

CAPITAL SENIOR LIVING CORP

Form 10-K

March 14, 2011

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

Form 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2010**
- 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: 1-13445

Capital Senior Living Corporation

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

**14160 Dallas Parkway, Suite 300
Dallas, Texas**

(Address of principal executive offices)

75-2678809

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

75254

(Zip Code)

Registrant's telephone number, including area code:

(972) 770-5600

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

**Name of each exchange
on which registered**

Common Stock, \$.01 par value

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by a check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act. Yes No

Indicate by a check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

The aggregate market value of the 26,161,412 shares of the Registrant's common stock, par value \$0.01 per share (Common Stock), held by non-affiliates (defined to exclude all of the Registrants executive officers and directors) on December 31, 2010, based upon the closing price of the Registrant's Common Stock as reported by the New York Stock Exchange on June 30, 2010, was approximately \$130.0 million. As of February 28, 2011, the Registrant had 27,151,919 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement pertaining to its 2011 Annual Meeting of Stockholders and filed or to be filed not later than 120 days after the end of the fiscal year pursuant to Regulation 14A are incorporated herein by reference into Part III of this report.

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PART I

ITEM 1. BUSINESS.

Overview

Capital Senior Living Corporation, a Delaware corporation (together with its subsidiaries, the Company), is one of the largest operators of senior living communities in the United States in terms of resident capacity. The Company and its predecessors have provided senior living services since 1990. As of December 31, 2010, the Company operated 77 senior living communities in 23 states with an aggregate capacity of approximately 11,000 residents, including 32 senior living communities which the Company either owned or in which the Company had an ownership interest and 45 senior living communities that the Company leased. As of December 31, 2010, the Company also operated one home care agency. During 2010, approximately 95% of total revenues for the senior living communities operated by the Company were derived from private pay sources.

The Company's operating strategy is to provide quality senior living communities and services to its residents, while achieving and sustaining a strong, competitive position within its chosen markets, as well as to continue to enhance the performance of its operations. The Company provides senior living services to the elderly, including independent living, assisted living, skilled nursing and home care services. Many of the Company's communities offer a continuum of care to meet its residents' needs as they change over time. This continuum of care, which integrates independent living and assisted living and is bridged by home care through independent home care agencies or the Company's home care agency, sustains residents' autonomy and independence based on their physical and mental abilities.

Website

The Company's Internet website www.capitalsenior.com contains an Investor Relations section, which provides links to the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, Section 16 filings and amendments to those reports and filings, which reports and filings are available through the Company's Internet website free of charge as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC).

Industry Background

The senior living industry encompasses a broad and diverse range of living accommodations and supportive services that are provided primarily to persons 75 years of age or older.

For the elderly who require limited services, independent living residences supplemented at times by home health care, offers a viable option. Most independent living communities typically offer community living packaged with basic services consisting of meals, housekeeping, laundry, 24-hour staffing, transportation, social and recreational activities and health care monitoring. Independent living residents typically are not reliant on assistance with activities of daily living (ADLs) although some residents may contract out for those services.

As a senior's need for assistance increases, care in an assisted living residence is often preferable and more cost-effective than home-based care or nursing home care. Typically, assisted living represents a combination of housing and support services designed to aid elderly residents with ADLs such as ambulation, bathing, dressing, eating, grooming, personal hygiene and monitoring or assistance with medications. Certain assisted living residences may also provide assistance to residents with low acuity medical needs, or may offer higher levels of personal

assistance for incontinent residents or residents with Alzheimer's disease or other cognitive or physical frailties. Generally, assisted living residents require higher levels of care than residents of independent living residences and retirement living centers, but require lower levels of care than patients in skilled nursing facilities. For seniors who need the constant attention of a skilled nurse or medical practitioner, a skilled nursing facility may be required.

According to the American Seniors Housing Association Seniors Housing Construction Trends Report for 2010, 14% of the senior housing supply in the 100 largest metropolitan areas of the United States are assisted living

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units, 19% are independent living units, 44% are nursing care beds, 3% are memory care units and 20% relate to age restricted senior apartments.

The senior living industry is highly fragmented and characterized by numerous small operators. Moreover, the scope of senior living services varies substantially from one operator to another. Many smaller senior living providers do not operate purpose-built residences, do not have extensive professional training for staff and provide only limited assistance with ADLs. The Company believes that many senior living operators do not provide the required comprehensive range of senior living services designed to permit residents to age in place within the community as residents develop further physical or cognitive frailties.

The Company believes that a number of demographic, regulatory and other trends will contribute to the continued growth in the senior living market, including the following:

Consumer Preference

The Company believes that senior living communities are increasingly becoming the setting preferred by prospective residents and their families for the care of the elderly. Senior living offers residents greater independence and allows them to age in place in a residential setting, which the Company believes results in a higher quality of life than that experienced in more institutional or clinical settings.

The likelihood of living alone increases with age. Most of this increase is due to an aging population in which women outlive men. Societal changes, such as high divorce rates and the growing numbers of persons choosing not to marry, have further increased the number of Americans living alone. This growth in the number of elderly living alone has resulted in an increased demand for services that historically have been provided by a spouse, other family members or live-in caregivers.

Demographics

According to the American Seniors Housing Association Seniors Housing Construction Trends Report for 2010, the largest 100 metropolitan areas contain approximately 66% of the total United States population, 62% of the age 65+ population, and 61% of the age 75+ population, based on the most recent population projections from the United States Census Bureau. As the number of persons aged 75 and over continues to grow, the Company believes that there will be corresponding increases in the number of persons who need assistance with ADLs.

Senior Affluence

The average net worth of senior citizens is typically higher than non-senior citizens, partially as a result of accumulated equity through home ownership. The Company believes that a substantial portion of the senior population has historically accumulated significant resources available for their retirement and long-term care needs. The Company's target population is comprised of moderate to upper income seniors who have, either directly or indirectly through familial support, the financial resources to pay for senior living communities, including an assisted living alternative to traditional long-term care. However, recent volatility and downturns in the housing, financial, and credit markets could negatively affect the ability of senior citizens to relocate into our communities, or the time at which they choose to do so, which could have a significant impact on our business, financial condition, cash flows, and results of operations.

Reduced Reliance on Family Care

Historically, the family has been the primary provider of care for seniors. The Company believes that the increase in the percentage of women in the work force, the reduction of average family size, and overall increased mobility in society is reducing the role of the family as the traditional caregiver for aging parents. The Company believes that these factors will make it necessary for many seniors to look outside the family for assistance as they age.

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Restricted Supply of Nursing Beds

Several states in the United States have adopted Certificate of Need (CON) or similar statutes generally requiring that, prior to the addition of new skilled nursing beds, the addition of new services, or the making of certain capital expenditures, a state agency must determine that a need exists for the new beds or the proposed activities. The Company believes that this CON process tends to restrict the supply and availability of licensed nursing facility beds. High construction costs, limitations on government reimbursement for the full costs of construction, and start-up expenses also act to constrain growth in the supply of such facilities. At the same time, nursing facility operators are continuing to focus on improving occupancy and expanding services to subacute patients generally of a younger age and requiring significantly higher levels of nursing care. As a result, the Company believes that there has been a decrease in the number of skilled nursing beds available to patients with lower acuity levels and that this trend should increase the demand for the Company's senior living communities, including, particularly, the Company's assisted living communities.

Cost-Containment Pressures

In response to rapidly rising health care costs, governmental and private pay sources have adopted cost containment measures that have reduced admissions and encouraged reduced lengths of stays in hospitals and other acute care settings. The federal government had previously acted to curtail increases in health care costs under Medicare by limiting acute care hospital reimbursement for specific services to pre-established fixed amounts. Private insurers have begun to limit reimbursement for medical services in general to predetermined charges, and managed care organizations (such as health maintenance organizations) are attempting to limit hospitalization costs by negotiating for discounted rates for hospital and acute care services and by monitoring and reducing hospital use. In response, hospitals are discharging patients earlier and referring elderly patients, who may be too sick or frail to manage their lives without assistance, to nursing homes and assisted living residences where the cost of providing care is typically lower than hospital care. In addition, third-party payors are increasingly becoming involved in determining the appropriate health care settings for their insureds or clients, based primarily on cost and quality of care. Based on industry data, the typical day-rate in an assisted living facility is two-thirds of the cost for comparable care in a nursing home.

Operating Strategy

The Company's operating strategy is to provide quality senior living services to its residents while achieving and sustaining a strong, competitive position within its chosen markets, as well as continuing to enhance the performance of its operations. The Company is implementing its operating strategy principally through the following methods:

Provide a Broad Range of Quality Personalized Care

Central to the Company's operating strategy is its focus on providing quality care and services that are personalized and tailored to meet the individual needs of each community resident. The Company's residences and services are designed to provide a broad range of care that permits residents to "age in place" as their needs change and as they develop further physical or cognitive frailties. By creating an environment that maximizes resident autonomy and provides individualized service programs, the Company seeks to attract seniors at an earlier stage, before they need the higher level of care provided in a skilled nursing facility. The Company also maintains a comprehensive quality assurance program designed to ensure the satisfaction of its residents and their family members. The Company conducts annual resident satisfaction surveys that allow residents at each community to express whether they are "very satisfied," "satisfied" or "dissatisfied" with all major areas of a community, including, housekeeping, maintenance, activities and transportation, food service, security and management. In both 2010 and 2009, the Company achieved 95% overall approval ratings from the residents' satisfaction surveys.

Offer Services Across a Range of Pricing Options

The Company's range of products and services is continually expanding to meet the evolving needs of its residents. The Company has developed a menu of products and service programs that may be further customized to

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serve both the moderate and upper income markets of a particular targeted geographic area. By offering a range of pricing options that are customized for each target market, the Company believes that it can develop synergies, economies of scale and operating efficiencies in its efforts to serve a larger percentage of the elderly population within a particular geographic market.

Improve Occupancy Rates

The Company continually seeks to maintain and improve occupancy rates by: (i) retaining residents as they age in place by extending optional care and service programs; (ii) attracting new residents through the on-site marketing programs focused on residents and family members; (iii) selecting communities in underserved markets; (iv) aggressively seeking referrals from professional community outreach sources, including area religious organizations, senior social service programs, civic and business networks, as well as the medical community; and (v) continually refurbishing and renovating its communities.

Improve Operating Efficiencies

The Company seeks to improve operating efficiencies at its communities by actively monitoring and managing operating costs. By having an established national portfolio of communities with regional management in place, the Company believes it has established a platform to achieve operating efficiencies through economies of scale in the purchase of bulk items, such as food and supplies and in the spreading of fixed costs, such as corporate overhead, over a larger revenue base, and to provide more effective management supervision and financial controls. The Company's growth strategy includes regional clustering of new communities to achieve further efficiencies.

Emphasize Employee Training and Retention

The Company devotes special attention to the hiring, screening, training, supervising and retention of its employees and caregivers to ensure that quality standards are achieved. In addition to normal on-site training, the Company conducts national management meetings and encourages sharing of expertise among managers. The Company's commitment to the total quality management concept is emphasized throughout its training program. This commitment to the total quality management concept means identification of the best practices in the senior living market and communication of those best practices to the Company's executive directors and their staff. The identification of best practices is realized by a number of means, including: emphasis on regional and executive directors keeping up with professional trade journals; interaction with other professionals and consultants in the senior living industry through seminars, conferences and consultations; visits to other properties; leadership and participation at national and local trade organization events; and information derived from marketing studies and resident satisfaction surveys. This information is continually processed by regional managers and the executive directors and communicated to the Company's employees as part of their training. The Company hires an executive director for each of its communities and provides them with autonomy, responsibility and accountability. The Company's staffing of each community with an executive director allows it to hire more professional employees at these positions, while the Company's developed career path helps it to retain the professionals it hires. The Company believes its commitment to and emphasis on employee training and retention differentiates the Company from many of its competitors.

Senior Living Services

The Company provides senior living services to the elderly, including independent living, assisted living, skilled nursing and home care services. By offering a variety of services and encouraging the active participation of the resident and the resident's family and medical consultants, the Company is able to customize its service plan to meet the specific needs and desires of each resident. As a result, the Company believes that it is able to maximize customer satisfaction and avoid the high cost of delivering unnecessary services to residents.

The Company's operating philosophy is to provide quality living communities and services to senior citizens and deliver a continuum of care for its residents as their needs change over time. This continuum of care, which integrates independent living and assisted living and is bridged by home care, sustains residents' autonomy and independence based on their physical and mental abilities. As residents age, in many of the Company's

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communities, they are able to obtain the additional needed services within the same community, avoiding the disruptive and often traumatic move to a different facility.

Independent Living Services

The Company provides independent living services to seniors who typically do not yet need assistance or support with ADLs, but who prefer the physical and psychological comfort of a residential community that offers health care and other services. As of December 31, 2010, the Company had ownership interests in 30 communities and leased 14 communities that provide independent living services, which include communities that combine assisted living services, with an aggregate capacity for approximately 6,600 residents.

Independent living services provided by the Company include daily meals, transportation, social and recreational activities, laundry, housekeeping and 24-hour staffing. The Company also fosters the wellness of its residents by offering access to health screenings (such as blood pressure checks), periodic special services (such as influenza inoculations), dietary and similar programs, as well as ongoing exercise and fitness classes. Classes are given by health care professionals to keep residents informed about health and disease management. Subject to applicable government regulation, personal care and medical services are available to independent living residents through either the community staff or through the Company's agency or other independent home care agencies. The Company's independent living residents pay a fee ranging from \$1,350 to \$4,560 per month, in general, depending on the specific community, program of services, size of the unit and amenities offered. The Company's contracts with its independent living residents are generally for a term of one year and are typically terminable by either party, under certain circumstances, upon 30 days notice.

Assisted Living Services

The Company offers a wide range of assisted living care and services, including personal care services, 24 hour staffing, support services, and supplemental services. As of December 31, 2010, the Company had ownership interests in 11 communities and leased 36 communities that provide assisted living services, which include communities that combine independent living and other services, with an aggregate capacity for approximately 3,700 residents. The residents of the Company's assisted living residences generally need help with some or all ADLs, but do not require the more acute medical care traditionally given in nursing homes. Upon admission to the Company's assisted living communities, and in consultation with the resident, the resident's family and medical consultants, each resident is assessed to determine his or her health status, including functional abilities and need for personal care services. The resident also completes a lifestyles assessment to determine the resident's preferences. From these assessments, a care plan is developed for each resident to ensure that all staff members who render care meet the specific needs and preferences of each resident where possible. Each resident's care plan is reviewed periodically to determine when a change in care is needed.

The Company has adopted a philosophy of assisted living care that allows a resident to maintain a dignified independent lifestyle. Residents and their families are encouraged to be partners in the residents' care and to take as much responsibility for their well being as possible. The basic types of assisted living services offered by the Company include the following:

Personal Care Services. These services include assistance with ADLs such as ambulation, bathing, dressing, eating, grooming, personal hygiene, and monitoring or assistance with medications.

Support Services. These services include meals, assistance with social and recreational activities, laundry services, general housekeeping, maintenance services and transportation services.

Supplemental Services. These services include extra transportation services, personal maintenance, extra laundry services, and special care services, such as services for residents with certain forms of dementia. Certain of these services require extra charges.

The Company's assisted living residents pay a fee ranging from \$1,550 to \$7,175 per month, in general, depending on the specific community, the level of personal care services, support service and supplemental services provided to the resident, size of the unit and amenities offered. The Company's contracts with its assisted living

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residents are generally for a term of one year and are typically terminable by either party, under certain circumstances, upon 30 days notice.

The Company maintains programs and special units at some of its assisted living communities for residents with certain forms of dementia, which provide the attention, care and services needed to help those residents maintain a higher quality of life. Specialized services include assistance with ADLs, behavior management and life skills based activities programs, the goal of which is to provide a normalized environment that supports residents remaining functional abilities. Whenever possible, residents assist with meals, laundry and housekeeping. Special units for residents with certain forms of dementia are located in a separate area of the community and have their own dining facilities, resident lounge areas, and specially trained staff. The special care areas are designed to allow residents the freedom to ambulate as they wish, while keeping them safely contained within a secure area with a minimum of disruption to other residents. Resident fees for these special units are dependent on the size of the unit, the design type and the level of services provided.

Continuing Care Retirement Community Services

The Company's continuing care retirement communities are senior living rental properties where the Company provides traditional long-term care through 24-hour-per-day skilled nursing care by registered nurses, licensed practical nurses and certified nursing assistants as well as assisted living and independent living care. The Company also offers a comprehensive range of restorative nursing and rehabilitation services in its communities including, but not limited to, physical, occupational, speech and medical social services. The Company's residents receiving skilled nursing services pay fees ranging from \$3,630 to \$7,500 per month, in general, depending on the specific community and the level of care provided. As of December 31, 2010, the Company had ownership interests in one community and leased one community providing a continuum of care services with an aggregate capacity for approximately 700 residents at all levels of care at those two communities.

Home Care Services

As of December 31, 2010, the Company provided home care services to clients at one senior living community through the Company's home care agency and made home care services available to clients at a majority of its senior living communities through third-party providers. The Company believes that the provision of private pay, home care services is an attractive adjunct to its independent living services because it allows the Company to provide more services to its residents as they age in place and increases the length of stay in the Company's communities. In addition, the Company makes available to residents certain customized physician, dentistry, podiatry and other health-related services that may be offered by third-party providers.

Operating Communities

The table below sets forth certain information with respect to senior living communities operated by the Company as of December 31, 2010.

Community	Units	Resident Capacity(1)			Total Ownership(2)	Commencement of Operations(3)
		IL	AL	CCRC		
Owned:						
Canton Regency	Canton, OH	291		357	357	100% 03/91
Gramercy Hill	Lincoln, NE	146	62	103	165	100% 10/98

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Heatherwood	Detroit, MI	158	185		185	100%	01/92
Independence Village	East Lansing, MI	151	161		161	100%	08/00
Independence Village	Peoria, IL	158	166		166	100%	08/00
Independence Village	Raleigh, NC	165	177		177	100%	08/00
Independence Village	Winston-Salem, NC	156	161		161	100%	08/00
Sedgwick Plaza	Wichita, KS	144	134	35	169	100%	08/00
Waterford at Columbia	Columbia, SC	120	141		141	100%	11/00
Waterford at Deer Park	Deer Park, TX	120	144		144	100%	11/00
Waterford at Edison Lakes	South Bend, IN	120	141		141	100%	12/00

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Community	Units	Resident Capacity(1)			Total Ownership(2)	Commencement of Operations(3)	
		IL	AL	CCRC			
Waterford at Fairfield	Fairfield, OH	120	140		140	100%	11/00
Waterford at Fort Worth	Fort Worth, TX	151	176		176	100%	06/00
Waterford at Highland Colony	Jackson, MS	120	143		143	100%	11/00
Waterford at Huebner	San Antonio, TX	120	135		135	100%	04/99
Waterford at Ironbridge	Springfield, MO	119	142		142	100%	06/01
Waterford at Mansfield	Mansfield, OH	119	142		142	100%	10/00
Waterford at Mesquite	Mesquite, TX	154	176		176	100%	09/99
Waterford at Pantego	Pantego, TX	120	143		143	100%	12/00
Waterford at Plano	Plano, TX	136	109	57	166	100%	12/00
Waterford at Shreveport	Shreveport, LA	117	136		136	100%	03/99
Waterford at Thousand Oaks	San Antonio, TX	120	135		135	100%	05/00
Wellington at Arapaho	Richardson, TX	137	112	57	169	100%	05/02
Wellington at North Richland Hills, TX	North Richland Hills, TX	119	139		139	100%	01/02
Wellington at Oklahoma City	Oklahoma City, OK	120	143		143	100%	11/00
		3,501	3,443	252	357	4,052	
Leased:							
Ventas:							
Amberleigh	Buffalo, NY	267	387		387	N/A	01/92
Cottonwood Village	Cottonwood, AZ	163	131	58	189	N/A	03/91
Crown Pointe	Omaha, NE	134	139	26	165	N/A	08/00
Georgetowne Place	Fort Wayne, IN	162	242		242	N/A	10/05
Harrison at Eagle Valley ⁴	Indianapolis, IN	124	138		138	N/A	03/91
Rose Arbor	Maple Grove, MN	137	86	87	173	N/A	06/06
Towne Centre	Merrillville, IN	327			358	N/A	03/91
Villa Santa Barbara	Santa Barbara, CA	126	64	62	126	N/A	08/00
West Shores	Hot Springs, AR	137	131	42	173	N/A	08/00
Whitley Place	Keller, TX	47		65	65	N/A	02/08
HCN:							
The Waterford at Ames	Ames, IA	59		122	122	N/A	02/06
The Waterford at Miracle Hills	Omaha, NE	64		70	70	N/A	03/06
	Omaha, NE	62		70	70	N/A	02/06

The Waterford at Roxbury Park The Waterford at Van Dorn	Lincoln, NE	68	84	84	N/A	02/06
The Waterford at Woodbridge	Plattsmouth, NE	40	45	45	N/A	02/06
Keepsake Village of Columbus	Columbus, IN	42	48	48	N/A	08/06
The Hearth at Prestwick	Avon, IN	132	150	150	N/A	08/06
The Hearth at Windermere	Fishers, IN	126	150	150	N/A	08/06
Spring Lake	Paris, TX	52	70	70	N/A	09/10
Pecan Point	Sherman, TX	52	70	70	N/A	09/10
Santa Fe Trails	Cleburne, TX	52	70	70	N/A	09/10
Walnut Creek	Mansfield, TX	52	70	70	N/A	09/10

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Community	Units	Resident Capacity(1)			Total Ownership(2)	Commencement of Operations(3)	
		IL	AL	CCRC			
Martin Crest	Weatherford, TX	52		70	70	N/A	09/10
Azalea Trails	Tyler, TX	52		70	70	N/A	09/10
Hawkins Creek	Longview, TX	52		70	70	N/A	09/10
Magnolia Court	Nacogdoches, TX	52		70	70	N/A	09/10
Buffalo Creek	Waxahachie, TX	52		70	70	N/A	09/10
Dogwood Trails	Palestine, TX	61		72	72	N/A	09/10
Stonefield	McKinney, TX	74		90	90	N/A	09/10
Heritage Oaks	Conroe, TX	74		90	90	N/A	09/10
HCP:							
Atrium of Carmichael	Sacramento, CA	152	155		155	N/A	01/92
Covenant Place of Abilene	Abilene, TX	50		55	55	N/A	08/04
Covenant Place of Burleson	Burleson, TX	74		80	80	N/A	08/04
Covenant Place of Waxahachie	Waxahachie, TX	50		55	55	N/A	08/04
Crescent Place	Cedar Hill, TX	80		85	85	N/A	11/05
Crescent Point	Cedar Hill, TX	112	134		134	N/A	08/04
Crosswood Oaks	Sacramento, CA	121	127		127	N/A	01/92
Good Place	North Richland Hills, TX	72		80	80	N/A	08/04
Meadow Lakes	North Richland Hills, TX	120	145		145	N/A	08/04
Tesson Heights	St. Louis, MO	184	134	72	206	N/A	10/98
Veranda Club	Boca Raton, FL	141	182		182	N/A	01/92
Charlotte Square	Charlotte, NC	73		125	125	N/A	12/06
Chesapeake Place	Chesapeake, VA	87		153	153	N/A	12/06
Greenville Place	Greenville, SC	87		153	153	N/A	12/06
Myrtle Beach Estates	Myrtle Beach, SC	80		142	142	N/A	12/06
		4,377	2,195	2,961	358	5,514	
Affiliates:							
SHPII/CSL:							
Libertyville	Libertyville, IL	197	208	45	253	5%	03/01
Naperville	Naperville, IL	193	186	45	231	5%	01/01
Summit	Summit, NJ	88		98	98	5%	11/00
Trumbull	Trumbull, CT	150	136	42	178	5%	09/00
SHPIII/CSL:							
Levis Commons	Toledo, OH	146	152	55	207	10%	04/09
Miami	Miamisburg, OH	146	150	90	240	10%	08/08
Richmond Heights	Richmond Heights, OH	141	152	75	227	10%	04/09

	1,061	984	450		1,434
Total	8,939	6,622	3,663	715	11,000

- (1) Independent living (IL) residences, assisted living (AL) residences and continuing care retirement community (CCRC) beds.
- (2) Those communities shown as 5% owned consist of the Company's ownership of 5% of the member interests in SHPII/CSL (as defined below). Those communities shown as 10% owned consist of the Company's ownership of 10% of the member interests in SHPIII/CSL (as defined below).

