

FIVE STAR QUALITY CARE INC

Form 10-Q

August 01, 2012

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

or

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

Commission File Number 001-16817

FIVE STAR QUALITY CARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland

(State or Other Jurisdiction of Incorporation or Organization)

04-3516029

(IRS Employer Identification No.)

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400 Centre Street, Newton, Massachusetts 02458

(Address of Principal Executive Offices) (Zip Code)

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

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Number of registrant's shares of common stock, \$.01 par value, outstanding as of July 31, 2012: 47,927,432.

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As used herein the terms “we”, “us” and “our” refer to Five Star Quality Care, Inc. and its consolidated subsidiaries unless otherwise noted.

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FIVE STAR QUALITY CARE, INC.

CONDENSED CONSOLIDATED BALANCE SHEET

(in thousands, except per share data)

(unaudited)

	June 30, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 23,635	\$ 28,374
Accounts receivable, net of allowance of \$4,348 and \$4,703 at June 30, 2012 and December 31, 2011, respectively	63,130	64,265
Investments in available for sale securities, of which \$5,851 and \$5,905 are restricted as of June 30, 2012 and December 31, 2011, respectively	14,993	9,114
Restricted cash	6,507	4,838
Prepaid expenses and other current assets	22,073	26,250
Assets of discontinued operations	8,401	8,675
Total current assets	138,739	141,516
Property and equipment, net	337,836	335,256
Equity investment in Affiliates Insurance Company	5,408	5,291
Restricted cash	6,313	4,092
Restricted investments in available for sale securities	11,299	13,115
Goodwill and other intangible assets	31,857	33,079
Other long term assets	50,233	51,128
	\$ 581,685	\$ 583,477
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Revolving credit facility, secured, principally by real estate	\$ 37,500	\$
Revolving credit facility, secured, principally by accounts receivable		
Accounts payable	24,766	23,899
Accrued expenses	23,742	21,705
Accrued compensation and benefits	45,388	39,704
Due to related persons	15,956	18,659
Mortgage notes payable	1,060	1,027
Bridge loan from Senior Housing Properties Trust		38,000
Accrued real estate taxes	11,378	11,505
Security deposit liability	10,033	10,606
Other current liabilities	17,421	15,745

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Liabilities of discontinued operations, of which \$7,619 and \$7,690 relate to mortgage notes payable at June 30, 2012 and December 31, 2011, respectively	8,491	8,481
Total current liabilities	195,735	189,331
Long term liabilities:		
Mortgage notes payable	38,175	38,714
Convertible senior notes	24,872	37,282
Continuing care contracts	1,838	2,045
Accrued self insurance obligations	28,296	28,496
Other long term liabilities	6,800	7,415
Total long term liabilities	99,981	113,952
Commitments and contingencies		
Shareholders' equity:		
Common stock, par value \$.01; 47,927 and 47,899 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively	479	479
Additional paid in capital	353,309	352,819
Accumulated deficit	(69,575)	(74,582)
Cumulative other comprehensive income	1,756	1,478
Total shareholders' equity	285,969	280,194
	\$ 581,685	\$ 583,477

See accompanying notes.

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FIVE STAR QUALITY CARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF INCOME

