Operating Income to assess our facility operating performance. We believe this non-GAAP measure, as we have defined it, is helpful in identifying trends in our day-to-day facility performance because the items excluded have little or no significance on our day-to-day facility operations. This measure provides an assessment of revenue generation and expense management and affords management the ability to make decisions which are expected to facilitate meeting current financial goals as well as to achieve optimal facility financial performance. It provides an indicator for management to determine if adjustments to current spending decisions are needed.

Facility Operating Income provides us with a measure of facility financial performance, independent of items that are beyond the control of management in the short-term, such as the change in the liability for the obligation to provide future services under existing lifecare contracts, depreciation and amortization (including non-cash impairment charges), straight-line lease expense (income), taxation and interest expense associated with our capital structure. This metric measures our facility financial performance based on operational factors that management can impact in the short-term, namely the cost structure or expenses of the organization. Facility Operating Income is one of the metrics used by our senior management and board of directors to review the financial performance of the business on a monthly basis. Facility Operating Income is also used by research analysts and investors to evaluate the performance of and value companies in our industry by investors, lenders and lessors. In addition, Facility Operating Income is a common measure used in the industry to value the acquisition or sales price of communities and is used as a measure of the returns expected to be generated by a community.

A number of our debt and lease agreements contain covenants measuring Facility Operating Income to gauge debt or lease coverages. The debt or lease coverage covenants are generally calculated as facility net operating income (defined as total operating revenue less operating expenses, all as determined on an accrual basis in accordance with GAAP). For purposes of the coverage calculation, the lender or lessor will further require a pro forma adjustment to facility operating income to include a management fee (generally 4% to 5% of operating revenue) and an annual capital reserve (generally \$250 to \$450 per unit). An investor or potential investor may find this item important in evaluating our performance, results of operations and financial position, particularly on a facility-by-facility basis.

### Limitations of Facility Operating Income

Facility Operating Income has limitations as an analytical tool. It should not be viewed in isolation or as a substitute for GAAP measures of earnings. Material limitations in making the adjustments to our earnings to calculate Facility Operating Income, and using this non-GAAP financial measure as compared to GAAP net income (loss), include:

- interest expense, income tax (benefit) provision and non-recurring charges related to gain (loss) on sale of communities and extinguishment of debt activities generally represent charges (gains), which may significantly affect our financial results; and
- depreciation and amortization, though not directly affecting our current cash position, represent the wear and tear and/or reduction in value of our communities, which affects the services we provide to our residents and may be

indicative of future needs for capital expenditures.

An investor or potential investor may find this item important in evaluating our performance, results of operations and financial position on a facility-by-facility basis. We use non-GAAP financial measures to supplement our GAAP results in order to provide a more complete understanding of the factors and trends affecting our business.

44

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TABLE OF CONTENTS

Facility Operating Income is not an alternative to net income, income from operations or cash flows provided by or used in operations as calculated and presented in accordance with GAAP. You should not rely on Facility Operating Income as a substitute for any such GAAP financial measure. We strongly urge you to review the reconciliation of Facility Operating Income to GAAP net income (loss), along with our condensed consolidated financial statements included herein. We also strongly urge you to not rely on any single financial measure to evaluate our business. In addition, because Facility Operating Income is not a measure of financial performance under GAAP and is susceptible to varying calculations, the Facility Operating Income measure, as presented in this report, may differ from and may not be comparable to similarly titled measures used by other companies.

The table below shows the reconciliation of net loss to Facility Operating Income for the three and nine months ended September 30, 2013 and 2012 (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net loss	\$(967 )	\$(12,216 )	\$(2,609 )	\$(41,775 )
Provision for income taxes	960	747	3,272	2,559
Equity in (earnings) loss of unconsolidated ventures	(431 )	249	(991 )	211
Loss on extinguishment of debt	53	—	946	221
Other non-operating income	(279 )	(500 )	(1,365 )	(392 )
Interest expense:				
Debt	23,467	24,615	71,291	73,691
Capitalized lease obligation	6,175	7,647	19,165	23,052
Amortization of deferred financing costs and debt discount	4,100	4,543	13,017	13,602
Change in fair value of derivatives and amortization	1,377	(140 )	(594 )	371
Interest income	(472 )	(676 )	(1,027 )	(2,220 )
Income from operations	33,983	24,269	101,105	69,320
Gain on facility lease termination	—	—	—	(2,780 )
Depreciation and amortization	68,644	62,876	200,557	189,781
Asset impairment	504	—	2,658	8,329
Loss on acquisition	—	—	—	636
Facility lease expense	69,232	71,167	207,028	213,240
General and administrative (including non-cash stock-based compensation expense)	45,824	43,158	138,470	134,202
Amortization of entrance fees	(7,013 )	(6,459 )	(21,178 )	(18,835 )
Management fees	(7,622 )	(7,407 )	(22,975 )	(22,350 )
Facility Operating Income	\$203,552	\$187,604	\$605,665	\$571,543