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- (3) Indicates the date on which the Company acquired or commenced operating the community. The Company operated certain of its communities pursuant to management agreements prior to acquiring interests in or leasing the communities.
- (4) The Company's home care agency is on-site at The Harrison at Eagle Valley community.

Management Contracts

The Company was party to a series of property management agreements (the *Midwest I Agreements*) to manage five communities acquired by Midwest Portfolio Holdings, L.P. (*Midwest I*), a joint venture owned approximately 89% by GE Healthcare Financial Services (*GE Healthcare*) and approximately 11% by the Company. The *Midwest I Agreements* were for an initial term of five years, extended until various dates through February 2011, and contained automatic one year renewals thereafter. The *Midwest I Agreements* generally provided for a management fee of 5% of gross revenues. On April 16, 2010, *Midwest I* closed the sale of the *Midwest I* subsidiaries that owned the five senior housing communities to Health Care REIT, Inc. (*HCN*). Upon closing the sale, the Company leased the five senior housing communities from *HCN*. For additional information, refer to Note 4, *Facility Lease Transactions*, in the notes to the consolidated financial statements.

The Company was party to a series of property management agreements (the *Midwest II Agreements*) to manage three communities acquired by Midwest Portfolio Holdings II, L.P. (*Midwest II*), a joint venture owned approximately 85% by GE Healthcare and approximately 15% by the Company. The *Midwest II Agreements* were for an initial term of five years, extended until various dates through August 2011, and contained automatic one year renewals thereafter. The *Midwest II Agreements* generally provided for a management fee of 5% of gross revenues. On April 30, 2010, *Midwest II* closed the sale of the *Midwest II* subsidiaries that owned the three senior housing communities to *HCN*. Upon closing the sale, the Company leased the three senior housing communities from *HCN*. For additional information, refer to Note 4, *Facility Lease Transactions*, in the notes to the consolidated financial statements.

The Company was party to a series of property management agreements with CGI Management, Inc. (the *CGIM Agreements*) currently expiring in August 2011. The *CGIM Agreements* generally provide for management fees of 5% to 6% of gross revenues, subject to certain base management fees. The Company managed one community under the *CGIM* agreements which the Company terminated during the fourth quarter of fiscal 2010. The Company no longer manages any communities under the *CGIM Agreements* as of December 31, 2010.

The Company is party to a series of property management agreements (the *SHPII/CSL Management Agreements*) with four joint ventures (collectively *SHPII/CSL*) owned 95% by Senior Housing Partners II, L.P. (*SHPII*), a fund managed by Prudential Real Estate Investors (*Prudential*), and 5% by the Company, which collectively own and operate four senior living communities (collectively the *Spring Meadows Communities*). The *SHPII/CSL Management Agreements* currently extend until various dates through November 2014. The *SHPII/CSL Management Agreements* generally provide for management fees of 5% of gross revenue plus reimbursement for costs and expenses related to the communities. On December 22, 2010, the Company announced that *SHPII* entered into an agreement to sell the *SHPII* subsidiaries that own the four senior living communities to *HCN*. As a condition to closing of the sale to *HCN*, the Company will enter into long term leases of the senior living communities.

The Company is party to a series of property management agreements (the *SHPIII/CSL Management Agreements*) with three joint ventures (collectively *SHPIII/CSL*) owned 90% by Senior Housing Partners III, L.P. (*SHPIII*), a fund managed by Prudential Investment Management, Inc. (*Prudential Investment*) and 10% by the Company, which collectively own and operate three senior living communities. The *SHPIII/CSL Management Agreements* are for initial terms of ten years from the date the certificate of occupancy was issued and currently extend until various dates

through January 2019. The SHPIII/CSL Management Agreements generally provide for management fees of 5% of gross revenue plus reimbursement for costs and expenses related to the communities.

Development Agreement Guarantees

In 2007, the Company and SHPIII entered into a series of joint venture agreements to develop three senior housing communities located in Ohio. The Company has guaranteed the communities will be completed and

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operated at budgeted costs approved by the joint venture members. These costs include the hard and soft construction costs and operating costs until each community reaches breakeven. The budgeted costs include contingency reserves for potential cost overruns and other unforeseen costs. The terms of these guarantees generally do not provide for a limitation on the maximum potential future payments. These joint venture communities are currently in lease up and one of the joint ventures had exhausted its lease up reserve under the existing loan commitment. The Company will be required to fund any operating deficits until the joint venture reaches breakeven for three consecutive months. Any amounts funded by the Company under this commitment, up to \$0.5 million, may be recoverable from the joint venture in the event of liquidation. As of December 31, 2010, the Company had recognized deficit charges of approximately \$0.4 million under these development agreement guarantees. The Company does not currently anticipate funding any deficits in excess of the amounts estimated to be recoverable from the joint ventures.

Growth Strategies

The Company believes that the fragmented nature of the senior living industry and the limited capital resources available to many small, private operators provide an attractive opportunity for the Company to expand its existing base of senior living operations. The Company believes that its current operations with geographic concentrations throughout the United States serve as the foundation on which the Company can build senior living networks in targeted geographic markets and thereby provide a broad range of high quality care in a cost-efficient manner.

The following are the principal elements of the Company's growth strategy:

Organic Growth

The Company intends to continue to focus on the lease-up of its non-stabilized communities and to increase its occupancy, rents and operating margins of its stabilized communities. The Company continually seeks to maintain and improve occupancy rates by: (i) retaining residents as they age in place by extending optional care and service programs; (ii) attracting new residents through the on-site marketing programs focused on residents and family members; (iii) aggressively seeking referrals from professional community outreach sources, including area religious organizations, senior social service programs, civic and business networks, as well as the medical community; and (iv) continually refurbishing and renovating its communities, including converting existing units to higher levels of care. Since 2004, our same community revenue has grown at an average rate of 5.3% per annum and our same community net operating income has grown at an average rate of 8.7% per annum.

Expansion and Conversion of Existing Communities

The Company intends to increase levels of care and capacity at certain of its existing communities through expansion and/or conversion of certain units. Increasing our levels of care and capacity is expected to increase revenue and operating income while meeting the needs of our residents who have an average age of 85 years old.

Pursue Strategic Acquisitions

The Company intends to continue to pursue acquisitions of senior living communities. Through strategic acquisitions, joint venture investments, or facility leases, the Company seeks to acquire communities in existing markets as a means to increase market share, augment existing clusters, strengthen its ability to provide a broad range of care, and create operating efficiencies. As the industry continues to consolidate, the Company believes that opportunities will arise to acquire other senior living companies. The Company believes that the current fragmented nature of the senior living industry, combined with the Company's financial resources, geographic presence, and extensive contacts within the industry, can be expected to provide it with the opportunity to evaluate a number of potential acquisition opportunities in the future. In reviewing acquisition opportunities, the Company will consider, among other things, geographic

location, competitive climate, reputation and quality of management and communities, and the need for renovation or improvement of the communities.

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Expand Referral Networks

The Company intends to continue to develop relationships with local and regional hospital systems, managed care organizations and other referral sources to attract new residents to the Company's communities. In certain circumstances these relationships may involve strategic alliances or joint ventures. The Company believes that such arrangements or alliances, which could range from joint marketing arrangements to priority transfer agreements, will enable it to be strategically positioned within the Company's markets if, as the Company believes, senior living programs become an integral part of the evolving health care delivery system.

Operations

Centralized Management

The Company centralizes its corporate and other administrative functions so that the community-based management and staff can focus their efforts on resident care. The Company maintains centralized accounting, finance, human resources, training and other operational functions at its national corporate office in Dallas, Texas. The Company also has a corporate office in New York, New York. The Company's corporate offices are generally responsible for: (i) establishing Company-wide policies and procedures relating to, among other things, resident care and operations; (ii) performing accounting functions; (iii) developing employee training programs and materials; (iv) coordinating human resources; (v) coordinating marketing functions; and (vi) providing strategic direction. In addition, financing, development, construction and acquisition activities, including feasibility and market studies, and community design, development, and construction management are conducted at the Company's corporate offices.

The Company seeks to control operational expenses for each of its communities through standardized management reporting and centralized controls of capital expenditures, asset replacement tracking, and purchasing for larger and more frequently used supplies through a group purchasing program. Community expenditures are monitored by regional and district managers who are accountable for the resident satisfaction and financial performance of the communities in their region.

Regional Management

The Company provides oversight and support to each of its senior living communities through experienced regional and district managers. A district manager will oversee the marketing and operations of three to six communities clustered in a small geographic area. A regional manager will cover a larger geographic area consisting of seven to twelve communities. In most cases, the district and regional managers will office out of the Company's senior living communities. Currently, there are regional managers based in the Eastern, Central Plains, Midwest, Southwest, Texas and West regions.

The executive director at each community reports to a regional or district manager. The regional and district managers report directly to senior management at the Company's corporate office. The district and regional managers make regular site visits to each of their communities. The site visits involve a physical plant inspection, quality assurance review, staff training, financial and systems audits, regulatory compliance, and team building.

Community-Based Management

An executive director manages the day-to-day operations at each senior living community, including oversight of the quality of care, delivery of resident services, and monitoring of financial performance. The executive director is also responsible for all personnel, including food service, maintenance, activities, security, assisted living, housekeeping, and, where applicable, nursing. In most cases, each community also has department managers who direct the

environmental services, nursing or care services, business management functions, dining services, activities, transportation, housekeeping, and marketing functions.

The assisted living and skilled nursing components of the senior living communities are managed by licensed professionals, such as a nurse and/or a licensed administrator. These licensed professionals have many of the same operational responsibilities as the Company's executive directors, but their primary responsibility is to oversee resident care. Many of the Company's senior living communities and all of its skilled nursing facilities are part of a

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campus setting, which include independent living. This campus arrangement allows for cross-utilization of certain support personnel and services, including administrative functions that result in greater operational efficiencies and lower costs than freestanding facilities.

The Company actively recruits personnel to maintain adequate staffing levels at its existing communities and hires new staff for new or acquired communities prior to opening. The Company has adopted comprehensive recruiting and screening programs for management positions that utilize corporate office team interviews and thorough background and reference checks. The Company offers system-wide training and orientation for all of its employees at the community level through a combination of Company-sponsored seminars and conferences.

Quality Assurance

Quality assurance programs are coordinated and implemented by the Company's corporate and regional staff. The Company's quality assurance is targeted to achieve maximum resident and resident family member satisfaction with the care and services delivered by the Company. The Company's primary focus in quality control monitoring includes routine in-service training and performance evaluations of caregivers and other support employees. Additional quality assurance measures include:

Resident and Resident's Family Input. On a routine basis, the Company provides residents and their family members the opportunity to provide valuable input regarding the day-to-day delivery of services. On-site management at each community has fostered and encouraged active resident councils and resident committees who meet independently. These resident bodies meet with on-site management on a monthly basis to offer input and suggestions as to the quality and delivery of services. Additionally, at each community the Company conducts annual resident satisfaction surveys to further monitor the satisfaction levels of both residents and their family members. These surveys are sent directly to a third party firm for tabulation then to the Company's corporate headquarters for distribution to onsite staff. For both 2010 and 2009, the Company achieved 95% approval ratings from its residents. For any departmental area of service scoring below a 90%, a plan of correction is developed jointly by on-site, regional and corporate staff for immediate implementation.

Regular Community Inspections. Each community is inspected, on at least a quarterly basis, by regional and/or corporate staff. Included as part of this inspection is the monitoring of the overall appearance and maintenance of the community interiors and grounds. The inspection also includes monitoring staff professionalism and departmental reviews of maintenance, housekeeping, activities, transportation, marketing, administration and food and health care services, if applicable. The inspections also include observing residents in their daily activities and the community's compliance with government regulations.

Independent Service Evaluations. The Company engages the services of outside professional independent consulting firms to evaluate various components of the community operations. These services include mystery shops, competing community analysis, pricing recommendations and product positioning. This provides management with valuable unbiased product and service information. A plan of action regarding any areas requiring improvement or change is implemented based on information received. At communities where health care is delivered, these consulting service reviews include the on-site handling of medications, record keeping and general compliance with all governmental regulations.

Marketing

Most communities are staffed by on-site sales directors and additional marketing/sales staff depending on the community size and occupancy status. The primary focus of the on-site marketing staff is to create awareness of the Company and its services among prospective residents and family members, professional referral sources and other

key decision makers. These efforts incorporate an aggressive marketing plan to include monthly, quarterly and annual goals for leasing, new lead generation, prospect follow up, community outreach and resident and family referrals. Additionally, the marketing plan includes a calendar of promotional events and a comprehensive media program. On-site marketing departments perform a competing community assessment quarterly. Corporate and regional marketing directors monitor the on-site marketing departments effectiveness and productivity on a monthly basis. Routine detailed marketing department audits are performed on an annual basis or more frequently if deemed necessary. Corporate and regional personnel assist in the development of marketing strategies for each

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community and produce creative media, assist in direct mail programs and necessary marketing collateral. Ongoing sales training of on-site marketing/sales staff is implemented by corporate and regional marketing directors.

In the case of new development, the corporate and regional staff develops a comprehensive community outreach program that is implemented at the start of construction. A marketing pre-lease program is developed and on-site marketing staff are hired and trained to begin the program implementation six to nine months prior to the community opening. Extensive use of media, including radio, television, print, direct mail and telemarketing, is implemented during this pre-lease phase.

After the community is opened and sustaining occupancy levels are attained, the on-site marketing staff is more heavily focused on resident and resident family referrals, as well as professional referrals. A maintenance program for continued lead generation is then implemented.

Government Regulation

Changes in existing laws and regulations, adoption of new laws and regulations and new interpretations of existing laws and regulations could have a material effect on the Company's operations. Failure by the Company to comply with applicable regulatory requirements could have a material adverse effect on the Company's business, financial condition, cash flows, and results of operations. Accordingly, the Company monitors legal and regulatory developments on local and national levels.

The health care industry is subject to extensive regulation and frequent regulatory change. At this time, no federal laws or regulations specifically regulate assisted or independent living residences. While a number of states have not yet enacted specific assisted living regulations, certain of the Company's assisted living communities are subject to regulation, licensing, CON and permitting by state and local health care and social service agencies and other regulatory authorities. While such requirements vary from state to state, they typically relate to staffing, physical design, required services and resident characteristics. The Company believes that such regulation will increase in the future. In addition, health care providers are receiving increased scrutiny under anti-trust laws as integration and consolidation of health care delivery increases and affects competition. The Company's communities are also subject to various zoning restrictions, local building codes, and other ordinances, such as fire safety codes. Failure by the Company to comply with applicable regulatory requirements could have a material adverse effect on the Company's business, financial condition, and results of operations. Regulation of the assisted living industry is evolving. The Company is unable to predict the content of new regulations and their effect on its business. There can be no assurance that the Company's operations will not be adversely affected by regulatory developments.

The Company believes that its communities are in substantial compliance with applicable regulatory requirements. However, in the ordinary course of business, one or more of the Company's communities could be cited for deficiencies. In such cases, the appropriate corrective action would be taken. To the Company's knowledge, no material regulatory actions are currently pending with respect to any of the Company's communities.

Under the Americans with Disabilities Act of 1990 (ADA), all places of public accommodation are required to meet certain federal requirements related to access and use by disabled persons. A number of additional federal, state and local laws exist that also may require modifications to existing and planned properties to permit access to the properties by disabled persons. While the Company believes that its communities are substantially in compliance with present requirements or are exempt therefrom, if required changes involve a greater expenditure than anticipated or must be made on a more accelerated basis than anticipated, additional costs would be incurred by the Company. Further legislation may impose additional burdens or restrictions with respect to access by disabled persons, the costs of compliance with which could be substantial.

The Health Insurance Portability and Accountability Act of 1996 (HIPAA), in conjunction with the federal regulations promulgated thereunder by the Department of Health and Human Services, has established, among other requirements, standards governing the privacy of certain protected and individually identifiable health information (PHI) that is created, received or maintained by a range of covered entities. HIPAA has also established standards governing uniform health care transactions, the codes and identifiers to be used by the covered entities and standards governing the security of certain electronic transactions conducted by covered entities.

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Penalties for violations can range from civil money penalties for errors and negligent acts to criminal fines and imprisonment for knowing and intentional misconduct. HIPAA is a complex set of regulations and many unanswered questions remain with respect to the manner in which HIPAA applies to businesses such as those operated by the Company.

In addition, the Company is subject to various federal, state and local environmental laws and regulations. Such laws and regulations often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of hazardous or toxic substances. The costs of any required remediation or removal of these substances could be substantial and the liability of an owner or operator as to any property is generally not limited under such laws and regulations and could exceed the property's value and the aggregate assets of the owner or operator. The presence of these substances or failure to remediate such contamination properly may also adversely affect the owner's ability to sell or rent the property, or to borrow using the property as collateral. Under these laws and regulations, an owner, operator or an entity that arranges for the disposal of hazardous or toxic substances, such as asbestos-containing materials, at a disposal site may also be liable for the costs of any required remediation or removal of the hazardous or toxic substances at the disposal site. In connection with the ownership or operation of its properties, the Company could be liable for these costs, as well as certain other costs, including governmental fines and injuries to persons or properties. The Company has completed Phase I environmental audits of substantially all of the communities in which the Company owns interests, typically at the time of acquisition, and such audits have not revealed any material environmental liabilities that exist with respect to these communities.

Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real estate may be required to investigate and clean up hazardous or toxic substances or petroleum product releases at such property, and may be held liable to a governmental entity or to third parties for property damage and for investigation and clean up costs. The Company is not aware of any environmental liability with respect to any of its owned, leased or managed communities that the Company believes would have a material adverse effect on its business, financial condition, or results of operations. The Company believes that its communities are in compliance in all material respects with all federal, state and local laws, ordinances and regulations regarding hazardous or toxic substances or petroleum products. The Company has not been notified by any governmental authority, and is not otherwise aware of any material non-compliance, liability or claim relating to hazardous or toxic substances or petroleum products in connection with any of the communities the Company currently operates.

The Company believes that the structure and composition of government and, specifically, health care regulations will continue to change and, as a result, regularly monitors developments in the law. The Company expects to modify its agreements and operations from time to time as the business and regulatory environments change. While the Company believes it will be able to structure all its agreements and operations in accordance with applicable law, there can be no assurance that its arrangements will not be successfully challenged.

Competition

The senior living industry is highly competitive, and the Company expects that all segments of the industry will become increasingly competitive in the future. Although there are a number of substantial companies active in the senior living industry and in the markets in which the Company operates, the industry continues to be very fragmented and characterized by numerous small operators. The Company primarily competes with Assisted Living Concepts, Brookdale Senior Living Inc., Emeritus Corporation, Five Star Quality Care, Inc. and Sunrise Senior Living, Inc. The Company believes that the primary competitive factors in the senior living industry are: (i) location; (ii) reputation for and commitment to a high quality of service; (iii) quality of support services offered (such as food services); (iv) price of services; and (v) physical appearance and amenities associated with the communities. The Company competes with other companies providing independent living, assisted living, skilled nursing, home health care, and other similar service and care alternatives, some of whom may have greater financial resources than the Company. Because seniors

tend to choose senior living communities near their homes, the Company's principal competitors are other senior living and long-term care communities in the same geographic areas as the Company's communities. The Company also competes with other health care businesses with respect to

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attracting and retaining nurses, technicians, aides and other high quality professional and non-professional employees and managers.

Employees

As of December 31, 2010, the Company employed 4,188 persons, of which 2,178 were full-time employees (60 of whom are located at the Company's corporate offices) and 2,010 were part-time employees. None of the Company's employees are currently represented by a labor union and the Company is not aware of any union organizing activity among its employees. The Company believes that its relationship with its employees is good.