(in thousands, except per share data)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Revenues:				
Senior living revenue	\$ 278,076	\$ 265,387	\$ 554,296	\$ 528,041
Rehabilitation hospital revenue	26,386	26,337	53,173	51,962
Institutional pharmacy revenue	17,232	19,573	35,853	38,910
Management fee revenue	1,302	25	2,390	25
Reimbursed costs incurred on behalf of managed communities	26,098	562	49,503	562
Total revenues	349,094	311,884	695,215	619,500
Operating expenses:				
Senior living wages and benefits	136,618	133,079	274,992	262,840
Other senior living operating expenses	66,242	61,473	133,204	124,453
Costs incurred on behalf of managed communities	26,098	562	49,503	562
Rehabilitation hospital expenses	23,872	23,445	47,991	47,498
Institutional pharmacy expenses	17,258	18,642	36,008	37,531
Rent expense	50,297	47,841	100,524	95,340
General and administrative	15,389	14,154	30,844	27,824
Depreciation and amortization	6,709	4,616	13,025	8,921
Total operating expenses	342,483	303,812	686,091	604,969
Operating income	6,611	8,072	9,124	14,531
Interest and other income	246	331	463	649
Interest and other expense	(1,605)	(870)	(3,031)	(1,371)
Acquisition related costs		(1,202)		(1,304)
Equity in income of Affiliates Insurance Company	76	46	121	83
Gain on settlement	3,365		3,365	
Gain on early extinguishment of debt	45		45	1
Gain (loss) on sale of available for sale securities reclassified from other comprehensive income		51	(1)	127
Income from continuing operations before income taxes	8,738	6,428	10,086	12,716
Provision for income taxes	(3,807)	(441)	(4,409)	(820)
Income from continuing operations	4,931	5,987	5,677	11,896
Loss from discontinued operations	(293)	(791)	(670)	(2,567)
Net income	\$ 4,638	\$ 5,196	\$ 5,007	\$ 9,329
Weighted average shares outstanding - basic	47,914	37,179	47,906	36,602

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Weighted average shares outstanding - diluted	49,953	40,046	47,906	39,481
Basic income per share from:				
Continuing operations	\$ 0.10	\$ 0.16	\$ 0.12	\$ 0.33
Discontinued operations	(0.01)	(0.02)	(0.01)	(0.07)
Net income per share - basic	\$ 0.09	\$ 0.14	\$ 0.11	\$ 0.26
Diluted income per share from:				
Continuing operations	\$ 0.10	\$ 0.16	\$ 0.12	\$ 0.32
Discontinued operations	(0.01)	(0.02)	(0.01)	(0.07)
Net income per share - diluted	\$ 0.09	\$ 0.14	\$ 0.11	\$ 0.25

See accompanying notes.

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FIVE STAR QUALITY CARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Net income	\$ 4,638	\$ 5,196	\$ 5,007	\$ 9,329
Other comprehensive income				
Unrealized gain on investments in available for sale securities	94	322	281	803
Less: Realized (gain) loss on investments in available for sale securities reclassified and included in net income		(51)	1	(127)
Unrealized (loss) gain on equity investment in Affiliates Insurance Company	(3)	39	(4)	43
Other comprehensive income	91	310	278	719
Comprehensive income	\$ 4,729	\$ 5,506	\$ 5,285	\$ 10,048

See accompanying notes.

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FIVE STAR QUALITY CARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)

(unaudited)

	Six months ended June 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 5,007	\$ 9,329
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	13,025	8,921
Gain on early extinguishment of debt	(45)	(1)
Loss from discontinued operations	670	2,567
Loss (gain) on sale of available for sale securities	1	(127)
Equity in income of Affiliates Insurance Company	(121)	(83)
Stock-based compensation	490	464
Provision for losses on receivables	2,651	4,266
Changes in assets and liabilities:		
Accounts receivable	(1,516)	(2,451)
Prepaid expenses and other assets	4,747	172
Accounts payable and accrued expenses	2,904	(789)
Accrued compensation and benefits	5,684	9,099
Due to related persons	(2,703)	(424)
Other current and long term liabilities	(46)	502
Cash provided by operating activities	30,748	31,445
Net cash used in discontinued operations	(316)	(2,365)
Cash flows from investing activities:		
Acquisition of property and equipment	(28,478)	(30,052)
Acquisition of senior living communities, net of working capital assumed		(53,486)
Payments from restricted cash and investment accounts, net	(3,890)	(2,419)
Purchase of available for sale securities	(4,554)	
Proceeds from disposition of property and equipment held for sale	14,093	15,322
Proceeds from sale of available for sale securities	772	1,281
Cash used in investing activities	(22,057)	(69,354)
Cash flows from financing activities:		
Net proceeds from the issuance of common stock		54,350
Proceeds from borrowings on credit facilities	47,500	12,000
Repayments of borrowings on credit facilities	(10,000)	(12,000)
Proceeds from borrowings on bridge loan from Senior Housing Properties Trust		41,000
Repayments of borrowings on bridge loan from Senior Housing Properties Trust	(38,000)	(32,000)
Purchase and retirement of convertible senior notes	(12,038)	(604)
Repayments of mortgage notes payable	(576)	(84)
Cash (used in) provided by financing activities	(13,114)	62,662
Change in cash and cash equivalents during the period	(4,739)	22,388
Cash and cash equivalents at beginning of period	28,374	20,770
Cash and cash equivalents at end of period	\$ 23,635	\$ 43,158