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are subject to market risks from changes in interest rates charged on our credit facilities, other floating-rate indebtedness and lease payments subject to floating rates. The impact on earnings and the value of our long-term debt and lease payments are subject to change as a result of movements in market rates and prices. As of September 30, 2013, we had approximately \$1.3 billion of long-term fixed rate debt, \$1.0 billion of long-term variable rate debt, excluding our line of credit, and \$299.3 million of capital and financing lease obligations. As of September 30, 2013, our total fixed-rate debt and variable-rate debt outstanding had a weighted-average interest rate of 4.5% (calculated using an imputed interest rate of 7.5% for our \$316.3 million convertible senior notes due 2018).

We enter into certain interest rate swap agreements with major financial institutions to manage our risk on variable rate debt. Additionally, we have entered into certain cap agreements to effectively manage our risk above certain interest rates. As of September 30, 2013, \$1.3 billion, or 57.1%, of our debt, excluding our line of credit and capital

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TABLE OF CONTENTS

and financing lease obligations, either has fixed rates or variable rates that are subject to swap agreements. As of September 30, 2013, \$700.2 million, or 30.9%, of our debt, excluding our line of credit and capital and financing lease obligations, is subject to cap agreements. The remaining \$271.6 million, or 12.0%, of our debt is variable rate debt, not subject to any cap or swap agreements. A change in interest rates would have impacted our annual interest expense related to all outstanding variable rate debt, excluding our line of credit and capital and financing lease obligations, as follows (after consideration of hedging instruments currently in place): a 100 basis point increase in interest rates would have an impact of \$9.5 million, a 500 basis point increase in interest rates would have an impact of \$45.1 million and a 1,000 basis point increase in interest rates would have an impact of \$59.2 million.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer each concluded that, as of September 30, 2013, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There has not been any change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended September 30, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information contained in Note 9 to the Condensed Consolidated Financial Statements contained in Part I, Item 1 of this Quarterly Report on Form 10-Q is incorporated herein by this reference.

Item 1A. Risk Factors

There have been no material changes to the risk factors set forth in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012.

Item 6. Exhibits

See Exhibit Index immediately following the signature page hereto, which Exhibit Index is incorporated by reference as if fully set forth herein.

TABLE OF CONTENTS

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.

BROOKDALE SENIOR LIVING INC.  
(Registrant)

By: /s/ Mark W. Ohlendorf  
Name: Mark W. Ohlendorf  
Title: President and Chief Financial Officer  
(Principal Financial and Accounting Officer)  
Date: November 8, 2013

TABLE OF CONTENTS

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
3.1	Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K filed on February 26, 2010).
3.2	Amended and Restated Bylaws of the Company (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on July 3, 2012).
4.1	Form of Certificate for common stock (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (Amendment No. 3) (No. 333-127372) filed on November 7, 2005).
4.2	Stockholders Agreement, dated as of November 28, 2005, by and among Brookdale Senior Living Inc., FIT-ALT Investor LLC, Fortress Brookdale Acquisition LLC, Fortress Investment Trust II and Health Partners (incorporated by reference to Exhibit 4.2 to the Company's Annual Report on Form 10-K filed on March 31, 2006).
4.3	Amendment No. 1 to Stockholders Agreement, dated as of July 25, 2006, by and among Brookdale Senior Living Inc., FIT-ALT Investor LLC, Fortress Registered Investment Trust, Fortress Brookdale Investment Fund LLC, FRIT Holdings LLC, and FIT Holdings LLC (incorporated by reference to Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q filed on August 14, 2006).
4.4	Amendment Number Two to Stockholders Agreement, dated as of November 4, 2009 (incorporated by reference to Exhibit 4.4 to the Company's Quarterly Report on Form 10-Q filed on November 4, 2009).
4.5	Indenture, dated as of June 14, 2011, between the Company and American Stock Transfer & Trust Company, LLC, as Trustee (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on June 14, 2011).
4.6	Supplemental Indenture, dated as of June 14, 2011, between the Company and American Stock Transfer & Trust Company, LLC, as Trustee (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on June 14, 2011).
4.7	Form of 2.75% Convertible Senior Note due 2018 (included as part of Exhibit 4.6).
10.1	Third Amended and Restated Credit Agreement, dated as of September 20, 2013, among certain subsidiaries of Brookdale Senior Living Inc., General Electric Capital Corporation, as administrative agent, lender and swingline lender, and the other lenders from time to time parties thereto.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.