Executive Officers and Other Key Employees of the Registrant

The following table sets forth certain information concerning each of the Company's executive officers and other key employees as of December 31, 2010:

Name	Age	Position(s) with the Company
Lawrence A. Cohen	57	Chief Executive Officer and Vice Chairman of the Board
Keith N. Johannessen	54	President and Chief Operating Officer
Ralph A. Beattie	61	Executive Vice President and Chief Financial Officer
Rob L. Goodpaster	57	Vice President National Marketing
David W. Beathard, Sr.	63	Vice President Operations
David R. Brickman	52	Vice President, Secretary and General Counsel
Joseph G. Solari	46	Vice President Corporate Development
Gloria Holland	43	Vice President Finance
Glen H. Campbell	66	Vice President Development
Robert F. Hollister	55	Property Controller

Lawrence A. Cohen has served as one of our directors since November 1996 and as Vice Chairman of the Board since November 1996. He has served as our Chief Executive Officer since May 1999 and was our Chief Financial Officer from November 1996 to May 1999. From 1991 to 1996, Mr. Cohen served as President and Chief Executive Officer of Paine Webber Properties Incorporated. Mr. Cohen serves on the boards of various charitable organizations and is active in several industry associations. Mr. Cohen was a founding member and is on the executive committee of the Board of Directors of the American Seniors Housing Association, serves on the board of the Assisted Living Federation of America (ALFA), and serves on the Operator Advisory Board of the National Investment Center for the Seniors Housing & Care Industry. Mr. Cohen is a licensed attorney and is also a Certified Public Accountant. He received an LLM from New York University School of Law, a JD from St. John's University School of Law, and a BBA in Accounting from The George Washington University. Mr. Cohen has had positions with businesses involved in senior living for 26 years.

Keith N. Johannessen has been a director since February 2004. Mr. Johannessen currently serves as our President and Chief Operating Officer. He has more than 32 years of operational experience in seniors housing. Mr. Johannessen began his senior housing career in 1978 with Life Care Services Corporation and then joined Oxford Retirement Services, Inc as Executive Vice President. He later served as Senior Manager in the health care practice of Ernst & Young LLP prior to joining the Company in 1993. Mr. Johannessen has served on the State of the Industry and Model Assisted Living Regulations Committees of the American Seniors Housing Association. He holds a BA degree.

Ralph A. Beattie joined the Company as Executive Vice President and Chief Financial Officer in May 1999. From 1997 to 1999, he served as Executive Vice President and the Chief Financial Officer of Universal Sports America, Inc., which was honored as the number one growth company in Dallas for 1998. For the eight years prior to that he was Executive Vice President and Chief Financial Officer for Hagggar Clothing Company, during which time Hagggar successfully completed its initial public offering. Mr. Beattie has earned his Masters of Business Administration from Carnegie Mellon University and is both a Certified Management Accountant and a Certified Financial Planner.

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Rob L. Goodpaster has served as Vice President National Marketing of the Company and its predecessors since December 1992. From 1990 to 1992, Mr. Goodpaster was National Director for Marketing for Autumn America, an owner and operator of senior housing facilities. Mr. Goodpaster has been active in professional industry associations and formerly served on the Board of Directors for the National Association for Senior Living Industries. Mr. Goodpaster has been active in the operational, development and marketing aspects of senior housing for 34 years.

David W. Beathard, Sr. has served as Vice President Operations of the Company and its predecessors since August 1996. From 1992 to 1996, Mr. Beathard owned and operated a consulting firm, which provided operational, marketing, and feasibility consulting regarding senior housing facilities. Mr. Beathard has been active in the operational, sales and marketing, and construction oversight aspects of senior housing for 37 years.

David R. Brickman has served as Vice President and General Counsel of the Company and its predecessors since July 1992 and has served as Secretary of the Company since May 2007. From 1989 to 1992, Mr. Brickman served as in-house counsel with LifeCo Travel Management Company, a corporation that provided travel services to U.S. corporations. Mr. Brickman has also earned a Masters of Business Administration and a Masters in Health Administration. He currently serves on the Board of Advisors for the Southern Methodist University Corporate Counsel Symposium. He is also a member of the National Center for Assisted Living In-house Counsel Roundtable Task Force as well as the Long-Term Care Risk Legal Forum. Mr. Brickman has either practiced law or performed in-house counsel functions for 24 years.

Joseph G. Solari joined the Company as Vice President Corporate Development in September 2010. Mr. Solari has more than 15 years of experience originating, structuring, negotiating and executing the acquisition, sale and divestiture of healthcare real estate and real estate operating companies. Prior to joining the Company, from 2007 to 2009, Mr. Solari was Managing Director, Acquisitions for Ventas, Inc., where he was responsible for the firm's real estate investment activities in the seniors housing and skilled nursing industries. Prior to Ventas, Inc., from 1999 to 2007, Mr. Solari spent eight years in the healthcare investment banking group of Houlihan Lokey, where he was responsible for the origination and execution of merger and acquisition, private placement and financial restructuring engagements for the firm's healthcare clients, with particular focus on facility-based, healthcare services companies. Mr. Solari earned his Masters in Business Administration degree from Virginia Commonwealth University.

Gloria M. Holland has served as Vice President Finance of the Company since June 2004. From 2001 to 2004, Ms. Holland served as Assistant Treasurer and a corporate officer for Aurum Technology, Inc., a privately held company that provided technology and outsourcing to community banks. From 1996 to 2001, Ms. Holland held positions in Corporate Finance and Treasury at Brinker International, an owner and operator of casual dining restaurants. From 1989 to 1996, Ms. Holland was a Vice President in the Corporate Banking division of NationsBank and predecessor banks. Ms. Holland received a BBA in Finance from the University of Mississippi in 1989.

Glen H. Campbell has served as Vice President Development of the Company since September 1997. From 1990 to 1997 Mr. Campbell served as Vice President of Development for Greenbrier Corporation, an assisted living development and management company. From 1985 to 1990 Mr. Campbell served as Director of Facility Management for Retirement Corporation of America. Mr. Campbell has been active in the design and development of retirement communities for 36 years.

Robert F. Hollister, a Certified Public Accountant, has served as Property Controller for the Company and its predecessors since April 1992. From 1985 to 1992, Mr. Hollister was Chief Financial Officer and Controller of Kavanaugh Securities, Inc., a National Association of Securities Dealers broker dealer. Mr. Hollister is a member of the American Institute of Certified Public Accountants.

Subsidiaries

Capital Senior Living Corporation is the parent company of several direct and indirect subsidiaries. Although Capital Senior Living Corporation and its subsidiaries are referred to for ease of reference in this Form 10-K as the

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Company, these subsidiaries are separately incorporated and maintain their legal existence separate and apart from the parent, Capital Senior Living Corporation.

ITEM 1A. RISK FACTORS.

Our business involves various risks. When evaluating our business the following information should be carefully considered in conjunction with the other information contained in our periodic filings with the SEC. Additional risks and uncertainties not known to us currently or that currently we deem to be immaterial also may impair our business operations. If we are unable to prevent events that have a negative effect from occurring, then our business may suffer. Negative events are likely to decrease our revenue, increase our costs, make our financial results poorer and/or decrease our financial strength, and may cause our stock price to decline.

We have significant debt and our failure to generate cash flow sufficient to cover required interest and principal payments could result in defaults of the related debt.

As of December 31, 2010, we had mortgage and other indebtedness totaling approximately \$175.7 million. We cannot assure you that we will generate cash flow from operations or receive proceeds from refinancings, other financings or the sales of assets sufficient to cover required interest and principal payments. Any payment or other default could cause the applicable lender to foreclose upon the communities securing the indebtedness with a consequent loss of income and asset value to us. Further, because some of our mortgages contain cross-default and cross-collateralization provisions, a payment or other default by us with respect to one community could affect a significant number of our other communities.

We have significant operating lease obligations and our failure to generate cash flows sufficient to cover these lease obligations could result in defaults under the lease agreements.

As of December 31, 2010, we leased 45 communities with future lease obligations totaling approximately \$409.7 million, with minimum lease obligations of \$45.4 million in fiscal 2011. We cannot assure you that we will generate cash flow from operations or receive proceeds from refinancings, other financings or the sales of assets sufficient to cover these required operating lease obligations. Any payment or other default under any such lease could result in the termination of the lease, with a consequent loss of income and asset value to us. Further, because our leases contain cross-default provisions, a payment or other default by us with respect to one leased community could affect all of our other leased communities with related lessors. Certain of our leases contain various financial and other restrictive covenants, which could limit our flexibility in operating our business. Failure to maintain compliance with the lease obligations as set forth in our lease agreements could have a material adverse impact on us.

Our failure to comply with financial covenants and other restrictions contained in debt instruments and lease agreements could result in the acceleration of the related debt or lease or in the exercise of other remedies.

Our outstanding indebtedness and leases are secured by our communities, and, in certain cases, a guaranty by one or more of our subsidiaries. Therefore, an event of default under the outstanding indebtedness or leases, subject to cure provisions in certain instances, would give the respective lenders or lessors, as applicable, the right to declare all amounts outstanding to be immediately due and payable, terminate the lease, or foreclose on collateral securing the outstanding indebtedness and leases.

There are various financial covenants and other restrictions in certain of our debt instruments and lease agreements, including provisions which:

require us to meet specified financial tests at the subsidiary company level, which include, but are not limited to, tangible net worth requirements;

require us to meet specified financial tests at the community level, which include, but are not limited to, occupancy requirements and lease coverage tests; and

require consent for changes in control of us.

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If we fail to comply with any of these requirements, then the related indebtedness or lease obligations could become due and payable prior to their stated dates. We cannot assure that we could pay these debt or lease obligations if they became due prior to their stated dates.

We will require additional financing and/or refinancings in the future and may issue equity securities.

Our ability to obtain such financing or refinancing on terms acceptable to us could have a material adverse effect on our business, financial condition, cash flows, and results of operations. Our ability to meet our long-term capital requirements, including the repayment of certain long-term debt obligations, will depend, in part, on our ability to obtain additional financing or refinancings on acceptable terms from available financing sources, including through the use of mortgage financing, joint venture arrangements, by accessing the debt and/or equity markets and possibly through operating leases or other types of financing, such as lines of credit. Recent turmoil in the financial markets has severely restricted the availability of funds for borrowing and may make it more difficult or costly for us to raise capital. There can be no assurance that financing or refinancings will be available or that, if available, will be on terms acceptable to us. Moreover, raising additional funds through the issuance of equity securities could cause existing stockholders to experience dilution and could adversely affect the market price of our common stock. The disruptions in the financial markets have had and may continue to have a significant adverse effect on the market value of our common stock and other adverse effects on us and our business. Our inability to obtain additional financing or refinancings on terms acceptable to us could delay or eliminate some or all of our growth plans, necessitate the sales of assets at unfavorable prices or both, and would have a material adverse effect on our business, financial condition, cash flows, and results of operations.

Any future floating rate debt and lease obligations could expose us to rising interest rates.

Future indebtedness and lease obligations, if applicable, may be based on floating interest rates prevailing from time to time. Therefore, increases in prevailing interest rates could increase in the future our interest or lease payment obligations and could in the future have a material adverse effect on our business, financial condition, cash flows, and results of operations.

We cannot assure that we will be able to effectively manage our growth.

We intend to expand our operations, directly or indirectly, through the acquisition of existing senior living communities, the expansion of some of our existing senior living communities and/or through an increase in the number of communities which we manage under management agreements. The success of our growth strategy will depend, in large part, on our ability to implement these plans and to effectively operate these communities. If we are unable to manage our growth effectively, our business, financial condition, cash flows, and results of operations may be adversely affected.

We cannot assure that we will attempt to, or be able to, acquire additional senior living communities, or expand existing senior living communities.

The acquisition of existing communities or other businesses involves a number of risks. Existing communities available for acquisition frequently serve or target different markets than those presently served by us. We may also determine that renovations of acquired communities and changes in staff and operating management personnel are necessary to successfully integrate those communities or businesses into our existing operations. The costs incurred to reposition or renovate newly acquired communities may not be recovered by us. In undertaking acquisitions, we also may be adversely impacted by unforeseen liabilities attributable to the prior operators of those communities or businesses, against whom we may have little or no recourse. The success of our acquisition strategy will be

determined by numerous factors, including our ability to identify suitable acquisition candidates; the competition for those acquisitions; the purchase price; the requirement to make operational or structural changes and improvements; the financial performance of the communities or businesses after acquisition; our ability to finance the acquisitions; and our ability to integrate effectively any acquired communities or businesses into our management, information, and operating systems. We cannot assure that our acquisition of senior living communities or other businesses will be completed at the rate currently expected, if at all, or if completed, that any acquired communities or businesses will be successfully integrated into our operations.

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Our ability to successfully expand existing senior living communities will depend on a number of factors, including, but not limited to, our ability to acquire suitable sites at reasonable prices; our success in obtaining necessary zoning, licensing, and other required governmental permits and authorizations; and our ability to control construction costs and accurately project completion schedules. Additionally, we anticipate that the expansion of existing senior living communities may involve a substantial commitment of capital for a period of time of two years or more until the new senior living communities or expansions are operating and producing revenue, the consequence of which could be an adverse impact on our liquidity.

Termination of resident agreements and resident attrition could affect adversely our revenues and earnings.

State regulations governing assisted living facilities require written resident agreements with each resident. Most of these regulations also require that each resident have the right to terminate the resident agreement for any reason on reasonable notice. Consistent with these regulations, the resident agreements signed by us allow residents to terminate their agreement on 30 days notice. Thus, we cannot contract with residents to stay for longer periods of time, unlike typical apartment leasing arrangements that involve lease agreements with specified leasing periods of up to a year or longer. If a large number of residents elected to terminate their resident agreements at or around the same time, then our revenues and earnings could be adversely affected. In addition, the advanced age of our average resident means that the resident turnover rate in our senior living facilities may be difficult to predict.

We largely rely on private pay residents and circumstances that adversely affect the ability of the elderly to pay for our services could have a material adverse effect on us.

Approximately 95% of our total revenues from communities that we operated were attributable to private pay sources and approximately 5% of our revenues from these communities were attributable to reimbursements from Medicare and Medicaid during fiscal 2010. We expect to continue to rely primarily on the ability of residents to pay for our services from their own or family financial resources. The current unfavorable economic conditions in the housing, financial, and credit markets, inflation, or other circumstances that adversely affect the ability of the elderly to pay for our services could have a material adverse effect on our business, financial condition, cash flows, and results of operations.

We are subject to risks related to third-party management agreements.

At December 31, 2010, we managed seven senior living communities for joint ventures in which we have a minority interest pursuant to multi-year management agreements. The management agreements generally have initial terms of five years, subject to certain renewal rights. Under these agreements we provide management services to joint venture owners to operate senior living communities and have provided, and may in the future provide, management and consulting services to third parties on market and site selection, pre-opening sales and marketing, start-up training and management services for facilities under development and construction. In most cases, either party to the agreements may terminate them upon the occurrence of an event of default caused by the other party. In addition, subject to our rights to cure deficiencies, community owners may terminate us as manager if any licenses or certificates necessary for operation are revoked, or if we have a change of control. Also, in some instances, a community owner may terminate the management agreement relating to a particular community if we are in default under other management agreements relating to other communities owned by the same community owner or its affiliates. In addition, in certain cases the community owner may terminate the agreement upon 30 days notice to us in the event of a sale of the community. In those agreements, which are terminable in the event of a sale of the community, we have certain rights to offer to purchase the community. The termination of a significant portion of our management agreements could have a material adverse effect on our business, financial condition, cash flows, and results of operations.

Failure to perform our obligations under our joint venture arrangements could have a material adverse effect on us.

We hold minority interests ranging from approximately 5% to 10% in several joint ventures with affiliates of Prudential and Prudential Investment. We also manage the communities owned by these joint ventures. Under the

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terms of the joint venture agreements with Prudential and Prudential Investment covering seven properties, we are obligated to meet certain cash flow targets and failure to meet these cash flow targets could result in termination of the management agreements.

The Company, on three joint venture developments with Prudential Investment, has guarantees that the communities will be completed and operated at the budgeted costs approved by the joint venture members. These costs include the hard and soft construction costs and operating costs until each community reaches breakeven. The budgeted costs include contingency reserves for potential costs overruns and other unforeseen costs. The terms of these guarantees generally do not provide for a limitation on the maximum potential future payments. These joint ventures are currently in lease up and one of the joint ventures has exhausted all of its reserves under the existing loan commitment. The Company will be required to fund operating deficits until the joint venture reaches breakeven for three consecutive months. Any amounts funded by the Company under this commitment, up to \$0.5 million, may be recoverable from the joint venture in the event of liquidation. As of December 31, 2010, the Company had recognized deficit charges of approximately \$0.4 million under these development agreement guarantees. The Company does not currently anticipate funding any deficits in excess of the amounts estimated to be recoverable from the joint ventures.

All of the management agreements with the joint ventures contain termination and renewal provisions. We do not control these joint venture decisions covering termination or renewal. Performance of the above obligations or termination or non-renewal of the management agreements could have a material adverse effect on our business, financial condition, cash flows, and results of operations.

The senior living services industry is very competitive and some competitors may have substantially greater financial resources than us.

The senior living services industry is highly competitive, and we expect that all segments of the industry will become increasingly competitive in the future. We compete with other companies providing independent living, assisted living, skilled nursing, home health care and other similar services and care alternatives. We also compete with other health care businesses with respect to attracting and retaining nurses, technicians, aides and other high quality professional and non-professional employees and managers. Although we believe there is a need for senior living communities in the markets where we operate residences, we expect that competition will increase from existing competitors and new market entrants, some of whom may have substantially greater financial resources than us. In addition, some of our competitors operate on a not-for-profit basis or as charitable organizations and have the ability to finance capital expenditures on a tax-exempt basis or through the receipt of charitable contributions, neither of which are available to us. Furthermore, if the development of new senior living communities outpaces the demand for those communities in the markets in which we have senior living communities, those markets may become saturated. Regulation in the independent and assisted living industry, which represents a substantial portion of our senior living services, is not substantial. Consequently, development of new senior living communities could outpace demand. An oversupply of those communities in our markets could cause us to experience decreased occupancy, reduced operating margins and lower profitability.

We rely on the services of key executive officers and the loss of these officers or their services could have a material adverse effect on us.

We depend on the services of our executive officers for our management. The loss of some of our executive officers and the inability to attract and retain qualified management personnel could affect our ability to manage our business and could adversely affect our business, financial condition, cash flows, and results of operations.

A significant increase in our labor costs could have a material adverse effect on us.

We compete with other providers of senior living services with respect to attracting and retaining qualified management personnel responsible for the day-to-day operations of each of our communities and skilled personnel responsible for providing resident care. A shortage of nurses or trained personnel may require us to enhance our wage and benefits package in order to compete in the hiring and retention of these personnel or to hire more expensive temporary personnel. We also will be dependent on the available labor pool of semi-skilled and unskilled

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employees in each of the markets in which we operate. No assurance can be given that our labor costs will not increase, or that, if they do increase, they can be matched by corresponding increases in rates charged to residents. Any significant failure by us to control our labor costs or to pass on any increased labor costs to residents through rate increases could have a material adverse effect on our business, financial condition, cash flows, and results of operations.

There is an inherent risk of liability in the provision of personal and health care services, not all of which may be covered by insurance.

The provision of personal and health care services in the long-term care industry entails an inherent risk of liability. In recent years, participants in the long-term care industry have become subject to an increasing number of lawsuits alleging negligence or related legal theories, many of which involve large claims and result in the incurrence of significant defense costs. Moreover, senior living communities offer residents a greater degree of independence in their daily living. This increased level of independence may subject the resident and, therefore, us to risks that would be reduced in more institutionalized settings. We currently maintain insurance in amounts we believe are comparable to those maintained by other senior living companies based on the nature of the risks, our historical experience and industry standards, and we believe that this insurance coverage is adequate. However, we may become subject to claims in excess of our insurance or claims not covered by our insurance, such as claims for punitive damages, terrorism and natural disasters. A claim against us not covered by, or in excess of, our insurance could have a material adverse effect upon us.

In addition, our insurance policies must be renewed annually. Based upon poor loss experience, insurers for the long-term care industry have become increasingly wary of liability exposure. A number of insurance carriers have stopped writing coverage to this market, and those remaining have increased premiums and deductibles substantially. Therefore, we cannot assure that we will be able to obtain liability insurance in the future or that, if that insurance is available, it will be available on acceptable economic terms.

We are subject to government regulations and compliance, some of which are burdensome and some of which may change to our detriment in the future.

Federal and state governments regulate various aspects of our business. The development and operation of senior living communities and the provision of health care services are subject to federal, state and local licensure, certification and inspection laws that regulate, among other matters, the number of licensed beds, the provision of services, the distribution of pharmaceuticals, billing practices and policies, equipment, staffing (including professional licensing), operating policies and procedures, fire prevention measures, environmental matters and compliance with building and safety codes. Failure to comply with these laws and regulations could result in the denial of reimbursement, the imposition of fines, temporary suspension of admission of new residents, suspension or decertification from the Medicare program, restrictions on the ability to acquire new communities or expand existing communities and, in extreme cases, the revocation of a community's license or closure of a community. We believe that such regulation will increase in the future and we are unable to predict the content of new regulations or their effect on our business, any of which could materially adversely affect us.

Various states, including several of the states in which we currently operate, control the supply of licensed skilled nursing beds, assisted living communities and home health care agencies through CON or other programs. In those states, approval is required for the construction of new health care communities, the addition of licensed beds and some capital expenditures at those communities, as well as the opening of a home health care agency. To the extent that a CON or other similar approval is required for the acquisition or construction of new communities, the expansion of the number of licensed beds, services, or existing communities, or the opening of a home health care agency, we could be adversely affected by our failure or inability to obtain that approval, changes in the standards applicable for

that approval, and possible delays and expenses associated with obtaining that approval. In addition, in most states, the reduction of the number of licensed beds or the closure of a community requires the approval of the appropriate state regulatory agency and, if we were to seek to reduce the number of licensed beds at, or to close, a community, we could be adversely affected by a failure to obtain or a delay in obtaining that approval.