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Supplemental cash flow information:			
Cash paid for interest	\$	2,751	\$ 1,195
Cash paid for income taxes	\$	1,235	\$ 1,042
Non-cash activities:			
Issuance of common stock	\$	114	\$ 298
Real estate acquisition	\$		\$ (19,952)
Assumption of mortgage notes payable	\$		\$ 19,952

See accompanying notes.

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FIVE STAR QUALITY CARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

Note 1. Basis of Presentation and Organization

The accompanying condensed consolidated financial statements of Five Star Quality Care, Inc. and its subsidiaries, which we refer to as we, us or our, have been prepared without audit. Certain information and disclosures required by U.S. generally accepted accounting principles, or GAAP, for complete financial statements have been condensed or omitted. We believe the disclosures made are adequate to make the information presented not misleading. However, the accompanying financial statements should be read in conjunction with the financial statements and notes contained in our Annual Report on Form 10-K for the year ended December 31, 2011, or our Annual Report. In the opinion of our management, all adjustments, which include only normal recurring adjustments, considered necessary for a fair presentation have been included. All material intercompany transactions and balances have been eliminated. Our operating results for interim periods are not necessarily indicative of the results that may be expected for the full year.

We operate senior living communities, including independent living communities, assisted living communities and skilled nursing facilities, or SNFs. As of June 30, 2012, we operated 247 senior living communities located in 30 states containing 27,497 living units, including 209 primarily independent and assisted living communities with 24,074 living units and 38 SNFs with 3,423 living units. As of June 30, 2012, we owned and operated 31 communities (2,954 living units), we leased and operated 191 communities (20,805 living units) and we managed 25 communities (3,738 living units). Our 247 senior living communities included 8,838 independent living apartments, 13,196 assisted living suites and 5,463 skilled nursing units. Two SNFs owned and operated by us containing 271 living units and one assisted living community leased from Senior Housing Properties Trust or its subsidiaries, or SNH, and operated by us containing 103 living units that we have classified as discontinued operations are excluded from all the preceding data in this paragraph.

We also lease and operate two rehabilitation hospitals with 321 beds that provide inpatient rehabilitation services to patients at the two hospitals and at three satellite locations. In addition, we lease and operate 13 outpatient clinics affiliated with these rehabilitation hospitals. We also own and operate five institutional pharmacies. On July 6, 2012, we entered into an agreement, or the Purchase Agreement, to sell our pharmacy business to Omnicare, Inc. and certain of its subsidiaries, or Omnicare (see Note 15).

Note 2. Property and Equipment

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

June 30,
2012

December 31,
2011

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Land	\$	21,339	\$	21,339
Buildings and improvements		275,714		272,384
Furniture, fixtures and equipment		104,223		97,205
		401,276		390,928
Accumulated depreciation		(63,440)		(55,672)
	\$	337,836	\$	335,256

As of June 30, 2012 and December 31, 2011, we had assets of \$8,354 and \$7,076, respectively, included in our property and equipment that we intend to sell to SNH for increased rent pursuant to the terms of our leases with SNH; however, we are not obligated to make these sales and SNH is not obligated to purchase the property and equipment.

Note 3. Financial Data by Segment

Our reportable segments consist of our senior living community business and our rehabilitation hospital business. In the senior living community segment, we operate for our own account and manage for the account of SNH independent living communities, assisted living communities and SNFs that are subject to centralized oversight and provide housing and services to elderly residents. Our rehabilitation hospital segment provides inpatient rehabilitation services to patients

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FIVE STAR QUALITY CARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

at two hospital locations and at three satellite locations and outpatient rehabilitation services at 13 affiliated outpatient clinics. We do not consider our institutional pharmacy operations to be a material, separately reportable segment of our business. Consequently, we report our institutional pharmacy revenues and expenses as separate items within our corporate and other activities. On July 6, 2012, we entered into the Purchase Agreement to sell our pharmacy business to Omnicare (see Note 15). All of our operations and assets are located in the United States, except for the operations of our captive insurance company subsidiary, which participates in our workers' compensation, professional liability and automobile insurance programs and which operates in the Cayman Islands.

We use segment operating profit as a means to evaluate our performance and for our business decision making purposes. Segment operating profit for our two reportable segments excludes interest and other income, interest and other expense, provision for income taxes, equity in income of Affiliates Insurance Company, or AIC, gains on settlement of litigation, sales of securities, and corporate income and expenses.

Our revenues by segment and a reconciliation of segment operating profit (loss) to income (loss) from continuing operations for the three and six months ended June 30, 2012 and 2011 are as follows:

	Senior Living Communities	Rehabilitation Hospitals	Corporate and Other(1)	Total
Three months ended June 30, 2012				
Segment revenues:				
Senior living, rehabilitation hospital and institutional pharmacy revenues	\$ 278,076	\$ 26,386	\$ 17,232	\$ 321,694
Management fee revenue	1,302			1,302
Reimbursed costs incurred on behalf of managed communities	26,098			26,098
Total segment revenues	305,476	26,386	17,232	349,094
Segment expenses:				
Operating expenses	202,860	23,872	17,258	243,990
Costs incurred on behalf of managed communities	26,098			26,098
Rent expense	47,641	2,656		50,297
Depreciation and amortization	5,770	53	886	6,709
Total segment expenses	282,369	26,581	18,144	327,094
Segment operating profit (loss)	23,107	(195)	(912)	22,000
General and administrative expenses(2)			(15,389)	(15,389)
Operating income (loss)	23,107	(195)	(16,301)	6,611
Interest and other income	19		227	246
Interest and other expense	(599)		(1,006)	(1,605)

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Equity in income of Affiliates Insurance Company				76		76
Gain on settlement				3,365		3,365
Gain on sale of available for sale securities				45		45
Provision for income taxes				(3,807)		(3,807)
Income (loss) from continuing operations	\$	22,527	\$	(195)	\$	(17,401)
					\$	4,931
Total Assets as of June 30, 2012	\$	486,428	\$	15,216	\$	80,041
					\$	581,685

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FIVE STAR QUALITY CARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

	Senior Living Communities	Rehabilitation Hospitals	Corporate and Other(1)	Total
Three months ended June 30, 2011				
Segment revenues:				
Senior living, rehabilitation hospital and institutional pharmacy revenues	\$ 265,387	\$ 26,337	\$ 19,573	\$ 311,297
Management fee revenue	25			25
Reimbursed costs incurred on behalf of managed communities	562			562
Total segment revenues	265,974	26,337	19,573	311,884
Segment expenses:				
Operating expenses	194,552	23,445	18,642	236,639
Costs incurred on behalf of managed communities	562			562
Rent expense	45,261	2,580		47,841
Depreciation and amortization	3,762	44	810	4,616
Total segment expenses	244,137	26,069	19,452	289,658
Segment operating profit	21,837	268	121	22,226
General and administrative expenses(2)			(14,154)	(14,154)
Operating profit (loss)	21,837	268	(14,033)	8,072
Interest and other income	19		312	331
Interest and other expense	(215)		(655)	(870)
Acquisition related costs			(1,202)	(1,202)
Equity in income of Affiliates Insurance Company			46	46
Gain on sale of available for sale securities			51	51
Provision for income taxes			(441)	(441)
Income (loss) from continuing operations	\$ 21,641	\$ 268	\$ (15,922)	\$ 5,987