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Federal and state anti-remuneration laws, such as anti-kickback laws, govern some financial arrangements among health care providers and others who may be in a position to refer or recommend patients to those providers. These laws prohibit, among other things, some direct and indirect payments that are intended to induce the referral of patients to, the arranging for services by, or the recommending of, a particular provider of health care items or services. Federal anti-kickback laws have been broadly interpreted to apply to some contractual relationships between health care providers and sources of patient referral. Similar state laws vary, are sometimes vague, and seldom have been interpreted by courts or regulatory agencies. Violation of these laws can result in loss of licensure, civil and criminal penalties, and exclusion of health care providers or suppliers from participation in Medicare and Medicaid programs. There can be no assurance that those laws will be interpreted in a manner consistent with our practices.

Under the Americans with Disabilities Act of 1990, all places of public accommodation are required to meet federal requirements related to access and use by disabled persons. A number of additional federal, state and local laws exist that also may require modifications to existing and planned communities to create access to the properties by disabled persons. Although we believe that our communities are substantially in compliance with present requirements or are exempt therefrom, if required changes involve a greater expenditure than anticipated or must be made on a more accelerated basis than anticipated, additional costs would be incurred by us. Further legislation may impose additional burdens or restrictions with respect to access by disabled persons, the costs of compliance with which could be substantial.

The Health Insurance Portability and Accountability Act of 1996, in conjunction with the federal regulations promulgated thereunder by the Department of Health and Human Services, has established, among other requirements, standards governing the privacy of certain protected and individually identifiable health information that is created, received or maintained by a range of covered entities. HIPAA has also established standards governing uniform health care transactions, the codes and identifiers to be used by the covered entities and standards governing the security of certain electronic transactions conducted by covered entities. Penalties for violations can range from civil money penalties for errors and negligent acts to criminal fines and imprisonment for knowing and intentional misconduct. HIPAA is a complex set of regulations and many unanswered questions remain with respect to the manner in which HIPAA applies to businesses such as those operated by us.

An increasing number of legislative initiatives have been introduced or proposed in recent years that would result in major changes in the health care delivery system on a national or a state level. Among the proposals that have been introduced are price controls on hospitals, insurance market reforms to increase the availability of group health insurance to small businesses, requirements that all businesses offer health insurance coverage to their employees and the creation of government health insurance plans that would cover all citizens and increase payments by beneficiaries. We cannot predict whether any of the above proposals or other proposals will be adopted and, if adopted, no assurances can be given that their implementation will not have a material adverse effect on our business, financial condition or results of operations.

We may be subject to liability for environmental damages.

Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real estate may be required to investigate and clean up hazardous or toxic substances or petroleum product releases at the property, and may be held liable to a governmental entity or to third parties for property damage and for investigation and clean up costs incurred by those parties in connection with the contamination. These laws typically impose clean-up responsibility and liability without regard to whether the owner knew of or caused the presence of the contaminants, and liability under these laws has been interpreted to be joint and several unless the harm is divisible and there is a reasonable basis for allocation of responsibility. The costs of investigation, remediation or removal of the substances may be substantial, and the presence of the substances, or the failure to properly remediate the property, may adversely affect the owner's ability to sell or lease the property or to borrow using the property as

collateral. In addition, some environmental laws create a lien on the contaminated site in favor of the government for damages and costs it incurs in connection with the contamination. Persons who arrange for the disposal or treatment of hazardous or toxic substances also may be liable for the costs of removal or remediation of the substances at the disposal or treatment facility, whether or not the facility is owned or operated by the person. Finally, the owner of a site may be subject to common law claims by third parties based on damages and

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costs resulting from environmental contamination emanating from a site. If we become subject to any of these claims the costs involved could be significant and could have a material adverse effect on our business, financial condition, cash flows, and results of operations.

Anti-takeover provisions in our governing documents, governing law, material agreements and our shareholder rights plan may discourage, delay or prevent a merger or acquisition that our stockholders may consider favorable or prevent the removal of our current board of directors and management.

Certain provisions of our amended and restated certificate of incorporation and our amended and restated by-laws may discourage, delay or prevent a merger or acquisition that our stockholders may consider favorable or prevent the removal of our current board of directors and management. We have a number of anti-takeover devices in place that will hinder takeover attempts, including: a staggered board of directors consisting of three classes of directors, each of whom serve three-year terms; removal of directors only for cause, and only with the affirmative vote of at least a majority of the voting interest of stockholders entitled to vote; right of our directors to issue preferred stock from time to time with voting, economic and other rights superior to those of our common stock without the consent of our stockholders; provisions in our amended and restated certificate of incorporation and amended and restated by-laws limiting the right of our stockholders to call special meetings of stockholders; advance notice requirements for stockholders with respect to director nominations and actions to be taken at annual meetings; requirement for two-thirds stockholder approval for amendment of our by-laws and certain provisions of our certificate of incorporation; and no provision in our amended and restated certificate of incorporation for cumulative voting in the election of directors, which means that the holders of a majority of the outstanding shares of our common stock can elect all the directors standing for election.

Several of our leases, loan documents and other material agreements require approval in case of a change of control of our company. These provisions may have the effect of delaying or preventing a change of control of our company even if this change of control would benefit our stockholders.

In addition to the anti-takeover provisions described above, we are subject to Section 203 of the Delaware General Corporation Law. Section 203 generally prohibits a person beneficially owning, directly or indirectly, 15% or more of our outstanding common stock from engaging in a business combination with us for three years after the person acquired the stock. However, this prohibition does not apply if (A) our directors approve in advance the person's ownership of 15% or more of the shares or the business combination or (B) the business combination is approved by our stockholders by a vote of at least two-thirds of the outstanding shares not owned by the acquiring person. Also, our board of directors adopted and our stockholders approved a stockholder rights plan, which may discourage a third party from making an unsolicited proposal to acquire 20% or more of our common stock.

Because we do not presently have plans to pay dividends on our common stock, stockholders must look solely to appreciation of our common stock to realize a gain on their investment.

It is the policy of our Board of Directors to retain any future earnings to finance the operation and expansion of the Company's business. Accordingly, the Company has not and does not currently anticipate declaring or paying cash dividends on your common stock in the foreseeable future. The payment of cash dividends in the future will be at the sole discretion of our Board of Directors and will depend on, among other things, the Company's earnings, operations, capital requirements, financial condition, restrictions in then existing financing agreements and other factors deemed relevant by our Board of Directors. Accordingly, stockholders must look solely to appreciation of our common stock to realize a gain on their investment. This appreciation may not occur.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. *PROPERTIES.*

The executive and administrative offices of the Company are located at 14160 Dallas Parkway, Suite 300, Dallas, Texas 75254, and consist of approximately 26,000 square feet. The lease on the premises extends through May 2013. The Company believes that its corporate office facilities are adequate to meet its requirements through at

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least fiscal 2011 and that suitable additional space will be available, as needed, to accommodate further physical expansion of corporate operations. The Company also leases executive office space in New York, New York pursuant to an annual lease agreement.

As of December 31, 2010, the Company owned, leased and/or managed the senior living communities referred to in Item 1 above under the caption Operating Communities.

ITEM 3. LEGAL PROCEEDINGS.

The Company has claims incurred in the normal course of its business. Most of these claims are believed by management to be covered by insurance, subject to normal reservations of rights by the insurance companies and possibly subject to certain exclusions in the applicable insurance policies. Whether or not covered by insurance, these claims, in the opinion of management, based on advice of legal counsel, should not have a material effect on the consolidated financial statements of the Company if determined adversely to the Company.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.****(a) Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters.****Market Information and Holders**

The Company's shares of common stock are listed for trading on the New York Stock Exchange (NYSE) under the symbol CSU . The following table sets forth, for the periods indicated, the high and low sales prices for the Company's common stock, as reported on the NYSE. At February 28, 2011, there were approximately 135 stockholders of record of the Company's common stock.

Year	2010		2009	
	High	Low	High	Low
First Quarter	\$ 5.49	\$ 4.21	\$ 3.42	\$ 2.10
Second Quarter	5.85	4.34	4.86	2.36
Third Quarter	5.61	4.73	6.49	3.95
Fourth Quarter	7.10	5.15	6.39	4.26

Dividends

It is the policy of the Company's Board of Directors to retain all future earnings to finance the operation and expansion of the Company's business. Accordingly, the Company has not and does not anticipate declaring or paying cash dividends on the common stock in the foreseeable future. The payment of cash dividends in the future will be at the sole discretion of the Company's Board of Directors and will depend on, among other things, the Company's earnings, operations, capital requirements, financial condition, restrictions in then existing financing agreements, and other factors deemed relevant by the Board of Directors.

Securities Authorized for Issuance under Equity Compensation Plans

The following table presents information relating to the Company's equity compensation plans as of December 31, 2010:

Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and	Weighted-Average Exercise Price of the Outstanding Options, Warrants	Number of Securities
		Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities

Plan Category	Rights	and Rights	Reflected in First Column)
Equity compensation plans approved by security holders	516,334	\$ 4.44	1,810,375
Equity compensation plans not approved by security holders			
Total	516,334	\$ 4.44	1,810,375

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The following Performance Graph shows the cumulative total return for the five-year period ended December 31, 2010, in the value of \$100 invested in: (1) the Company's common stock; (2) the Standard & Poor's Broad Market Index (the S&P 500); and (3) the common stock of the Peer Group (as defined below) of companies, whose returns represent the arithmetic average of such companies. The values with each investment as of the beginning of each year are based on share price appreciation and the reinvestment with dividends on the respective ex-dividend dates.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
Among Capital Senior Living Corporation, The S&P 500 Index,
And A Peer Group

* \$100 invested on 12/31/05 in stock or index, including reinvestment of dividends.
 Fiscal year ending December 31.

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The preceding graph assumes \$100 invested at the beginning of the measurement period, including reinvestment of dividends, in the Company's common stock, the S&P 500, and the Peer Group was plotted using the following data:

	Cumulative Total Returns					
	12/05	12/06	12/07	12/08	12/09	12/10
Capital Senior Living Corporation	100.00	102.90	96.03	28.82	48.55	64.80
S & P 500	100.00	115.80	122.16	76.96	97.33	111.99
Peer Group	100.00	133.37	98.06	21.71	51.83	62.73

The Company's Peer Group, which was selected in good faith on an industry basis, consists of Assisted Living Concepts, Inc., Brookdale Senior Living, Inc., Emeritus Corporation, Five Star Quality Care, Inc., and Sunrise Senior Living, Inc.

(b) Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities.

Not Applicable.

Table of Contents***(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers.***

The following information is provided pursuant to Item 703 of Regulation S-K. The Company did not repurchase any shares of its common stock pursuant to the Company's share repurchase program (as described below) during the year ended December 31, 2010. The information set forth in the table below reflects shares repurchased by the Company pursuant to this program prior to the year ended December 31, 2010.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(1)
Total at December 31, 2009	349,800	\$ 2.67	349,800	\$ 9,065,571
January 1 – March 31, 2010				
April 1 – June 30, 2010				
July 1 – September 30, 2010				
October 1 – December 31, 2010				
Total at December 31, 2010	349,800	\$ 2.67	349,800	\$ 9,065,571

(1) On January 22, 2009, the Company's board of directors approved a share repurchase program that authorized the Company to purchase up to \$10.0 million of the Company's common stock. The repurchase program does not obligate the Company to acquire any particular amount of common stock and the share repurchase authorization has no stated expiration date. All shares that have been purchased by the Company under this program were purchased in open-market transactions.

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The following table presents selected financial data of the Company which has been derived from the audited consolidated financial statements of the Company. The selected financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes thereto included in this Annual Report.

	2010	At and for the Year Ended December 31,			2006
		2009	2008	2007	
		(In thousands, except per share data)			
Statements of Operations Data:					
Total revenues	\$ 211,929	\$ 191,991	\$ 193,274	\$ 189,052	\$ 159,070
Income from operations(1)	18,515	16,612	17,015	20,006	14,068
Net income (loss)	4,254	2,759	3,724	4,360	(2,600)
Net income (loss) per share:					
Basic income (loss) per share	0.16	0.10	0.14	0.17	(0.10)
Diluted income (loss) per share	\$ 0.16	\$ 0.10	\$ 0.14	\$ 0.16	\$ (0.10)
Balance Sheet Data:					
Cash and cash equivalents	\$ 31,248	\$ 28,972	\$ 25,880	\$ 23,359	\$ 25,569
Working capital(2)	31,434	18,796	13,799	12,919	15,331
Total assets	382,781	380,503	388,120	390,053	394,488
Long-term debt, excluding current portion	170,026	173,822	177,541	185,733	196,647
Stockholders' equity	\$ 163,823	\$ 158,130	\$ 155,149	\$ 150,157	\$ 144,084
Other Data:					
Communities (at end of period)					
Owned or leased	70	50	50	49	48
Joint ventures & managed	7	16	14	15	16
Total	77	66	64	64	64
Resident capacity:					
Owned or leased	9,566	7,950	7,701	7,636	7,551
Joint ventures & managed	1,434	2,234	1,750	1,908	1,993
Total	11,000	10,184	9,451	9,544	9,544

(1) Income from operations for fiscal 2007 and 2006 was revised to reduce facility lease costs to include amortization of deferred gains on sales of assets of \$3,243 and \$2,401, respectively, which had no impact on net income.

(2) Working capital for fiscal 2007 and 2006 was revised to reclassify capital replacement reserves and certain escrow deposits of \$220 and \$76, respectively, from current assets to other assets, which had no impact on total assets.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Certain information contained in this report constitutes Forward-Looking Statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which can be identified by the use of forward-looking terminology such as may, will, would, intend, could, believe, expect, anticipate, estimate or continue or the negative thereof or other variations thereon or comparable terminology. The Company cautions readers that forward-looking statements, including, without limitation, those relating to the Company's future business prospects, revenues, working capital, liquidity, capital needs, interest costs, and income, are subject to certain risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements, due to several important

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factors herein identified. These factors include the Company's ability to find suitable acquisition properties at favorable terms, financing, licensing, business conditions, risks of downturn in economic conditions generally, satisfaction of closing conditions such as those pertaining to licensure, availability of insurance at commercially reasonable rates, and changes in accounting principles and interpretations, among others, and other risks and factors identified from time to time in the Company's reports filed with the SEC.

Overview

The following discussion and analysis addresses (i) the Company's results of operations on a historical consolidated basis for the years ended December 31, 2010, 2009, and 2008, and (ii) liquidity and capital resources of the Company and should be read in conjunction with the Company's historical consolidated financial statements and the selected financial data contained elsewhere in this report.

The Company is one of the largest operators of senior living communities in the United States. The Company's operating strategy is to provide quality senior living services to its residents, while achieving and sustaining a strong, competitive position within its chosen markets, as well as to continue to enhance the performance of its operations. The Company provides senior living services to the elderly, including independent living, assisted living, skilled nursing and home care services.

As of December 31, 2010, the Company operated 77 senior living communities in 23 states with an aggregate capacity of approximately 11,000 residents, including 32 senior living communities which the Company either owned or in which the Company had an ownership interest, and 45 senior living communities that the Company leased. As of December 31, 2010, the Company also operated one home care agency.

Significant Financial and Operational Highlights

The Company's operating strategy is to provide quality senior living communities and services to its residents, while achieving and sustaining a strong, competitive position within its chosen markets, as well as to continue to enhance the performance of its operations. The Company provides senior living services to the elderly, including independent living, assisted living, skilled nursing and home care services. Many of the Company's communities offer a continuum of care to meet its residents' needs as they change over time. This continuum of care, which integrates independent living and assisted living and is bridged by home care through independent home care agencies or the Company's home care agency, sustains residents' autonomy and independence based on their physical and mental abilities.

The Company primarily derives its revenue by providing senior living and healthcare services to the elderly and operating senior living communities under joint venture arrangements. Despite challenging economic conditions, when comparing fiscal 2010 to fiscal 2009 the Company was able to increase total revenues approximately \$19.9 million, or 10.4%, of which approximately 92.9% of these revenues consisted of senior living and healthcare services compared to 89.2% in fiscal 2009.

In April 2010, the Company and GE Healthcare sold its respective ownership interests in Midwest I and II to HCN in sale/leaseback transactions of eight senior living communities owned by subsidiaries of Midwest I and II. Upon closing the sales, the Company leased the senior housing communities from HCN. As a result of these sale/leaseback transactions, the Company received cash proceeds of approximately \$4.5 million, net of closing costs, resulting in gains to the Company of approximately \$1.2 million, which have been deferred and are being recognized in the Company's statement of income as a reduction in facility lease expense over the initial 15-year lease term.

In September 2010, the Company acquired the leasehold interests in 12 communities and certain related personal property from Signature Assisted Living of Texas, LLC (the "Signature Transaction"). Simultaneously with closing the

Signature Transaction, the Company executed a Master Lease Agreement with affiliates of HCN for the 12 communities (the Master Lease Agreement). The Master Lease Agreement has a term of fifteen years with one 15-year renewal option beyond the initial lease term. The initial lease rate is 8.5% and is subject to certain conditional escalation clauses. The Master Lease Agreement is a triple net lease pursuant to which the Company pays all expenses of the properties except principal and interest on any mortgage debt of the properties. The Master

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Lease Agreement contains customary representations and warranties as well as affirmative and negative covenants and the lease payments are guaranteed by other subsidiaries of the Company.

During 2010, the Company was able to decrease general and administrative expenses 2.9% when compared to fiscal 2009. These reductions were primarily the result of the Company's ability to leverage resources and identify areas where overhead could be reduced without compromising superior levels of service and care to our residents.

During 2010, the Company extinguished \$7.5 million of its outstanding debt obligations, which included a pay-off settlement with a Lehman securitized trust for a promissory note of one of the Company's wholly owned subsidiaries. The securitized promissory note carried an outstanding principal balance of \$4.6 million which was collateralized with the assets of the subsidiary and was nonrecourse to the Company. The pay-off settlement was for \$3.7 million, excluding amounts reserved and escrowed, with no further obligation to the Company's subsidiary and resulted in a gain to the Company of approximately \$0.7 million. These principal reductions further reduced the Company's exposure to the volatility in the credit markets and enabled the Company to reduce interest expense by approximately \$0.6 million, or 4.9%, during fiscal 2010 when compared to fiscal 2009.

The senior living industry continues to be negatively impacted by unfavorable conditions in the housing, credit and financial markets and the overall economy, generally resulting in lower than anticipated occupancy rates. Throughout fiscal 2010, in response to these conditions, the Company has continued to focus on maintaining an emphasis on occupancy increases, improvement in rental rates, expense management and growth in net operating income per unit, conversions of existing units to higher levels of care, and other opportunities to enhance cash flow and shareholder value.

Joint Venture Transactions and Management Contracts

As of December 31, 2010, the Company managed 7 communities owned by joint ventures in which the Company has a minority interest. For communities owned by joint ventures, the Company typically receives a management fee of 5% of gross revenues.

The Company believes that the factors affecting the financial performance of communities managed under contracts with third parties do not vary substantially from the factors affecting the performance of owned and leased communities, although there are different business risks associated with these activities.

The Company's third-party and joint venture management fees are primarily based on a percentage of gross revenues. As a result, the cash flow and profitability of such contracts to the Company are more dependent on the revenues generated by such communities and less dependent on net cash flow than for owned or leased communities. Further, the Company is not responsible for capital investments in managed communities. The management contracts are generally terminable only for cause or upon the sale of a community, subject to the Company's right to offer to purchase such community. At December 31, 2010, the Company did not manage any communities in which it did not have an ownership interest.

Midwest I Transaction

In January 2006, the Company and GE Healthcare formed Midwest I to acquire five senior housing communities from a third party. Midwest I was owned approximately 89% by GE Healthcare and 11% by the Company. The Company contributed \$2.7 million for its interest in Midwest I. The five communities currently comprise 293 assisted living units with a combined capacity of 391 residents. The Company accounted for its investment in Midwest I under the equity method of accounting.

The Company was party to a series of property management agreements (the Midwest I Agreements) to manage the five communities acquired by Midwest I. The Midwest I Agreements were for an initial term of five years, extended until various dates through February 2011, and contained automatic one year renewals thereafter. The Midwest I Agreements generally provided for a management fee of 5% of gross revenues. On April 16, 2010, Midwest I closed the sale of the Midwest I subsidiaries that owned the five senior housing communities to HCN. Upon closing the sale, the Company leased the five senior housing communities from HCN. For additional information, refer to Note 4, Facility Lease Transactions, in the notes to the consolidated financial statements.

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Midwest II Transaction

In August 2006, the Company and GE Healthcare formed Midwest II to acquire three senior housing communities from a third party. Midwest II was owned approximately 85% by GE Healthcare and 15% by the Company. The Company contributed \$1.6 million for its interest in Midwest II. The three communities currently comprise 300 assisted living and memory care units with a combined capacity of 348 residents. The Company accounted for its investment in Midwest II under the equity method of accounting.

The Company was party to a series of property management agreements (the Midwest II Agreements) to manage the three communities acquired by Midwest II. The Midwest II Agreements were for an initial term of five years, extended until various dates through August 2011, and contained automatic one year renewals thereafter. The Midwest II Agreements generally provided for a management fee of 5% of gross revenues. On April 30, 2010, Midwest II closed the sale of the Midwest II subsidiaries that owned the three senior housing communities to HCN. Upon closing the sale, the Company leased the three senior housing communities from HCN. For additional information, refer to Note 4, Facility Lease Transactions, in the notes to the consolidated financial statements.

SHPII/CSL Transactions

In November 2004, the Company formed SHPII/CSL with SHPII. SHPII/CSL is owned 95% by SHPII and 5% by the Company. In November 2004, SHPII/CSL acquired the Spring Meadows Communities which currently comprise 628 units with a combined capacity of 758 residents. The Company contributed \$1.3 million for its interests in SHPII/CSL. The Company accounts for its investment in SHPII/CSL under the equity method of accounting.

The Company is party to a series of property management agreements (the SHPII/CSL Management Agreements) with SHPII/CSL, which collectively own and operate the Spring Meadows Communities. The SHPII/CSL Management Agreements currently extend until various dates through November 2014. The SHPII/CSL Management Agreements generally provide for management fees of 5% of gross revenue plus reimbursement for costs and expenses related to the communities. On December 22, 2010, the Company announced that SHPII/CSL entered into an agreement to sell the Spring Meadows Communities to HCN. As a condition to closing of the sale to HCN, the Company will enter into long term leases of the communities with HCN.