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

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

Senior Living Communities	Rehabilitation Hospitals	Corporate and Other(1)	Total
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Six months ended June 30, 2012

Segment revenues:

Senior living, rehabilitation hospital and institutional pharmacy revenues	\$	554,296	\$	53,173	\$	35,853	\$	643,322
Management fee revenue		2,390						2,390
Reimbursed costs incurred on behalf of managed communities		49,503						49,503
Total segment revenues		606,189		53,173		35,853		695,215

Segment expenses:

Operating expenses		408,196		47,991		36,008		492,195
Costs incurred on behalf of managed communities		49,503						49,503
Rent expense		95,252		5,272				100,524
Depreciation and amortization		11,151		105		1,769		13,025
Total segment expenses		564,102		53,368		37,777		655,247

Segment operating profit (loss)		42,087		(195)		(1,924)		39,968
General and administrative expenses(2)						(30,844)		(30,844)
Operating income (loss)		42,087		(195)		(32,768)		9,124
Interest and other income		39				424		463
Interest and other expense		(1,206)				(1,825)		(3,031)
Equity in income of Affiliates Insurance Company						121		121
Gain on settlement						3,365		3,365
Gain on early extinguishment of debt						45		45
Loss on sale of available for sale securities						(1)		(1)
Provision for income taxes						(4,409)		(4,409)
Income (loss) from continuing operations	\$	40,920	\$	(195)	\$	(35,048)	\$	5,677

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FIVE STAR QUALITY CARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

	Senior Living Communities	Rehabilitation Hospitals	Corporate and Other ⁽¹⁾	Total
Six months ended June 30, 2011				
Segment revenues:				
Senior living, rehabilitation hospital and institutional pharmacy revenues	\$ 528,041	\$ 51,962	\$ 38,910	\$ 618,913
Management fee revenue	25			25
Reimbursed costs incurred on behalf of managed communities	562			562
Total segment revenues	528,628	51,962	38,910	619,500
Segment expenses:				
Operating expenses	387,293	47,498	37,531	472,322
Costs incurred on behalf of managed communities	562			562
Rent expense	90,179	5,161		95,340
Depreciation and amortization	7,235	86	1,600	8,921
Total segment expenses	485,269	52,745	39,131	577,145
Segment operating profit (loss)	43,359	(783)	(221)	42,355
General and administrative expenses ⁽²⁾			(27,824)	(27,824)
Operating income (loss)	43,359	(783)	(28,045)	14,531
Interest and other income	68		581	649
Interest and other expense	(214)		(1,157)	(1,371)
Acquisition related costs			(1,304)	(1,304)
Equity in income of Affiliates Insurance Company			83	83
Gain on early extinguishment of debt			1	1
Gain on sale of available for sale securities			127	127
Provision for income taxes			(820)	(820)
Income (loss) from continuing operations	\$ 43,213	\$ (783)	\$ (30,534)	\$ 11,896

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

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

Note 4. Goodwill and Other Intangible Assets

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The changes in the carrying amount of goodwill and other intangible assets from January 1, 2012 to June 30, 2012 are as follows:

	Senior Living Communities(1)	Corporate and Other(2)	Total
Balance as of January 1, 2012	\$ 29,413	\$ 3,666	\$ 33,079
Amortization of intangibles	(1,041)	(181)	(1,222)
Balance as of June 30, 2012	\$ 28,372	\$ 3,485	\$ 31,857

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FIVE STAR QUALITY CARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

(1) The goodwill and other intangible assets balance in our Senior Living Communities segment relate to management agreements and trademarks we acquired in connection with a lease we entered into with SNH in 2009, goodwill and resident agreements we acquired in connection with our purchase of six senior living communities located in Indiana (See Note 8) and goodwill of \$10,988 we recorded in connection with our senior living community acquisitions in previous years.