SHPIII Transactions

In May 2007, the Company and SHPIII formed SHPIII/CSL Miami, LLC (SHPIII/CSL Miami) to develop a senior housing community in Miamisburg, Ohio. Under the joint venture and related agreements, the Company earns development and management fees and may receive incentive distributions. The senior housing community currently consists of 101 independent living units and 45 assisted living units and opened in August 2008. The Company contributed \$0.8 million to SHPIII/CSL Miami for its 10% interest. The Company accounts for its investment in SHPIII/CSL Miami under the equity method of accounting.

In November 2007, the Company and SHPIII formed SHPIII/CSL Richmond Heights, LLC (SHPIII/CSL Richmond Heights) to develop a senior housing community in Richmond Heights, Ohio. Under the joint venture and related agreements, the Company earns development and management fees and may receive incentive distributions. The senior housing community currently consists of 96 independent living units and 45 assisted living units and opened in April 2009. The Company contributed \$0.8 million to SHPIII/CSL Richmond Heights for its 10% interest. The Company accounts for its investment in SHPIII/CSL Richmond Heights under the equity method of accounting.

In December 2007, the Company and SHPIII formed SHPIII/CSL Levis Commons, LLC (SHPIII/CSL Levis Commons) to develop a senior housing community near Toledo, Ohio. Under the joint venture and related

agreements, the Company earns development and management fees and may receive incentive distributions. The senior housing community currently consists of 101 independent living units and 45 assisted living units and opened in April 2009. The Company contributed \$0.8 million to SHPIII/CSL Levis Commons for its 10% interest. The Company accounts for its investment in SHPIII/CSL Levis Commons under the equity method of accounting.

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The Company is party to a series of property management agreements (the SHPIII/CSL Management Agreements) with SHPIII/CSL Miami, SHPIII/CSL Richmond Heights, and SHPIII/CSL Levis Commons (collectively SHPIII/CSL), which joint ventures are owned 90% by Senior Housing Partners III, L.P. (SHPIII), a fund managed by Prudential Investment and 10% by the Company, which collectively own and operate SHPIII/CSL. The SHPIII/CSL Management Agreements are for initial terms of ten years from the date the certificate of occupancy was issued and currently extend until various dates through January 2019. The SHPIII/CSL Management Agreements generally provide for management fees of 5% of gross revenue plus reimbursement for costs and expenses related to the communities.

CGIM Transaction

The Company was party to a series of property management agreements with CGIM (the CGIM Agreements) expiring in August 2011. The CGIM Agreements generally provided for management fees of 5% to 6% of gross revenues, subject to certain base management fees. The Company managed one community under the CGIM agreements which the Company terminated during the fourth quarter of fiscal 2010. The Company no longer manages any communities under the CGIM Agreements as of December 31, 2010.

Lease Transactions

The Company currently leases 45 senior living communities from certain real estate investment trusts (REITs). The lease terms are generally for 10-15 years with renewal options for 5-15 years at the Company s option. Under these lease agreements the Company is responsible for all operating costs, maintenance and repairs, insurance and property taxes.

As of December 31, 2010, the Company leased ten senior living facilities (collectively the Ventas Lease Agreements), from Ventas Healthcare Properties, Inc. (Ventas). The Ventas Lease Agreements each have an initial term of approximately ten years, with two five-year renewal extensions available at the Company s option. The initial lease rate under each of the Ventas Lease Agreements range from 7.75% to 8% and are subject to certain conditional escalation clauses which will be recognized when probable or incurred. The initial terms on the Ventas Lease Agreements expire on various dates through January 2018. The Company incurred \$2.2 million in lease acquisition costs related to the Ventas Lease Agreements. These deferred lease acquisition costs are being amortized over the initial 10-year lease terms and are included in facility lease expense in the Company s statement of income. The Company accounts for each of the Ventas Lease Agreements as operating leases.

As of December 31, 2010, the Company leased 15 senior living facilities (collectively the HCP Lease Agreements), from HCP, Inc. (HCP). The HCP Lease Agreements each have an initial term of ten years, with two ten year renewal extensions available at the Company s option. The initial lease rate under the HCP Lease Agreements range from 7.25% to 8% and are subject to certain conditional escalation clauses, which will be recognized when probable or incurred. The initial terms on the HCP Lease Agreements expire on various dates through October 2018. The Company incurred \$1.5 million in lease acquisition costs related to the HCP Lease Agreements. These deferred lease acquisition costs are being amortized over the initial 10-year lease terms and are included in facility lease expense in the Company s statement of income. The Company accounts for each of the HCP Lease Agreements as operating leases.

As of December 31, 2010, the Company leased 20 senior living facilities (collectively the HCN Lease Agreements), from HCN. The HCN Lease Agreements each have an initial term of 15 years, with one 15 year renewal extension available at the Company s option. The initial lease rate under the HCN Lease Agreements range from 8.25% to 8.5% and are subject to certain conditional escalation clauses, which will be recognized when probable or incurred. The initial terms on the HCN Lease Agreements expire on various dates through September 2025. The Company incurred

\$1.2 million in lease acquisition costs related to the HCN Lease Agreements. These deferred lease acquisition costs are being amortized over the initial 15-year lease terms and are included in facility lease expense in the Company's statement of income. The Company accounts for each of the HCN Lease Agreements as operating leases.

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The following table summarizes each of the Company's lease agreements (dollars in millions):

Landlord	Date of Lease	Number of Communities	Value of Transaction	Term	Initial Lease Rate(1)	Lease Acquisition Costs(2)	Deferred Gains / Lease Concessions(3)
Ventas	September 30, 2005	6	\$ 84.6	10 years (Two five-year renewals)	8%	\$ 1.3	\$ 4.6
Ventas	October 18, 2005	1	19.5	10 years (Two five-year renewals)	8%	0.2	
Ventas	March 31, 2006	1	29.0	10 years (Two five-year renewals)	8%	0.1	14.3
Ventas	June 8, 2006	1	19.1	9.5 years (Two five-year renewals)	8%	0.4	
Ventas	January 31, 2008	1	5.0	10 years (Two five-year renewals)	7.75%	0.2	
HCP	May 1, 2006	3	54.0	(4) (Two ten-year renewals)	8%	0.2	12.8
HCP	May 31, 2006	6	43.0	10 years (Two ten-year renewals)	8%	0.2	0.6
HCP	December 1, 2006	4	51.0	(4) (Two ten-year renewals)	8%	0.7	
HCP	December 14, 2006	1	18.0	(4) (Two ten-year renewals)	7.75%	0.3	
HCP	April 11, 2007	1	8.0	(4) (Two ten-year renewals)	7.25%	0.1	
HCN	April 16, 2010	5	48.5		8.25%	0.6	0.8

HCN	May 1, 2010	3	36.0	15 years (One 15-year renewal)	8.25%	0.2	0.4
HCN	September 10, 2010	12	104.6	15 years (One 15-year renewal)	8.50%	0.4	2.0
Subtotal						4.9	35.5
Accumulated amortization through December 31, 2010						(1.8)	
Accumulated deferred gain recognized through December 31, 2010							(16.4)
Net lease acquisition costs / deferred gains / lease concessions as of December 31, 2010						\$ 3.1	\$ 19.1

- (1) Initial lease rates are measured against agreed upon fair market values and are subject to conditional lease escalation provisions as forth in each lease agreement.
- (2) Lease acquisition costs are being amortized over the leases' initial term.
- (3) Deferred gains of \$32.9 million and lease concessions of \$2.6 million are being recognized in the Company's statement of income as a reduction in facility lease expense over the leases' initial term. Lease concessions of \$0.6 million relate to the HCP transaction on May 31, 2006, and \$2.0 million relate to the Signature Transaction on September 10, 2010.
- (4) Initial lease term expires on October 31, 2018.

Facility lease expense in the Company's statement of income includes rent expense plus amortization expense relating to leasehold acquisition costs offset by the amortization of deferred gains and lease incentives.

On September 10, 2010, in conjunction with the Signature Transaction, a non-cancelable lease that expires in 2013 for ten 12-passenger Ford Minibuses used to transport residents of the communities was transferred from Signature to the Company. The lease is classified as a capital lease because it contains a bargain purchase option which resulted in the Company recording a Capital Lease Obligation for \$0.2 million.

There are various financial covenants and other restrictions in our lease agreements. Under the terms of certain lease agreements, the Company was required to pay additional cash collateral of approximately \$1.1 million and

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\$1.2 million during the fiscal years ended December 31, 2010 and 2009, respectively. Once the Company reaches certain performance targets, the additional cash collateral paid is returnable to the Company. At December 31, 2010, the Company was not in compliance with a certain lease covenant which was cured by the Company through a lease modification amendment agreed to by the Company and landlord on March 11, 2011. There were no other lease covenant violations at December 31, 2010. The Company was in compliance with all of its lease covenants at December 31, 2009.

Debt Transactions

On September 10, 2010, in conjunction with the Signature Transaction, the Company obtained certain insurance policies and entered into a finance agreement totaling \$0.3 million. The finance agreement has a fixed interest rate of 3.30% with principal being repaid over a 7-month term.

On September 10, 2010, the Company issued standby letters of credit, totaling \$2.2 million, for the benefit of HCN on certain leases between HCN and the Company.

On May 31, 2010, the Company renewed certain insurance policies and entered into a finance agreement totaling \$3.7 million. The finance agreement has a fixed interest rate of 3.30% with principal being repaid over a 12-month term.

On April 16, 2010, the Company issued standby letters of credit, totaling \$1.7 million, for the benefit of HCN on certain leases between HCN and the Company.

On April 15, 2010, the Company negotiated a pay-off settlement with a Lehman securitized trust for a promissory note of one of the Company's wholly owned subsidiaries that matured on September 1, 2009. The securitized promissory note carried an outstanding principal balance of \$4.6 million which was collateralized with the assets of the subsidiary and was nonrecourse to the Company. The pay-off settlement was for \$3.7 million, excluding amounts reserved and escrowed, with no further obligation to the Company's subsidiary and resulted in a gain to the Company of approximately \$0.7 million.

On October 31, 2009, the Company renewed certain insurance policies and entered into a finance agreement totaling \$0.5 million. The finance agreement has a fixed interest rate of 3.66% with principal being repaid over a 10-month term.

On May 31, 2009, the Company renewed certain insurance policies and entered into a finance agreement totaling \$1.6 million. The finance agreement has a fixed interest rate of 3.66% with principal being repaid over a 10-month term.

The senior housing communities owned by the Company and encumbered by mortgage debt are provided as collateral under their respective loan agreements. At December 31, 2010 and 2009, these communities carried a total net book value of \$212.7 million and \$224.9 million, respectively, with total mortgage loans outstanding of \$174.0 million and \$182.3 million, respectively.

The Company must maintain certain levels of tangible net worth and comply with other restrictive covenants under the terms of certain promissory notes. The Company was in compliance with all of its debt covenants at December 31, 2010 and 2009.

Recent Events

On December 22, 2010, the Company announced that SHPII/CSL entered into an agreement to sell the Spring Meadows Communities to HCN. As a condition to closing of the sale to HCN, the Company will enter into long term leases of the communities. The Company currently manages the Spring Meadows Communities in the SHPII/CSL joint venture under long-term management agreements.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the

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accompanying financial statements and related notes. Management bases its estimates and assumptions on historical experience, observance of industry trends and various other sources of information and factors, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates. Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially could result in materially different results under different assumptions and conditions. The Company believes the following critical accounting policies require management's most difficult, subjective and complex judgments.

Revenue Recognition

Resident and health care revenue is recognized at estimated net realizable amounts, based on historical experiences, due from residents in the period to which the rental and other services are provided.

Revenues from the Medicare and Medicaid programs accounted for approximately 5% of the Company's revenue in fiscal 2010 and 6% of the Company's revenue in each of fiscal 2009 and 2008. Seventeen of the Company's communities are providers of services under Medicaid programs. Accordingly, the communities are entitled to reimbursement under the foregoing program at established rates that are lower than private pay rates. Patient service revenue for Medicaid patients is recorded at the reimbursement rates as the rates are set prospectively by the state upon the filing of an annual cost report. Two of the Company's communities are providers of services under the Medicare program and are entitled to payment under the foregoing programs in amounts determined based on rates established by the federal government.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Management services revenue is recognized when earned. Management services revenue relates to providing certain management and administrative support services under management contracts, which currently have terms expiring through 2018.

Substantially all community fees received from residents are non-refundable and are recorded initially by the Company as deferred revenue. The deferred amounts are amortized over the respective residents' initial lease term which is consistent with the contractual obligation associated with the estimated stay of the resident.

Community reimbursement revenue is comprised of reimbursable expenses from non-consolidated communities that the Company operates under long-term management agreements.

Investments in Joint Ventures

The Company accounts for its investments in joint ventures under the equity method of accounting. The Company was the general partner in two partnerships and owns member interests in seven other joint ventures. The Company has not consolidated these joint venture interests because the Company has concluded that the limited partners or the other members of each joint venture has substantive kick-out rights or substantive participating rights. Under the equity method of accounting, the Company records its investments in joint ventures at cost and adjusts such investments for its share of earnings and losses of the joint venture.

Development Agreement Guarantees

In 2007, the Company and SHPIII entered into a series of joint venture agreements to develop three senior housing communities located in Ohio. The Company has guaranteed the communities will be completed and operated at budgeted costs approved by the joint venture members. These costs include the hard and soft construction costs and operating costs until each community reaches breakeven. The budgeted costs include contingency reserves for potential cost overruns and other unforeseen costs. The terms of these guarantees generally do not provide for a limitation on the maximum potential future payments. These joint venture communities are

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currently in lease up and one of the joint ventures had exhausted its lease up reserve under the existing loan commitment. The Company will be required to fund any operating deficits until the joint venture reaches breakeven for three consecutive months. Any amounts funded by the Company under this commitment, up to \$0.5 million, may be recoverable from the joint venture in the event of liquidation. As of December 31, 2010, the Company had recognized deficit charges of approximately \$0.4 million under these development agreement guarantees. The Company does not currently anticipate funding any deficits in excess of the amounts estimated to be recoverable from the joint ventures.

Assets Held for Sale

Assets are classified as held for sale when the Company has committed to selling the asset and believes that it will be disposed of within one year. The Company determines the fair value, net of costs of disposal, of an asset on the date the asset is categorized as held for sale, and the asset is recorded at the lower of its fair value, net of cost of disposal, or carrying value on that date. The Company periodically reevaluates assets held for sale to determine if the assets are still recorded at the lower of fair value, net of cost of disposal, or carrying value. The Company has one parcel of land classified as held for sale at December 31, 2010. The fair value of this property is generally determined based on market rates, industry trends and recent comparable sales transactions. The actual sales price of this asset could differ significantly from the Company's estimate.

Lease Accounting

The Company determines whether to account for its leases as either operating, capital or financing leases depending on the underlying terms of each lease agreement. This determination of classification is complex and requires significant judgment relating to certain information including the estimated fair value and remaining economic life of the community, the Company's cost of funds, minimum lease payments and other lease terms. As of December 31, 2010, the Company leased 45 communities and classified each of the leases as an operating lease. The Company incurs lease acquisition costs and amortizes these costs over the term of the lease agreement. Certain leases entered into by the Company qualified as sale/leaseback transactions and as such any related gains have been deferred and are being amortized over the lease term.

Facility lease expense in the Company's statement of income includes rent expense plus amortization expense relating to leasehold acquisition costs offset by the amortization of deferred gains and lease incentives.

Long-Lived Assets

Property and equipment are stated at cost and depreciated on a straight-line basis over the estimated useful lives of the assets. The estimated useful lives are 10 to 40 years for buildings and building improvements, 3 to 10 years for leasehold improvements, 5 to 20 years for land improvements and 5 to 10 years for furniture, equipment and automobiles.

At each balance sheet date, the Company reviews the carrying value of its property and equipment to determine if facts and circumstances suggest that they may be impaired or that the depreciation period may need to be changed. The Company considers internal factors such as net operating losses along with external factors relating to each asset, including contract changes, local market developments, and other publicly available information. The carrying value of a long-lived asset is considered impaired when the anticipated undiscounted cash flows from such asset is separately identifiable and is less than its carrying value. In that event, a loss is recognized based on the amount the carrying value exceeds the fair market value, generally based on discounted cash flows, of the long-lived asset. The Company analyzed certain long-lived assets with operating losses, under the undiscounted cash flow method, for impairment. The Company does not believe there are any material indicators that would require, and the cash flow

analysis did not require, an adjustment to the carrying value of the property and equipment or their remaining useful lives as of December 31, 2010 and 2009.

Table of Contents***Income Taxes***

At December 31, 2010, the Company had recorded on its consolidated balance sheet deferred tax assets of approximately \$4.8 million. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management regularly evaluates the future realization of deferred tax assets and provides a valuation allowance, if considered necessary, based on such evaluation. The Company has evaluated future expectations of net income and various tax planning strategies that it believes are both prudent and feasible, including various strategies to utilize net built-in gains on the Company's appreciated assets. However, the benefits of the net deferred tax assets might not be realized if actual results differ from expectations. The Company believes based upon this analysis that the realization of the net deferred tax assets is reasonably assured and therefore has not provided for a valuation allowance.

The Company evaluates uncertain tax positions through consideration of accounting and reporting guidance on thresholds, measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition that is intended to provide better financial-statement comparability among different companies. The Company is required to recognize a tax benefit in its financial statements for an uncertain tax position only if management's assessment is that its position is more likely than not (i.e., a greater than 50 percent likelihood) to be upheld on audit based only on the technical merits of the tax position. The Company's policy is to recognize interest related to unrecognized tax benefits as interest expense and penalties as income tax expense. The Company is not subject to income tax examinations for tax years prior to 2006.

Recently Issued Accounting Guidance

In August 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standard Updates (ASU) 2010-24, Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries, which clarifies that a health care entity generally remains liable for payment of claims and retains the risk of loss for that claim even if an insurance entity is paying for the defense of the claim and ultimately pays for some or all of the award or settlement. It was concluded that gross presentation of the claim reflects that the health care entity remains obligated for the claim and that the entity is exposed to credit risk from the insurer until the claim has been resolved. The guidance provided in this ASU is effective for the fiscal years, and interim periods within those years, beginning after December 15, 2010. The adoption of this standard is not expected to have a significant impact on the Company's financial condition, results of operations or cash flows.

FASB Accounting Standards Codification (ASC) 810-10 (formerly FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R)) requires an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity. This analysis identifies the primary beneficiary of a variable interest entity as the enterprise that has both the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. This guidance also requires ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity and was effective for the Company on January 1, 2010. The adoption did not have an impact on the Company's financial condition, results of operations, or cash flows.

Table of Contents**Results of Operations**

The following tables set forth, for the periods indicated, selected historical consolidated statements of income data in thousands of dollars and expressed as a percentage of total revenues.

	Year Ended December 31,					
	2010		2009		2008	
	\$	%	\$	%	\$	%
Revenues:						
Resident and healthcare revenue	\$ 196,936	92.9%	\$ 171,194	89.2%	\$ 172,025	89.0%
Unaffiliated management services revenue	60	0.0	72	0.0	194	0.1
Affiliated management services revenue	2,044	1.0	2,698	1.4	4,882	2.5
Community reimbursement income	12,889	6.1	18,027	9.4	16,173	8.4
Total revenues	211,929	100.0	191,991	100.0	193,274	100.0
Expenses:						
Operating expenses (exclusive of facility lease expense and depreciation and amortization shown below)	119,614	56.4	104,790	54.6	107,315	55.5
General and administrative expenses	11,535	5.5	11,883	6.2	13,654	7.1
Facility lease expense	34,253	16.2	25,872	13.4	25,057	13.0
Provision for bad debts	174	0.1	344	0.2	556	0.3
Stock-based compensation	919	0.4	1,201	0.6	1,036	0.5
Depreciation and amortization	14,030	6.6	13,262	6.9	12,468	6.5
Community reimbursement expense	12,889	6.1	18,027	9.4	16,173	8.4
Total expenses	193,414	91.3	175,379	91.3	176,259	91.2
Income from operations	18,515	8.7	16,612	8.7	17,015	8.8
Other income (expense):						
Interest income	48	0.0	67	0.0	422	0.2
Interest expense	(11,242)	(5.3)	(11,819)	(6.2)	(12,217)	(6.3)
Gain on settlement of debt	684	0.3				
Gain on sale of properties					681	0.4
Write-down of assets held for sale					(134)	(0.1)
Write-off of deferred loan costs						
Other income	(330)	(0.1)	107	0.1	270	0.1
Income before income taxes	7,675	3.6	4,967	2.6	6,037	3.1
Provision for income taxes	(3,421)	(1.6)	(2,208)	(1.2)	(2,313)	(1.2)
Net income	\$ 4,254	2.0%	\$ 2,759	1.4%	\$ 3,724	1.9%

Year Ended December 31, 2010 Compared to the Year Ended December 31, 2009

Revenues

Total revenues were \$211.9 million for the year ended December 31, 2010, compared to \$192.0 million for the year ended December 31, 2009, representing an increase of approximately \$19.9 million, or 10.4%. This increase in revenue is primarily the result of a \$25.7 million increase in resident and healthcare revenue offset by a decrease in affiliated management services revenue of \$0.7 million and a \$5.1 million decrease in community reimbursement revenue.

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The increase in resident and healthcare revenue primarily results from an increase of \$15.5 million from the consolidation of eight communities previously owned by Midwest I and Midwest II that were sold to HCN and leased back by the Company in April 2010, an increase of \$9.3 million from the addition of the leasehold interests in 12 communities from Signature in September 2010, and an increase in occupancy of 0.3% which was partially offset by a decrease in average rental rates of 0.5% at the Company's other consolidated communities.

The decrease in affiliated management services revenue of \$0.7 million primarily results from the sale of the eight communities owned by Midwest I and Midwest II to HCN and leased back by the Company in April 2010.

Community reimbursement revenue is comprised of reimbursable expenses from non-consolidated communities that the Company operates under long-term management agreements. The decrease in community reimbursement revenue of \$5.1 million primarily results from the sale of the eight communities owned by Midwest I and Midwest II to HCN and leased back by the Company in April 2010.

Expenses

Total expenses were \$193.4 million in fiscal 2010 compared to \$175.4 million in fiscal 2009, representing an increase of \$18.0 million, or 10.3%. This increase is primarily the result of a \$14.8 million increase in operating expenses, a \$8.4 million increase in facility lease expense, and a \$0.8 million increase in depreciation and amortization expense offset by a \$0.3 million decrease in general and administrative expenses, a \$0.3 million decrease in stock-based compensation, a \$0.2 million decrease in the provision for bad debts, and a decrease in community reimbursement expense of \$5.1 million.

The increase in operating expenses primarily results from an increase of \$8.9 million from the consolidation of eight communities previously owned by Midwest I and Midwest II that were sold to HCN and leased back by the Company in April 2010, an increase of \$5.0 million from the addition of the leasehold interests in 12 communities from Signature in September 2010, and an increase in operating costs at the Company's other consolidated communities of \$0.9 million primarily due to an increase in labor and benefit costs of \$0.6 million and utilities of \$0.3 million.

The increase in facility lease expense primarily results from an increase of \$4.8 million from the consolidation of eight communities previously owned by Midwest I and Midwest II that were sold to HCN and leased back by the Company in April 2010, \$2.7 million from the addition of the leasehold interests in 12 communities from Signature in September 2010, and \$0.9 million for contingent annual rental rate escalations for certain existing leases.

Depreciation and amortization expense increased \$0.8 million primarily as a result of an increase in depreciable assets at the Company's consolidated communities.

General and administrative expenses decreased \$0.3 million primarily due to a decrease in employee benefit claims paid, which resulted in lower health insurance costs to the Company.

Stock-based compensation decreased \$0.3 million due to a decrease in the number of unvested restricted shares outstanding.

The provision for bad debts decreased \$0.2 million due to better collection results of resident accounts receivable during fiscal 2010.

Community reimbursement expense represents payroll and administrative costs paid by the Company for the benefit of non-consolidated communities and joint ventures. The decrease in community reimbursement expense of \$5.1 million primarily results from the sale of the eight communities owned by Midwest I and Midwest II to HCN and leased back by the Company in April 2010.

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Other income and expense

Interest income results from interest earned on investment of cash balances and escrowed funds. Interest income decreased primarily due to lower interest rates in fiscal 2010 when compared to fiscal 2009.

Interest expense decreased \$0.6 million to \$11.2 million in fiscal 2010 compared to \$11.8 million in fiscal 2009. This decrease in interest expense primarily results from lower debt outstanding combined with a slightly lower average interest rate during fiscal 2010 compared to fiscal 2009.

Gain on settlement of debt represents the recognition of the gain associated with the pay-off settlement of the promissory note with the Lehman securitized trust in April 2010.

Other (expense) income in fiscal 2010 and 2009 relates to the Company's equity in the net losses of unconsolidated affiliates, which represents the Company's share of the net losses on its investments in joint ventures.

Provision for income taxes

Provision for income taxes for fiscal 2010 was \$3.4 million, or 44.6% of income before taxes, compared to a provision for income taxes of \$2.2 million, or 44.5% of income before taxes, for fiscal 2009. The effective tax rates for fiscal 2010 and 2009 differ from the statutory tax rates due to state income taxes and permanent tax differences. The Company is impacted by the Texas Margin Tax (TMT) and Michigan Business Tax (MBT), which effectively impose taxes on modified gross revenues for communities within the States of Texas and Michigan, respectively. As of December 31, 2010, the Company consolidated 29 Texas communities and two Michigan communities and the TMT and MBT increased the overall provision for income taxes. Management regularly evaluates the future realization of deferred tax assets and provides a valuation allowance, if considered necessary, based on such evaluation. The Company has evaluated future expectations of net income and various tax planning strategies that it believes are both prudent and feasible including various strategies to utilize net built-in gains on the Company's appreciated assets. The Company believes, based upon this analysis, that the realization of the net deferred tax asset is reasonably assured and therefore has not provided for a valuation allowance.

Net income

As a result of the foregoing factors, the Company reported net income of \$4.3 million for the fiscal year ended December 31, 2010 compared to net income of \$2.8 million for the fiscal year ended December 31, 2009.

Year Ended December 31, 2009 Compared to the Year Ended December 31, 2008

Revenues

Total revenues were \$192.0 million for the year ended December 31, 2009, compared to \$193.3 million for the year ended December 31, 2008, representing a decrease of approximately \$1.3 million or 0.7%. This decrease in revenue was primarily the result of a \$0.8 million decrease in resident and healthcare revenue, a \$2.2 million decrease in affiliated management services revenue, and a \$0.1 million decrease in unaffiliated management services revenue offset by an increase in community reimbursement revenue of \$1.8 million.

Resident and healthcare revenue decreased \$0.8 million, or 0.5%, primarily due to a decrease in average occupancy of 1.4% partially offset by an increase in average revenue collected of 2.2% at the Company's

consolidated communities.

The decrease in affiliated management services revenue of \$2.2 million, or 44.7%, primarily resulted from the Company no longer earning development and marketing fees from three joint venture communities that were under development during fiscal 2008.

The decrease in unaffiliated management services revenue of \$0.1 million primarily resulted from the management of one community owned by a third party during fiscal 2009 compared to two communities owned by third parties during fiscal 2008.

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Community reimbursement revenue is comprised of reimbursable expenses from non-consolidated communities that the Company operates under long-term management agreements.

Expenses

Total expenses were \$175.4 million for the year ended December 31, 2009, compared to \$176.3 million for the year ended December 31, 2008, representing a decrease of \$0.9 million, or 0.5%. This decrease was primarily the result of a \$2.5 million decrease in operating expenses, a \$1.8 million decrease in general and administrative expenses, and a \$0.2 million decrease in bad debt expense, offset by a \$1.9 million increase in community reimbursement expense, a \$0.8 million increase in depreciation and amortization expense, a \$0.8 million increase in facility lease expense, and a \$0.1 million increase in stock-based compensation.

Operating expenses decreased \$2.5 million, or 2.4%, primarily due to a reduction of \$2.1 million in independent living expenses, a reduction of \$0.3 million in assisted living expenses, and a reduction of \$0.3 million in insurance expense offset by an increase in healthcare expenses of \$0.1 million. Decreases in independent living expenses primarily consisted of a decrease in labor and benefit costs of \$0.7 million, a decrease in food costs of \$0.5 million, a decrease in utilities costs of \$0.2 million, and a net decrease of \$0.7 million in other general independent living operating costs. Assisted living expenses decreased primarily due to a decrease in employee benefit costs. Insurance expense decreased due to an improved claims history which allowed for lower negotiated premium renewals during fiscal 2009. Healthcare expenses increased due to a net increase in other general healthcare operating costs.

General and administrative expenses decreased \$1.8 million, or 13%, primarily due to the write-off of accumulated due diligence costs of \$0.6 million during fiscal 2008 related to a potential acquisition that the Company terminated and a reduction in corporate compensation of \$1.2 million due to the reduction of corporate employees.

Depreciation and amortization expense increased \$0.8 million primarily as a result of an increase in depreciable assets at the Company's consolidated communities and leasehold improvements.

Facility lease costs increased \$0.8 million primarily due to contingent annual rental rate escalations for existing leases.

Stock-based compensation increased \$0.1 million during fiscal 2009 compared to fiscal 2008 primarily due to the award of additional restricted shares of common stock to certain employees of the Company.

Community reimbursement expense represents payroll and administrative costs paid by the Company for the benefit of non-consolidated communities and joint ventures.

Other income and expense

Interest income reflects interest earned on the investment of cash balances and interest earned on escrowed funds. Interest income decreased \$0.4 million primarily due to lower interest rates in fiscal 2009 compared to fiscal 2008.

Interest expense decreased \$0.4 million to \$11.8 million in fiscal 2009 compared to \$12.2 million in fiscal 2008. This decrease in interest expense primarily resulted from less debt outstanding during fiscal 2009 compared to fiscal 2008.

Gain on sale of assets in fiscal 2008 represented gains associated with the sale of two parcels of land of \$0.7 million and the amortization of a deferred gain on the sale of the Richmond Heights land in fiscal 2007 to a joint venture in which the Company has an equity interest, offset by a \$0.1 million impairment adjustment on a parcel of land, located in Fort Wayne, Indiana, which is classified as held for sale.

Other income (expense) in fiscal 2009 and 2008 relates to the Company's equity in the earnings/losses of unconsolidated affiliates, which represents the Company's share of the earnings or losses on its investments in joint ventures.

Table of Contents*Provision for income taxes*

Provision for income taxes for fiscal 2009 was \$2.2 million, or 44.5% of income before taxes, compared to a provision for income taxes of \$2.3 million, or 38.3% of income before taxes, for fiscal 2008. The effective tax rates for fiscal 2009 and 2008 differ from the statutory tax rates due to state income taxes and permanent tax differences. The Company is significantly impacted by the TMT and MBT, which effectively impose taxes on modified gross revenues for communities within the States of Texas and Michigan. The Company consolidated 17 Texas communities and two Michigan communities in fiscal 2009 and the TMT and MBT increased the overall provision for income taxes. Management regularly evaluates the future realization of deferred tax assets and provides a valuation allowance, if considered necessary, based on such evaluation. The Company has evaluated future expectations of net income and various tax planning strategies that it believes are both prudent and feasible, including various strategies to utilize net built-in gains on the Company's appreciated assets. However, the benefits of the net deferred tax assets might not be realized if actual results differ from expectations. The Company believes, based upon this analysis, that the realization of net deferred tax assets is reasonably assured and therefore has not provided for a valuation allowance.

Net income

As a result of the foregoing factors, the Company reported net income of \$2.8 million for the fiscal year ended December 31, 2009, compared to net income of \$3.7 million for the fiscal year ended December 31, 2008.

Quarterly Results

The following table presents certain unaudited quarterly financial information for each of the four quarters ended December 31, 2010 and 2009, respectively. This information has been prepared on the same basis as the audited Consolidated Financial Statements of the Company appearing elsewhere in this report and include, in the opinion of the Company's management, all adjustments (consisting of normal recurring adjustments) necessary to present fairly the quarterly results when read in conjunction with the audited Consolidated Financial Statements of the Company and the related notes thereto.

	2010 Calendar Quarters			
	First	Second	Third	Fourth
	(In thousands, except per share amounts)			
Total revenues	\$ 47,908	\$ 50,513	\$ 53,600	\$ 59,908
Income from operations	4,066	4,714	3,760	5,975
Net income	725	1,458	481	1,590
Net income per share, basic	\$ 0.03	\$ 0.05	\$ 0.02	\$ 0.06
Net income per share, diluted	\$ 0.03	\$ 0.05	\$ 0.02	\$ 0.06
Weighted average shares outstanding, basic	26,540	26,575	26,607	26,624
Weighted average shares outstanding, fully diluted	26,638	26,670	26,703	26,732

	2009 Calendar Quarters			
	First	Second	Third	Fourth
	(In thousands, except per share amounts)			
Total revenues	\$ 47,975	\$ 47,205	\$ 48,114	\$ 48,697

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Income from operations	4,286	3,759	4,219	4,348
Net income	820	429	750	760
Net income per share, basic	\$ 0.03	\$ 0.02	\$ 0.03	\$ 0.03
Net income per share, diluted	\$ 0.03	\$ 0.02	\$ 0.03	\$ 0.03
Weighted average shares outstanding, basic	26,346	26,187	26,222	26,275
Weighted average shares outstanding, fully diluted	26,395	26,272	26,351	26,395

Table of Contents**Liquidity and Capital Resources**

The impact of the current economic environment could result in decreases in the fair value of assets, slowing of transactions, and tightening liquidity and credit markets. These impacts could make securing debt for acquisitions or refinancings for the Company, its joint ventures, or buyers of the Company's properties more difficult or on terms not acceptable to the Company. Additionally, the Company may be more susceptible to being negatively impacted by operating or performance deficits based on the exposure associated with certain development guarantees or lease coverage requirements.

In addition to approximately \$31.2 million of unrestricted cash balances on hand as of December 31, 2010, the Company's principal sources of liquidity are expected to be cash flows from operations, cash flows from SHPIII/CSL Miami, SHPIII/CSL Richmond Heights, SHPIII/CSL Levis Commons, SHPII/CSL, debt refinancings, and/or proceeds from the sale of assets. The Company expects its available cash and cash flows from operations, cash flows from SHPIII/CSL Miami, SHPIII/CSL Richmond Heights, SHPIII/CSL Levis Commons, and SHPII/CSL, and proceeds from the sale of assets to be sufficient to fund its short-term working capital requirements. The Company's long-term capital requirements, primarily for acquisitions and other corporate initiatives, could be dependent on its ability to access additional funds through joint ventures and the debt and/or equity markets. The Company from time to time considers and evaluates transactions related to its portfolio including refinancings, purchases and sales, reorganizations and other transactions. There can be no assurance that the Company will continue to generate cash flows at or above current levels or that the Company will be able to obtain the capital necessary to meet the Company's short and long-term capital requirements.

In summary, the Company's cash flows were as follows (in thousands):

173,437 \$ 576,493 513,846

a. Segment Data

Summarized financial information for the Company's reportable segments as of, and for, the three and nine months ended March 31, 2013 and 2012, is shown in the following tables:

	Three Months Ended March 31, 2013			Three Months Ended March 31, 2012		
	Net Sales	Operating Income (Loss)	Income Before Taxes	Net Sales	Operating Income (Loss)	Income Before Taxes
GMI	\$ 185,712	12,635	10,563	\$ 156,745	22,482	21,329
Globe Metais	—	—	—	—	—	—
Globe Metales	10,005	(5,861)	(6,481)	15,035	2,424	1,879
Solsil	—	(20,552)	(20,552)	—	(280)	(280)
Corporate	—	(20,224)	(20,687)	—	(4,755)	(4,718)
Other	2,836	(8,177)	(8,312)	7,831	(566)	(617)
Eliminations	(2,708)	(467)	(467)	(6,174)	645	645
Total	\$ 195,845	(42,646)	(45,936)	\$ 173,437	19,950	18,238

	Nine Months Ended March 31,				Nine Months Ended March 31,		
	2013	Income (Loss)		Total	2012	Income (Loss)	
	Net Sales	Operating Income (Loss)	Before Income Taxes	Assets	Net Sales	Operating Income (Loss)	Before Income Taxes
GMI	\$ 535,249	59,064	56,548	699,017	\$ 458,212	79,191	76,346
Globe Metais	—	—	—	—	—	(2)	(2)
Globe Metales	37,843	(3,164)	(4,658)	75,364	48,201	8,845	7,581
Solsil	—	(20,987)	(20,987)	9,351	—	(786)	(786)
Corporate	—	(49,960)	(51,277)	408,423	—	(17,239)	(15,963)
Other	8,299	(9,941)	(10,136)	29,569	22,320	841	507
				(322,839)			
Eliminations	(4,898)	(754)	(754)		(14,887)	3,795	3,795
Total	\$ 576,493	(25,742)	(31,264)	898,885	\$ 513,846	74,645	71,478

The accounting policies of the Company's operating segments are the same as those disclosed in note 2 (Summary of Significant Accounting Policies) to our June 30, 2012 financial statements. The Company evaluates segment performance principally based on operating income (loss).

b. Geographic Data

Net sales are attributed to geographic regions based upon the location of the selling unit. Net sales by geographic region for the three and nine months ended March 31, 2013 and 2012 consist of the following:

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
United States	\$154,512	156,694	\$445,889	457,969
Argentina	7,560	13,520	33,208	42,219
Canada	31,104	—	89,264	—
China	42	209	246	2,496
Poland	2,627	3,014	7,886	11,162
Total	\$195,845	173,437	\$576,493	513,846

Long-lived assets by geographical region at March 31, 2013 and June 30, 2012 consist of the following:

	March	
	31, 2013	June 30, 2012
United States	\$330,814	330,724
Argentina	24,725	31,185
Canada	103,001	100,842
China	17,229	26,288
Poland	902	939
Total	\$476,671	489,978

Long-lived assets consist of property, plant, and equipment, net of accumulated depreciation, depletion and amortization, and goodwill and other intangible assets.

c. Major Customer Data

The following is a summary of the Company's major customers and their respective percentages of consolidated net sales for the three and nine months ended March 31, 2013 and 2012:

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Dow Corning	17%	13%	19%	12%
Momentive Performance Materials	12%	5%	9%	9%
All other customers	71%	82%	72%	79%
Total	100%	100%	100%	100%

The majority of sales to Dow Corning for the three and nine months ended March 31, 2013 and 2012 are associated with Dow Corning's 49% ownership interest in WVA LLC and QSLP. Sales to Dow Corning and Momentive Performance Materials are included in the GMI segment.

(19) Business Interruption Insurance Recovery

In November 2011, there was a fire at the Bridgeport, Alabama ferrosilicon plant. The Company recorded and received business interruption insurance recovery payments totaling \$4,046 throughout March 2013.

Prior to acquisition, there was a fire at the Quebec Silicon plant. The Company recorded and received a business interruption insurance recovery payment totaling \$548 in March 2013.

(20) Subsequent Events

On May 1, 2013 the Company announced that the Board of Directors authorized the repurchase of common stock of up to \$75,000 over an eight month period. As of the date of this filing, no shares have been repurchased.

On May 3, 2013 the Company announced that it exercised its right to lockout union employees at the Company's affiliate, Quebec Silicon Limited Partnership, which operates a 47,000 MT silicon metal plant in Bécancour, Quebec.

On May 7, 2013 the Company amended its \$300,000 multi-currency revolving credit agreement with the consent and approval of the lenders. The credit agreement was amended to allow, at the Company's option, the ability to pay a dividend before June 30, 2013, subject to approval by the Company's Board of Directors, and to modify the conditions under which dividends can be paid in fiscal 2014.

The Company has evaluated subsequent events through the date these financial statements were issued.

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

This Quarterly Report on Form 10-Q contains "forward-looking statements" as that term is used in the Private Securities Litigation Reform Act of 1995. Certain statements made in this quarterly report involve risks and uncertainties. These forward-looking statements reflect the Company's best judgment based on our current expectations, assumptions, estimates, and projections about us and our industry, and although we base these statements on circumstances that we believe to be reasonable when made, there can be no assurance that future events will not affect the accuracy of such forward-looking information. As such, the forward-looking statements are not guarantees of future performance, and actual results may vary materially from the results and expectations discussed in this report. Factors that might cause the Company's actual results to differ materially from those anticipated in forward-looking statements are more fully described in the "Risk Factors" sections contained in our Annual Report on Form 10-K for the fiscal year ended June 30, 2012 and in this Quarterly Report. The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included elsewhere in this report, as well as the more detailed information in our Annual Report on Form 10-K for the fiscal year ended June 30, 2012.

Introduction

Globe Specialty Metals, Inc., together with its subsidiaries (collectively, "we" or "our") is one of the leading manufacturers of silicon metal and silicon-based alloys. As of March 31, 2013, we owned and operated six principal manufacturing facilities and coal mines, in two primary operating segments: GMI, our U.S. operations and, Globe Metales, our Argentine operations.

Business Segments

We operate in six reportable segments:

• **GMI** — a manufacturer of silicon metal and silicon-based alloys located in North America with plants in Beverly, Ohio, Alloy, West Virginia, Niagara Falls, New York, Selma, Alabama, Bridgeport, Alabama and Bécancour, Quebec and a provider of specialty metallurgical coal for the silicon metal and silicon-based alloys industries located in Corbin, Kentucky;

• **Globe Metais** — a distributor of silicon metal manufactured in Brazil. This segment includes the historical Brazilian manufacturing operations, previously comprised of a manufacturing plant in Breu Branco and mining operations and forest reserves, which were all sold on November 5, 2009;

• **Globe Metales** — a manufacturer of silicon-based alloys located in Argentina with a silicon-based alloys plant in Mendoza and a cored-wire fabrication facility in San Luis;

• **Solsil** — a developer and manufacturer of upgraded metallurgical grade silicon metal located in the United States with operations in Beverly, Ohio;

- **Corporate** — a corporate office including general expenses, investments, and related investment income; and

• **Other** — includes an electrode production operation in China (Yonvey) and a cored-wire production facility located in Poland. These operations do not fit into the above reportable segments, and are immaterial for purposes of separate disclosure.

Overview and Recent Developments

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Sales and shipments increased in the third quarter compared to the second quarter and compared to the third quarter of fiscal 2012. The end markets for silicon metal, including chemicals and aluminum, appear to be improving. Silicon metal customers are generally reporting an increase in volumes and the need for additional Globe products.

Shipments for the third quarter increased 14% compared to the third quarter of fiscal 2012, as a result of the acquisition of Quebec Silicon in June 2012 and increased 12% from the second quarter of fiscal 2013 as a result of higher customer demand. Silicon metal average selling prices declined 4% in the quarter compared to the third quarter of last fiscal year as our annual contracts renewed at lower prices for calendar 2013, which was partially offset by higher prices from the cost-plus arrangement with our joint venture partner at the newly acquired Quebec Silicon plant. Silicon-based alloy average selling prices declined 10% in the quarter due to market conditions and foreign competition.

Net sales for the quarter ended March 31, 2013 increased \$22,408,000, or 13%, from the quarter ended March 31, 2012, as a result of a 14% increase in tons shipped partially offset by a 4% reduction in average selling price of silicon metal and silicon-based alloys. The increase in sales from the prior year relates to the Quebec Silicon acquisition. Net sales increased \$15,905,000, or 9%, from the quarter ended December 31, 2012 as a result of a 12% increase in tons shipped partially offset by a 4% reduction in average selling prices of silicon metal and silicon-based alloys.

Gross profit for the quarter ended March 31, 2013 decreased \$19,422,000, or 57%, from the quarter ended March 31, 2012 as a result of the reduction in average selling prices and an increase in production costs. The reduction in average selling prices served to reduce gross margin by approximately \$11,000,000 and the increase in production costs reduced gross margin by approximately \$8,000,000. The higher production costs included: 1) lower contribution margin from Alden Resources directly related to higher mining costs due to lower coal production; 2) higher production costs at Alloy, West Virginia, Niagara Falls, New York, Beverly, Ohio and Bridgeport, Alabama primarily related to maintenance outages and production inefficiencies; 3) higher production costs related to a planned maintenance outage in Argentina; and, 4) costs relating to adding an additional quartz wash plant at Alabama Sand and Gravel. In total, more than two-thirds of these incremental production costs were directly related to planned maintenance outages and an intentional reduction in coal inventory.

We did not expect the planned maintenance outages in the third quarter to negatively impact our costs to the extent they did. The outage in Alloy, West Virginia was on the Company's largest furnace. It was taken down in December 2012 for a major overhaul that was more extensive and took longer to complete and re-start than planned. The maintenance outage in Argentina and the installation of additional capacity at our quartz mine in Alabama took longer and were more costly than expected. We have undertaken an analysis of the entire outage process including engineering and execution to ensure that we do not encounter the unplanned downtime to this extent in the future. With outages, come lost production, maintenance expense and under absorbed fixed costs.

Globe took \$50,439,000 of impairment charges in the quarter ended March 31, 2013 to write-down the value of several international and non-core operations as follows: 1) \$16,935,000 to write-off Nigerian exploratory mining licenses which, based on local instability and security risks, no longer support a viable business opportunity; 2) \$20,374,000 to write-down equipment and inventory originally acquired to manufacture solar grade silicon using a production technology which is no longer commercially viable; 3) \$7,130,000 to write-down goodwill related to Globe's electrode factory in China which is operating at less than full capacity; and, 4) \$6,000,000 to write-down goodwill related to Globe's business in Argentina which is experiencing declining earnings primarily due to reduced steel production in Europe.

Loss before benefit for income taxes totaled \$45,936,000 in the quarter ended March 31, 2013. During the quarter ended March 31, 2013, the impairment charges reduced pre-tax income by \$50,439,000, the re-measurement of our liability-classified stock option awards reduced pre-tax income by \$534,000, a gain on the re-measurement of an equity investment added \$170,000 to pre-tax income, transaction and due diligence expenses negatively impacted

pre-tax income by \$312,000 and the receipt of business interruption insurance proceeds added \$4,594,000 to pre-tax income. This compares to income before provision for income taxes in the quarter ended March 31, 2012 of \$18,238,000, which included pre-tax transaction and due diligence costs of \$1,047,000.

Outlook

Customer demand in the United States is good, in particular with the major silicones and aluminum producers reporting good volume, but Europe remains weak. This has resulted in modest supply and demand imbalances. We believe the stage is being set for more robust times generally but we cannot predict timing. We have entered into contracts to sell approximately 80% of our silicon metal capacity for calendar 2013. More than half of those contracts are index-based containing monthly or quarterly adjustments tied to those indices. Indications are that the silicon metal indices may rise in calendar 2013, but they are presently approximately \$0.20 per pound lower than the beginning of calendar 2012. As our average selling price for the third quarter indicated, the current average price of our total book of fixed-priced contracts and index-based contracts is higher than the current spot index. The actual price we realize on silicon metal sales during calendar 2013 will vary based on movements in spot prices and the indices.

We expect that the planned maintenance outages that were taken in the third quarter will translate into more efficient operations in the future, which will start to be realized in the fourth quarter and more fully realized in future quarters. To improve overall costs, we continue to look at all areas of the Company and will take strong measures, such as the lockout at the Becancour, Quebec plant taken to address high labor costs and to significantly improve the cost structure in order to make that plant competitive with the cost structures of our other plants.

We anticipate taking one major and two minor planned maintenance outages in the fourth quarter and have not finalized our plan for fiscal 2014.

Overall, we expect earnings in the fourth quarter to increase modestly from the third quarter, excluding the impairment and other items mentioned above, despite the impact of the work stoppage in Becancour, Quebec.

Critical Accounting Policies

We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities. Management bases our estimates and judgments on historical experience and other factors that are believed to be reasonable under the circumstances. Actual results may differ from the estimates used under different assumptions or conditions. We have provided a description of significant accounting policies in the notes to our condensed consolidated financial statements and our Annual Report on Form 10-K for the fiscal year ended June 30, 2012. Our critical accounting policies have not significantly changed from those discussed in “Part II — Item 7. — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies” of our Annual Report on Form 10-K for the fiscal year ended June 30, 2012. Matters that, in future periods, may result in updates to certain estimates and assumptions involving the application of certain of the Company’s critical accounting policies are presented below.

Results of Operations

GSM Three months ended March 31, 2013 vs. 2012

Consolidated Operations:

		Three Months Ended		
	2013	March 31, 2012	Increase (Decrease)	Percentage Change

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(Dollars in thousands)

Results of Operations				
Net sales	\$ 195,845	173,437	22,408	12.9%
Cost of goods sold	181,238	139,408	41,830	30.0%
Selling, general and administrative expenses	13,330	13,979	(649)	(4.6%)
Research and development	—	100	(100)	NA
Business interruption insurance recovery	(4,594)	—	(4,594)	NA
Goodwill impairment	13,130	—	13,130	NA
Impairment of long-lived assets	35,387	—	35,387	NA
Operating (loss) income	(42,646)	19,950	(62,596)	(313.8%)
Gain on remeasurement of equity investment	170	—	170	NA
Interest expense, net	(1,595)	(1,569)	(26)	1.7%
Other loss	(1,865)	(143)	(1,722)	1,204.2%
(Loss) income before (benefit from) provision for income taxes	(45,936)	18,238	(64,174)	(351.9%)
(Benefit from) provision for income taxes	(5,941)	5,972	(11,913)	(199.5%)
Net (loss) income	(39,995)	12,266	(52,261)	(426.1%)
Income attributable to noncontrolling interest, net of tax	(140)	(653)	513	(78.6%)
Net (loss) income attributable to Globe Specialty Metals, Inc.	\$ (40,135)	11,613	(51,748)	(445.6%)

Net Sales:

	Three Months Ended March 31, 2013 Net Sales			Three Months Ended March 31, 2012 Net Sales		
	\$ (in 000s)	MT	\$/MT	\$ (in 000s)	MT	\$/MT
	Silicon metal	\$ 112,602	40,310	\$ 2,793	\$ 87,653	30,210
Silicon-based alloys	60,164	29,072	2,069	70,039	30,618	2,287
Silicon metal and silicon-based alloys	172,766	69,382	2,490	157,692	60,828	2,592
Silica fume and other	23,079			15,745		
Total net sales	\$ 195,845			\$ 173,437		

Net sales increased \$22,408,000 or 13% from the prior year to \$195,845,000 primarily as a result of a 14% increase in metric tons sold, offset by a 4% decrease in average selling prices. The increase in sales volume was driven by a 33% increase in silicon metal tons sold, offset by a 5% decrease in silicon-based alloys tons sold, resulting in an increase of \$25,767,000. The increase in silicon metal volume was entirely due to the acquisition of Quebec Silicon on June 13, 2012 which contributed 10,250 tons during the third quarter of fiscal 2013. The decrease in silicon-based alloys was primarily due to the planned major maintenance at our Argentine facility in the third quarter of fiscal 2013.

The average selling price of silicon metal decreased 4% and the average selling price of silicon-based alloys decreased 10% in the third quarter of fiscal year 2013 as compared to the third quarter of fiscal year 2012. The decrease in silicon metal pricing was due to lower pricing on calendar 2013 contracts, including lower pricing on index-based contracts, and the effect of selling 49% of the silicon metal volume from the Becancour, Quebec joint venture at cost plus a modest margin. The decrease in silicon-based alloys pricing was due to weaker pricing in the marketplace driven by end-user demand, particularly in Europe and a mix shift to lower price ferrosilicon products.

Other revenue increased \$7,334,000 due to an increase in third party coal sales from Alden Resources, the acquisition of Quebec Silicon and the step acquisition of a 50% interest in an existing equity investment.

Cost of Goods Sold:

The \$41,830,000 or 30% increase in cost of goods sold was a result of a 14% increase in metric tons sold and 13% increase in cost per ton sold. The increase in cost per ton sold is primarily due to the impact of the planned major maintenance performed on several of our furnaces during the third quarter of fiscal 2013, including a 60 day outage on our largest furnace at our Alloy, West Virginia facility, a 31 day outage on a furnace at our Niagara Falls, New York facility, a 10 day outage on our only furnace at our Bridgeport, Alabama facility and a 30 day outage on one of our two furnaces at our Argentine facility. Additionally, the acquisition of Quebec Silicon, which increased the mix of silicon metal sales which has higher production costs than silicon-based alloys also increased our cost per ton sold. Furthermore, a write-down of \$1,922,000 due to expected lower net realizable values for certain Solsil inventories resulted in higher cost of goods sold.

Gross margin represented approximately 7% of net sales in the third quarter of fiscal year 2013 and decreased from 20% of net sales in the third quarter of fiscal year 2012. This decrease was primarily as a result of a higher cost per ton sold, lower silicon metal and silicon-based alloy selling prices, and the write-down of inventories.

Selling, General and Administrative Expenses:

The decrease in selling, general and administrative expenses of \$649,000 or 5% was primarily due to a reduction in variable-based compensation of \$1,932,000 and reduction of due diligence and transaction related costs of \$735,000. This was partially offset by an increase in stock based compensation expense of approximately \$390,000 from the remeasurement of outstanding liability classified option awards and vesting of awards in the third quarter of fiscal 2013. In addition, the acquisition of Quebec Silicon increased expenses by \$782,000 in the third quarter of fiscal year 2013.

Business Interruption Insurance Recovery:

In the third quarter of fiscal year 2013, we recognized business interruption proceeds of \$4,594,000, of which \$4,046,000 was related to the fire at our Bridgeport, Alabama facility in the second quarter of fiscal year 2012.

Goodwill Impairment

Impairment of goodwill recognized in the third quarter of fiscal year 2013 was approximately \$13,130,000.

During the quarter ended March 31, 2013, we recognized an impairment charge to write-off goodwill associated with our electrode business in China (Yonvey) as a result of delays in our ability to develop a new production method that caused us to revise our expected future cash flows. In estimating the fair value of Yonvey, we considered cash flow projections using assumptions about, among other things, overall market conditions and successful cost rationalization initiatives (principally through the development of new production methods that will enable sustainable quality and

pricing). We made a downward revision in the forecasted cash flows from our Yonvey reporting unit which resulted in an impairment of the entire goodwill balance of approximately \$7,800,000. The impairment charge is recorded within the Other reporting segment. As of March 31, 2013, the carrying value of the property, plant and equipment at Yonvey is expected to be recovered by the undiscounted future cash flows associated with the asset group. Yonvey is currently testing new raw materials for use in new production methods. Deterioration in overall market conditions or our inability to execute our cost rationalization initiatives (through development of new production methods or other means) could have a negative effect on these assumptions, and might result in an impairment of Yonvey's long lived assets in the future.

During the quarter ended March 31, 2013, in connection with our annual goodwill impairment test, we recognized an impairment charge of \$6,000,000 related to the partial impairment of goodwill at our silicon-based alloy business in Argentina (Metales) resulting from sustained sales price declines that caused us to revise our expected future cash flows. The impairment charge is recorded within the Metales reporting segment. Fair value was estimated based on discounted cash flows and market multiples. Estimates under our discounted income based approach involve numerous variables including anticipated sales price and volumes, cost structure, discount rates and long term growth that are subject to change as business conditions change, and therefore could impact fair values in the future. As of March 31, 2013, the fair value of Metales' reporting unit exceeded the carrying value of the reporting unit by less than 10%. The remaining goodwill is \$8,313,000 as of March 31, 2013.

Impairment of long-lived assets:

Impairment of long-lived assets recognized in the third quarter of fiscal year 2013 was approximately \$35,387,000.

In recent years, Solsil has been focused on research and development projects and was not producing material for commercial sale. Although we expected to expand operations through the construction of new facilities using new technologies, the falling prices of polysilicon make further research and development pursuits commercially not viable. During the quarter ended March 31, 2013, we recognized an impairment charge of \$18,452,000 to write-off equipment related to Solsil as a result of our decision to take these assets out of service which was done, in response to sustained pricing declines that have rendered our production methods uneconomical. The amount of the impairment charge was determined by comparing the estimated fair value (assumed to be zero) of the assets to their carrying amount. The impairment is recorded within the Solsil reporting segment.

In 2011, we acquired exploration licenses related to certain mines located in Nigeria, which granted us the right to explore for, among other things, manganese ore, a raw material used in the production of certain silicon and manganese based alloys. During the quarter ended March 31, 2013, based upon difficulties encountered in gaining secure access to the mines, we determined that exploration of these mines is not feasible and have decided to abandon our plan to conduct exploration activities. Accordingly, we recognized an impairment charge of \$16,935,000 (representing the aggregate carrying amount of the licenses) during the quarter ended March 31, 2013. The impairment has been recorded to the Corporate segment.

Gain on Remeasurement of Equity Investment:

In the third quarter of fiscal year 2013, we recorded an adjustment of \$170,000 to the gain recognized on the fair value remeasurement on our existing 50% equity investment. This adjustment was as a result of the purchase of the remaining 50% interest in an existing equity investment during the second quarter of fiscal year 2013.

Net Interest Expense:

Net interest expense increased by \$26,000 primarily due higher average debt outstanding following the acquisition of Quebec Silicon on June 13, 2012 offset by the refinancing to the multi-currency revolving credit facility at a lower interest rate.

Other loss:

Other loss increased by \$1,722,000 primarily due to the revaluation of a U.S. dollar loan at a foreign subsidiary, the devaluation of the Argentine peso and the mark-to-market of foreign exchange forward contracts.

(Benefit from) Provision for Income Taxes:

(Benefit from) income taxes as a percentage of pre-tax income was approximately 13% or (\$5,941,000) in the third quarter of fiscal year 2013 and was approximately 33% or \$5,972,000 in the third quarter of fiscal year 2012. The decrease in the effective tax rate was mainly attributable to the fact that no tax benefit was recorded for goodwill and certain long-lived asset impairments recognized in the third quarter of fiscal year 2013. The impairments occurred in jurisdictions that do not allow tax deductions for such items, or in jurisdictions in which it is more likely than not that the tax benefit will not be utilized with future taxable income.

Segment Operations

GMI

	Three Months Ended		Increase (Decrease)	Percentage Change
	2013	March 31, 2012		
	(Dollars in thousands)			
Results of Operations				
Net sales	\$ 185,712	156,745	28,967	18.5%
Cost of goods sold	168,495	126,541	41,954	33.2%
Selling, general and administrative expenses	9,176	7,722	1,454	18.8%
Business interruption insurance recovery	(4,594)	—	(4,594)	NA
Operating income	\$ 12,635	22,482	(9,847)	(43.8%)

Net sales increased by \$28,967,000 or 19% from the prior year to \$185,712,000. The increase was primarily attributable to a 20% increase in tons sold, offset by a 4% decrease in average selling prices. Silicon metal volume increased 33% primarily due to the acquisition of Quebec Silicon on June 13, 2012 which contributed 10,250 tons during the third quarter of fiscal 2013. Silicon-based alloys volume increased 4% primarily due to demand from the steel and automotive industries. Silicon metal pricing decreased 4% primarily due to lower pricing on calendar 2013 contracts, including lower pricing on index-based contracts, and the effect of selling 49% of the silicon metal volume from the Becancour, Quebec joint venture at cost plus a modest margin. Silicon-based alloys pricing decreased 10% due to weaker pricing and a mix shift to lower price ferrosilicon products.

Operating income decreased by \$9,847,000 from the prior year to \$12,635,000. The decrease was primarily due to an increase in cost per ton sold and decrease in average selling prices, offset by increase in tons sold and the business interruption insurance recovery. Cost of goods sold increase by 33% while sales volume increased by 20%. The increase in cost per ton sold is primarily due to the impact of the planned major maintenance performed on several of our furnaces during the third quarter of fiscal 2013, including a 60 day outage on our largest furnace in Alloy, West Virginia, a 31 day outage on a furnace at our Niagara Falls, New York facility and a 10 day outage at our only furnace at our Bridgeport, Alabama facility. Additionally, the acquisition of Quebec Silicon, which increased the mix of silicon metal sales which have higher production costs than silicon-based alloys also increased our cost per ton sold. The increase in selling, general and administrative expenses is mainly attributable to an increase of \$782,000 from the acquisition of Quebec Silicon and an increase in allowance for doubtful accounts in the third quarter of fiscal 2013.

Globe Metales

	Three Months Ended		
	March 31,	Increase	Percentage

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	2013	2012	(Decrease)	Change
	(Dollars in thousands)			
Results of Operations				
Net sales	\$ 10,005	15,035	(5,030)	(33.5%)
Cost of goods sold	9,440	11,621	(2,181)	(18.8%)
Selling, general and administrative expenses	426	990	(564)	(57.0%)
Goodwill impairment	6,000	—	6,000	NA
Operating (loss) income	\$ (5,861)	2,424	(8,285)	(341.8%)

Net sales decreased \$5,030,000 or 34% from the prior year to \$10,005,000. This decrease was primarily due to a 34% decrease volume and a 2% decrease in average selling price. Volume declined due to a 30 day planned major maintenance in the third quarter of fiscal year 2013 and weak demand from Europe. Overall pricing decreased primarily due to weaker demand from the steel market and continued weakness in Europe.

(Loss) income from operations decreased by \$8,285,000, from operating income of \$2,424,000 in the prior year to operating losses of (\$5,861,000). The decrease was primarily due to the recognition of goodwill impairment of \$6,000,000 during the third quarter of fiscal year 2013. This was further impacted by a higher cost per ton sold, lower volume and lower average selling prices. Cost of goods sold decreased by 19% while volume decreased by 34%. The increase in cost per ton sold was primarily due to the effects of the 30 day planned major maintenance outage.

Solsil

	Three Months Ended		Increase	Percentage
	2013	March 31, 2012	(Decrease)	Change
	(Dollars in thousands)			
Results of Operations				
Cost of goods sold	\$ 2,046	125	1,921	1,536.8%
Selling, general and administrative expenses	54	55	(1)	(1.8%)
Research and development	—	100	(100)	NA
Impairment of long-lived assets	18,452	—	18,452	NA
Operating loss	\$ (20,552)	(280)	(20,272)	(7,240.0%)

Net sales remained constant from the prior year at \$0. This was attributable to Solsil suspending commercial production during fiscal year 2010 as a result of a significant decline the price of polysilicon and the decline in demand for upgrades metallurgical silicon. We are concentrating our efforts on research and development activities focused on reducing the cost of production.

Operating loss increased by \$20,272,000 from the prior year to (\$20,552,000) mainly attributable to impairment charge recognized to write-off equipment as a result of our decision to indefinitely take these assets out of service in response to sustained pricing declines that have rendered its production methods uneconomical.

Corporate

	Three Months Ended		Increase (Decrease)	Percentage Change
	2013	March 31, 2012		
	(Dollars in thousands)			
Results of Operations				
Selling, general and administrative expenses	\$ 3,289	4,755	(1,466)	(30.8%)
Impairment of long-lived assets	16,935	—	16,935	NA
Operating loss	\$ (20,224)	(4,755)	(15,469)	(325.3%)

Operating loss increased by \$15,469,000 from the prior year to (\$20,224,000). Selling, general and administrative expenses decreased by \$1,466,000 primarily due to a reduction in variable-based compensation of \$1,932,000 and a reduction of due diligence and transaction related costs of \$735,000, offset by an increase in stock based compensation of \$390,000 and an increase in legal and professional fees.

Impairment of long-lived assets recognized in the third quarter of fiscal year 2013 was \$16,935,000. In December 2010, we acquired exploration licenses related to certain mines located in Nigeria, which granted us the right to explore for, among other things, manganese ore, a raw material used in the production of certain silicon and manganese based alloys. During the third quarter of fiscal year 2013, based upon difficulties encountered in gaining secure access to the mines, we determined that exploration of these mines is not feasible and have decided to abandon our plan to conduct exploration activities at these mines. Accordingly, we recognized an impairment charge of approximately \$16,935,000 (representing the aggregate cost basis of the licenses).

GSM Nine months ended March 31, 2013 vs. 2012

Consolidated Operations:

	Nine Months Ended		Increase (Decrease)	Percentage Change
	2013	March 31, 2012		
	(Dollars in thousands)			
Results of Operations				
Net sales	\$ 576,493	513,846	62,647	12.2%
Cost of goods sold	498,209	396,506	101,703	25.6%
Selling, general and administrative expenses	60,103	43,096	17,007	39.5%
Research and development	—	103	(103)	NA
Business interruption insurance recovery	(4,594)	(450)	(4,144)	920.9%
Goodwill impairment	13,130	—	13,130	NA
Impairment of long-lived assets	35,387	—	35,387	NA
Gain on sale of business	—	(54)	54	NA
Operating (loss) income	(25,742)	74,645	(100,387)	(134.5%)
Gain on remeasurement of equity investment	1,877	—	1,877	NA
Interest expense, net	(4,549)	(4,400)	(149)	3.4%
Other (loss) income	(2,850)	1,233	(4,083)	(331.1%)
(Loss) income before (benefit from) provision for income taxes	(31,264)	71,478	(102,742)	(143.7%)
(Benefit from) provision for income taxes	(1,837)	23,530	(25,367)	(107.8%)
Net (loss) income	(29,427)	47,948	(77,375)	(161.4%)

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Income attributable to noncontrolling interest, net of tax	(1,345)	(2,198)	853	(38.8%)
Net (loss) income attributable to Globe Specialty Metals, Inc.	\$ (30,772)	45,750	(76,522)	(167.3%)

Net Sales:

	Nine Months Ended March 31, 2013			Nine Months Ended March 31, 2012		
	Net Sales			Net Sales		
	\$ (in 000s)	MT	\$/MT	\$ (in 000s)	MT	\$/MT
Silicon metal	\$328,098	116,070	\$ 2,827	\$263,103	84,291	\$ 3,121
Silicon-based alloys	184,760	85,314	2,166	198,862	82,128	2,421
Silicon metal and silicon-based alloys	512,858	201,384	2,547	461,965	166,419	2,776
Silica fume and other	63,635			51,881		
Total net sales	\$576,493			\$513,846		

Net sales increased \$62,647,000 or 12% from the prior year to \$576,493,000 primarily as a result of a 21% increase in metric tons sold, offset by an 8% decrease in average selling prices. The increase in sales volume was driven by a 38% increase in silicon metal tons sold and a 4% increase in silicon-based alloys tons sold, resulting in an increase of \$106,908,000. The increase in silicon metal volume was due to the acquisition of Quebec Silicon on June 13, 2012 which contributed 29,357 tons during the nine months of fiscal 2013 and an increase due to the timing of shipments from our Alloy, West Virginia joint venture. The increase in silicon-based alloys was primarily due to increased demand from the steel and automotive industries in North America.

The average selling price of silicon metal decreased by 9%, and the average selling price of silicon-based alloys decreased by 11% in the first nine months of fiscal 2013 as compared to the first nine months of fiscal 2012. The decrease in silicon metal pricing was due to lower pricing on calendar 2012 and 2013 contracts, including lower pricing on index-based contracts, and the effect of selling 49% of the silicon volume from the Becancour, Quebec plant joint venture at cost plus a modest margin. The decrease in silicon-based alloys pricing was due to weaker pricing in the marketplace driven by end-user demand, particularly in Europe and a mix shift to lower price ferrosilicon products.

Other revenue increased \$11,754,000 due to an increase in third party coal sales from Alden Resources, the acquisition of Quebec Silicon and the step acquisition of a 50% interest in an existing equity investment.

Cost of Goods Sold:

The \$101,703,000 or 26% increase in cost of goods sold was a result of a 21% increase in metric tons sold and a 3% increase in cost per ton sold. The increase in cost per ton sold is primarily due to the impact of the planned major maintenance performed on several of our furnaces during the first nine months of fiscal year 2013, including a 60 day outage on our largest furnace in Alloy, West Virginia, a 31 outage on a furnace at our Niagara Falls, New York facility, a 10 day outage at our only furnace at our Bridgeport, Alabama facility, and a 30 day outage on one of our two furnaces at our Argentine facility. Additionally, the acquisition of Quebec Silicon, which increased the mix of silicon metal sales which has higher production costs than silicon-based alloys also increased our cost per ton sold. Furthermore, a write-down of \$1,922,000 due to expected lower net realizable values for certain Solsil inventories resulted in higher cost of goods sold. These increases were partially offset by costs associated with the fire at our Bridgeport, Alabama ferrosilicon facility and planned major maintenance on six of our domestic furnaces in the first nine months of fiscal 2012.

Gross margin represented approximately 14% of net sales in the first nine months of fiscal year 2013 and decreased from 23% of net sales in the first nine months of fiscal year 2012. This decrease was a result of lower silicon metal and silicon-based alloy selling prices, higher cost per ton sold and the write-down of inventories.

Selling, General and Administrative Expenses:

The increase in selling, general and administrative expenses of \$17,007,000 or 40% was primarily due to an increase in stock based compensation expense of approximately \$21,068,000 of which \$18,983,000 represents the remeasurement of compensation cost resulting from the remeasurement and vesting of outstanding liability classified option awards. In addition, the acquisition of Quebec Silicon increased expenses of \$1,871,000 in the first nine months of fiscal year 2013. This was offset by a reduction in variable-based compensation of \$4,219,000 and a reduction of due diligence and transaction related costs of \$1,275,000.

Business Interruption Insurance Recovery:

In the first nine months of fiscal year 2013, we recognized business interruption proceeds of \$4,594,000, of which \$4,046,000 was related to the fire at our Bridgeport, Alabama facility. In the first nine months of fiscal year 2012, we recognized business interruption proceeds of \$450,000.

Goodwill Impairment

Impairment of goodwill recognized in the first nine months of fiscal year 2013 was approximately \$13,130,000.

During the quarter ended March 31, 2013, we recognized an impairment charge to write-off goodwill associated with our electrode business in China (Yonvey) as a result of delays in our ability to develop a new production method that caused us to revise our expected future cash flows. In estimating the fair value of Yonvey, we considered cash flow projections using assumptions about, among other things, overall market conditions and successful cost rationalization initiatives (principally through the development of new production methods that will enable sustainable quality and pricing). We made a downward revision in the forecasted cash flows from our Yonvey reporting unit which resulted in an impairment of the entire goodwill balance of approximately \$7,800,000. The impairment charge is recorded within the Other reporting segment. As of March 31, 2013, the carrying value of the property, plant and equipment at Yonvey is expected to be recovered by the undiscounted future cash flows associated with the asset group. Yonvey is currently testing new raw materials for use in new production methods. Deterioration in overall market conditions or our inability to execute our cost rationalization initiatives (through development of new production methods or other means) could have a negative effect on these assumptions, and might result in an impairment of Yonvey's long lived

assets in the future.

During the quarter ended March 31, 2013, in connection with our annual goodwill impairment testing, we recognized an impairment charge of \$6,000,000 related to the partial impairment of goodwill at our silicon-based alloy business in Argentina (Metales) resulting from sustained sales price declines that caused us to revise our expected future cash flows. The impairment charge is recorded within the Metales reporting segment. Fair value was estimated based on discounted cash flows and market multiples. Estimates under our discounted income based approach involve numerous variables including anticipated sales price and volumes, cost structure, discount rates and long term growth that are subject to change as business conditions change, and therefore could impact fair values in the future. As of March 31, 2013, the fair value of Metales' reporting unit exceeded the carrying value of the reporting unit by less than 10%. The remaining goodwill is \$8,313,000 as of March 31, 2013.

Impairment of long-lived assets:

Impairment of long-lived assets recognized in the first nine months of fiscal year 2013 was approximately \$35,387,000.

In recent years, Solsil has been focused on research and development projects and was not producing material for commercial sale. Although we expected to expand operations through the construction of new facilities using new technologies, the falling prices of polysilicon make further research and development pursuits commercially not viable. During the quarter ended March 31, 2013, we recognized an impairment charge of \$18,452,000 to write-off equipment related to Solsil as a result of our decision to take these assets out of service which was done, in response to sustained pricing declines that have rendered our production methods uneconomical. The amount of the impairment charge was determined by comparing the estimated fair value of the assets (assumed to be zero) to their carrying amount. The impairment is recorded within the Solsil reporting segment.

In 2011, we acquired exploration licenses related to certain mines located in Nigeria, which granted us the right to explore for, among other things, manganese ore, a raw material used in the production of certain silicon and manganese based alloys. During the quarter ended March 31, 2013, based upon difficulties encountered in gaining secure access to the mines, we determined that exploration of these mines is not feasible and have decided to abandon our plan to conduct exploration activities. Accordingly, we recognized an impairment charge of \$16,935,000 (representing the aggregate carrying amount of the licenses) during the quarter ended March 31, 2013. The impairment has been recorded to the Corporate segment.

Gain on Sale of Business:

The gain on sale of business for the first nine months of fiscal year 2012 was the result of a subsequent settlement associated with the sale of our Brazilian manufacturing operations on November 5, 2009.

Gain on Remeasurement of Equity Investment:

In the first nine months of fiscal year 2013, we purchased the remaining 50% interest in an existing equity investment. We recognized a gain on the fair value remeasurement on our existing 50% equity investment.

Net Interest Expense:

Net interest expense increased by \$149,000 primarily due to higher average debt outstanding following the acquisition of Quebec Silicon on June 13, 2012, offset by the refinancing to the multi-currency revolving credit facility at a lower interest rate.

Other (loss) income:

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Other loss increased by \$4,083,000, from income of \$1,233,000 to a loss of (\$2,850,000), primarily due to the revaluation of a U.S. dollar loan at a foreign subsidiary, the devaluation of the Argentine peso and the mark-to-market of foreign exchange forward contracts, offset by the foreign exchange gains from the revaluation of long-term Brazilian reais denominated liabilities in the prior year.

(Benefit from) Provision for Income Taxes:

Benefit from income taxes as a percentage of pre-tax income was approximately 6% or (\$1,837,000) in the first nine months of fiscal year 2013 and provision for income taxes was approximately 33% or \$23,530,000 in the first nine months of fiscal year 2012. The decrease in the effective tax rate was mainly attributable to the fact that no tax benefit was recorded for goodwill and certain long-lived asset impairments recognized in the first nine months of fiscal year 2013. The impairments occurred in jurisdictions that do not allow tax deductions for such items, or in jurisdictions in which it is more likely than not that the tax benefit will not be utilized with future taxable income.

Segment Operations

GMI

	Nine Months Ended		Increase (Decrease)	Percentage Change
	2013	March 31, 2012		
	(Dollars in thousands)			
Results of Operations				
Net sales	\$ 535,249	458,212	77,037	16.8%
Cost of goods sold	456,899	358,689	98,210	27.4%
Selling, general and administrative expenses	23,880	20,782	3,098	14.9%
Business interruption insurance recovery	(4,594)	(450)	(4,144)	920.9%
Operating income	\$ 59,064	79,191	(20,127)	(25.4%)

Net sales increased by \$77,037,000 or 17% from the prior year to \$535,249,000. The increase was primarily attributable to a 25% increase in tons sold, offset by a 7% decrease in average selling prices. Silicon metal volume increased 38% primarily due to the acquisition of Quebec Silicon on June 13, 2012 which contributed 29,357 tons during the first nine months of fiscal 2013 and an increase due to the timing of shipments from our Alloy, West Virginia joint venture. Silicon-based alloys volume increased 8% primarily due to increased demand from the steel and automotive industries. Silicon metal pricing decreased by 9% primarily due to lower pricing on calendar 2012 and 2013 contracts, including lower pricing on index-based contracts, and the effect of selling 49% of the silicon metal volume from the Becancour, Quebec joint venture at cost plus a modest margin. Silicon-based alloys pricing decreased 8% due to a reduction in both ferrosilicon and magnesium ferrosilicon pricing driven by pricing pressure from imports.

Operating income decreased by \$20,127,000 from the prior year to \$59,064,000. This decrease was primarily due to lower average selling prices for silicon metal and silicon-based alloys offset by an increase in volume. Cost of goods sold increased by 27% while shipments increased by 25%. The increase in cost per ton sold is primarily due to the acquisition of Quebec Silicon, which increased the mix of silicon metal sales, a product with higher cost of production, partially offset by the impact of the fire at our Bridgeport facility during the first nine months of fiscal year 2012. Additionally, selling, general and administrative expenses increased by \$3,098,000 as a result of the acquisition of Quebec Silicon and an increase in allowance for doubtful accounts in the first nine months of fiscal year 2013.

Globe Metales

	Nine Months Ended		Increase (Decrease)	Percentage Change
	2013	March 31, 2012		

(Dollars in thousands)

Results of Operations				
Net sales	\$ 37,843	48,201	(10,358)	(21.5%)
Cost of goods sold	32,996	36,374	(3,378)	(9.3%)
Selling, general and administrative expenses	2,011	2,982	(971)	(32.6%)
Goodwill impairment	6,000	—	6,000	NA
Operating (loss) income	\$ (3,164)	8,845	(12,009)	(135.8%)

Net sales decreased \$10,358,000 or 22% from the prior year to \$37,843,000. This decrease was primarily due to a 13% decrease in volume and a 11% decrease in average selling price. Volume declined due to a 30 day planned major maintenance in the first nine months of fiscal year 2013 and weak demand from Europe. Overall pricing decreased due to weaker demand from the steel market, continued weakness in Europe and a mix shift from calcium silicon to ferrosilicon, a lower margin product.

(Loss) income from operations decreased by \$12,009,000, from operating income of \$8,845,000 in the prior year to operating losses of (\$3,164,000). The decrease was primarily due to the recognition of goodwill impairment of \$6,000,000 during the third quarter of fiscal year 2013. This was further impacted by lower average selling prices and decreased volume. Cost of goods sold decreased by 9% while shipments decreased by 13% due to a mix shift to ferrosilicon with lower margin. This was further impacted by the write-off of \$6,000,000 in goodwill impairment recorded during the third quarter of fiscal year 2013.

Solsil

	Nine Months Ended		Increase (Decrease)	Percentage Change
	2013	March 31, 2012		
(Dollars in thousands)				
Results of Operations				
Cost of goods sold	\$ 2,382	402	1,980	492.5%
Selling, general and administrative expenses	153	281	(128)	(45.6%)
Research and development	—	103	(103)	NA
Impairment of long-lived assets	18,452	—	18,452	NA
Operating loss	\$ (20,987)	(786)	(20,201)	(2,570.1%)

Net sales remained constant from the prior year at \$0. This was attributable to Solsil suspending commercial production during the fiscal year 2010 as a result of a significant decline the price of polysilicon and the decline in demand for upgrades metallurgical silicon. We are concentrating our efforts on research and development activities focused on reducing the cost of production.

Operating loss increased by \$20,201,000 from the prior year to (\$20,987,000) mainly attributable to impairment charge recognized to write-off equipment as a result of our decision to indefinitely take these assets out of service in response to sustained pricing declines that have rendered its production methods uneconomical.

Corporate

	Nine Months Ended		Increase (Decrease)	Percentage Change
	2013	March 31, 2012		
	(Dollars in thousands)			
Results of Operations				
Selling, general and administrative expenses	\$ 33,025	17,293	15,732	91.0%
Gain on sale of business	—	(54)	54	NA
Impairment of long-lived assets	16,935	—	16,935	NA
Operating loss	\$ (49,960)	(17,239)	(32,721)	(189.8%)

Operating loss increased by \$32,721,000 from the prior year to (\$49,960,000). Selling, general and administrative expenses increased by \$15,732,000 year over year primarily due to an increase in stock based compensation of approximately \$21,068,000 of which \$18,983,000 represents the remeasurement of liability classified option awards. This was offset by a reduction in variable-based compensation of \$4,219,000 and a reduction of due diligence and transaction related costs of \$1,275,000.

Impairment of long-lived assets recognized in the first nine months of fiscal year 2013 was \$16,935,000. In December 2010, we acquired exploration licenses related to certain mines located in Nigeria, which granted us the right to explore for, among other things, manganese ore, a raw material used in the production of certain silicon and manganese based alloys. During the first nine months of fiscal year 2013, based upon difficulties encountered in gaining secure access to the mines, we determined that exploration of these mines is not feasible and have decided to abandon our plan to conduct exploration activities at these mines. Accordingly, we recognized an impairment charge of approximately \$16,935,000 (representing the aggregate cost basis of the licenses).

Liquidity and Capital Resources

Sources of Liquidity

Our principal sources of liquidity are our cash and cash equivalents balance, cash flows from operations, and unused commitments under our existing credit facilities. At March 31, 2013, our cash and cash equivalents balance was approximately \$161,001,000, and we had \$183,514,000 available for borrowing under our existing financing arrangements. We generated cash flows from operations totaling \$39,757,000 during the nine months period ended March 31, 2013.

Certain of our subsidiaries borrow funds in order to finance working capital requirements and capital expansion programs. The terms of certain of our financing arrangements place restrictions on distributions of funds to us, however, we do not expect this to have an impact on our ability to meet our cash obligations. We believe we have access to adequate resources to meet our needs for normal operating costs, capital expenditure, and working capital for our existing business. Our ability to fund planned capital expenditures and make acquisitions will depend upon our future operating performance, which will be affected by prevailing economic conditions in our industry as well as financial, business and other factors, some of which are beyond our control.

We have been advised that the debt capital markets are strong and we are considering pursuing a private bond offering to refinance our revolving credit facility and provide funds for general corporate purposes, including acquisitions. Any such offering would be subject to market and other conditions.

Cash Flows

The following table is a summary of consolidated cash flows:

	Nine Months Ended March 31,	
	2013	2012
	(Dollars in thousands)	
Cash and cash equivalents at beginning of period	\$ 178,010	166,208
Cash flows provided by operating activities	39,757	47,671
Cash flows used in investing activities	(40,825)	(111,519)
Cash flows (used in) provided by financing activities	(14,419)	38,348
Effect of exchange rate changes on cash	(1,522)	(53)
Cash and cash equivalents at end of period	\$ 161,001	140,655

Operating Activities:

Our business is cyclical and cash flows from operating activities may fluctuate during the year and from year-to-year due to economic conditions.

Net cash provided by operating activities was \$39,757,000 and \$47,671,000 during the first nine months of fiscal years 2013 and 2012, respectively. Excluding the impact of the goodwill and long-lived assets impairment charges, the gain on remeasurement of equity investment and gain on sale of business, the \$7,914,000 decrease in net cash provided by operating activities was due to lower operating results partially offset by a decrease in working capital.

Investing Activities:

Net cash used in investing activities was approximately \$40,825,000 and \$111,519,000 during the first nine months of fiscal years 2013 and 2012, respectively. The \$70,694,000 decrease was due to the acquisition of Alden Resources, LLC in the first nine months of fiscal 2012 which resulted in the use of approximately \$73,194,000 in cash offset by the acquisition of the remaining 50% interest in an existing equity investment.

Financing Activities:

Net cash (used in) provided by financing activities was approximately (\$14,419,000) and \$38,348,000 during the first nine months of fiscal years 2013 and 2012, respectively. Net borrowings of approximately \$9,988,000 of long-term and short-term debt occurred during the first nine months of fiscal year 2013, as compared to net borrowings of \$55,309,000 in the first nine months of fiscal 2012. The net borrowings during the first nine months of fiscal year 2012 included \$55,000,000 for the acquisition of Alden Resources, LLC. Dividend payments of \$23,500,000 and \$15,007,000 were paid to our common stockholders during the first nine months of fiscal year 2013 and 2012, respectively. Proceeds from stock option exercises contributed \$1,000,000 and \$195,000 during the first nine months of fiscal year 2013 and 2012, respectively.

Exchange Rate Changes on Cash:

The effect of exchange rate changes on cash was related to fluctuations in the Canadian dollar, the functional currency of the Canadian subsidiary as well as fluctuations in the renminbi, the functional currency of our Chinese subsidiary.

Commitments and Contractual Obligations

Our commitments and contractual obligations have not changed significantly from those disclosed in “Part II — Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Commitments and Contractual Obligations” of our Annual Report on Form 10-K for the fiscal year ended June 30, 2012.

Off-Balance Sheet Arrangements

We do not have any material off-balance sheet arrangements or relationships with unconsolidated entities of financial partnerships, such as entities often referred to as structured finance or special purpose entities.

Litigation and Contingencies

We are subject to various lawsuits, investigations, claims and proceedings that arise in the normal course of business, including, but not limited to, employment, commercial, environmental, safety and health matters, as well as claims associated with our historical acquisitions and divestitures. Although it is not presently possible to determine the outcome of these matters, in the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

At March 31, 2013 and June 30, 2012, there are no significant liabilities recorded for environmental contingencies. With respect to the cost for ongoing environmental compliance, including maintenance and monitoring, such costs are expensed as incurred unless there is a long-term monitoring agreement with a governmental agency, in which case a liability is established at the inception of the agreement.

Recently Implemented Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) amended its accounting guidance on the presentation of comprehensive income in financial statements to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items that are recorded in other comprehensive income. The new accounting guidance requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The provisions of the guidance were effective as of the beginning of the Company’s 2013 fiscal year. Accordingly, we have presented the components of net income and other comprehensive income for the three and nine months ended March 31, 2013 and 2012 as two separate but consecutive statements. In February 2013, the FASB issued guidance that would require an entity to provide enhanced footnote disclosures to explain the effect of reclassification adjustments on other comprehensive income by component and provide tabular disclosure in the footnotes showing the effect of items reclassified from accumulated other comprehensive income on the line items of net income. This guidance becomes effective prospectively for the Company’s fiscal 2014 first quarter, with early adoption permitted. The Company will apply this new guidance when it becomes effective, and the adoption of this guidance is not expected to have a significant impact on its consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our market risks have not changed significantly from those disclosed in “Part II — Item 7A. — Quantitative and Qualitative Disclosures About Market Risk” of our Annual Report on Form 10-K for the fiscal year ended June 30, 2012.

Item 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer (our Principal Executive Officer and Principal Financial Officer, respectively), we have evaluated our disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e)) as of March 31, 2013. Based upon that evaluation, our Principal Executive Officers and Principal Financial Officer have concluded that our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

In the first nine months of fiscal year 2013, we implemented an SAP enterprise resource planning software system at our U.S. subsidiaries. SAP replaced our accounting and other systems that were used to record and report our financial results and associated disclosures. In conjunction with the SAP implementation, we modified the design, operation and documentation of our internal controls over financial reporting. Certain deficiencies during the implementation have been noted and the Company will continue to monitor and test these systems as part of management's annual evaluation of internal control over financial reporting.

Additionally, as previously announced, our Chief Financial Officer will depart the Company by the later of August 31, 2013, or the date that the Company's Annual Report on Form 10-K for the fiscal year ending June 30, 2013 is filed with the Securities and Exchange Commission.

Other than the matters mentioned above, there have been no changes in our internal control over financial reporting that occurred during the period covered by the report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

Item 1. Legal Proceedings

In the ordinary course of business, we are subject to periodic lawsuits, investigations, claims and proceedings, including, but not limited to, contractual disputes, employment, environmental, health and safety matters, as well as claims associated with our historical acquisitions and divestitures. Although we cannot predict with certainty the ultimate resolution of lawsuits, investigations, claims and proceedings asserted against us, we do not believe any currently pending legal proceeding to which we are a party will have a material adverse effect on our business, prospects, financial condition, cash flows, results of operations or liquidity.

Item 1A. Risk Factors

A description of the risks associated with our business, financial condition, and results of operations is set forth in “Part I — Item 1A. — Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended June 30, 2012. There have been no material changes in our risks from such description.

Item 4. Mine Safety Disclosure

The information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of Regulations S-K (17 CFR 229.104) is included in exhibit 95 to the quarterly report.

Item 6. Exhibits

Exhibit Number	Description of Document
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
32.1	Certification of the Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002†
95	Mine Safety Disclosure†
101	The following materials from our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 formatted in eXtensible Business Reporting Language (“XBRL”): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Comprehensive Income (Loss), (iv) the Condensed Consolidated Statements of Changes in Stockholders’ Equity, (v) the Condensed Consolidated Statements of Cash Flows, and (vi) notes to these condensed consolidated financial statements. *

† Filed herewith.

* In accordance with Rule 406T of Regulation S-T, the XBRL related documents in Exhibit 101 to this Quarterly Report on Form 10-Q are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or Section 12 of the Securities Act of 1933, as amended; are deemed not

filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended; and otherwise are not subject to liability under those Sections.

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.

Globe Specialty Metals, Inc.
(Registrant)

By: /s/ Jeff Bradley
Jeff Bradley
Chief Executive Officer

By: /s/ Malcolm Appelbaum
Malcolm Appelbaum
Chief Financial Officer

May 9, 2013