(2) Intangible assets in our Corporate and Other segment relate to customer agreements we acquired in connection with our pharmacy acquisitions.

Note 5. Income Taxes

During the fourth quarter of 2011 we evaluated the realizability of our net deferred tax assets, which include, among other things, our net operating losses, or NOL, and tax credits, and determined that it is more likely than not that we will realize the benefit of our deferred tax assets. As a result, we realized in the fourth quarter of 2011, the full amount of the valuation allowance we had previously maintained against these deferred tax assets of \$52,111. For the six months ended June 30, 2012, we recognized tax expense from continuing operations of \$4,409. We also recognized a tax benefit from discontinued operations of \$505. Our effective income tax rate increased during the six months ended June 30, 2012 to 43.7% compared to 8.4% in the prior year period primarily because our previous rate had been reduced from the statutory rate due to the full utilization of the previously maintained valuation allowance against our NOL carry forwards. As of December 31, 2011, our federal NOL carry forward, which begins to expire in 2025 if unused, was approximately \$100,710, and our tax credit carry forward, which begins to expire in 2022 if unused, was approximately \$6,820. Our NOL carry forwards and tax credit carry forwards are subject to audit and adjustments by the Internal Revenue Service.

We do not currently recognize the benefit of certain deferred tax assets related to capital losses because we have not historically been able to demonstrate that it is more likely than not we will realize such benefit. As further described in Note 15, on July 6, 2012, we entered into the Purchase Agreement to sell our pharmacy business to Omnicare. If that sale is completed, we expect to recognize a capitalized gain that would be sufficient an amount to allow us to realize the benefit of these deferred tax assets as an income tax benefit in our consolidated statement of income.

Note 6. Earnings Per Share

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We computed basic earnings per common share, or EPS, for the three and six months ended June 30, 2012 and 2011 using the weighted average number of shares outstanding during the periods. Diluted EPS for the periods ended June 30, 2012 and 2011 reflects additional shares of our common stock, \$.01 par value per share, or our common shares, related to our convertible senior notes due in 2026, or the Notes, that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income applicable to common shareholders that would result from their assumed issuance. The weighted average shares outstanding used to calculate basic and diluted EPS include 556 and 512 unvested common shares as of June 30, 2012 and 2011, respectively, issued to our officers and others under our equity compensation plan, or our Share Award Plan. Unvested shares issued under our Share Award Plan are deemed participating securities because they participate equally in earnings with all of our other common shares.

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

	Three Months Ended June 30,					
	2012			2011		
	Income (loss)	Shares	Per Share	Income (loss)	Shares	Per Share
Income from continuing operations	\$ 4,931	47,914	\$ 0.10	\$ 5,987	37,179	\$ 0.16
Effect of the Notes	149	2,039		335	2,867	
Diluted income from continuing operations	\$ 5,080	49,953	\$ 0.10	\$ 6,322	40,046	\$ 0.16
Diluted loss from discontinued operations	\$ (293)	49,953	\$ (0.01)	\$ (791)	40,046	\$ (0.02)

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FIVE STAR QUALITY CARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

	Six Months Ended June 30,					
	2012			2011		
	Income (loss)	Shares	Per Share	Income (loss)	Shares	Per Share
Income from continuing operations	\$ 5,677	47,906	\$ 0.12	\$ 11,896	36,602	\$ 0.33
Effect of the Notes				668	2,879	
Diluted income from continuing operations	\$ 5,677	47,906	\$ 0.12	\$ 12,564	39,481	\$ 0.32
Diluted loss from discontinued operations	\$ (670)	47,906	\$ (0.01)	\$ (2,567)	39,481	\$ (0.07)

Note 7. Fair Values of Assets and Liabilities

The information below presents the assets and liabilities that are measured at fair value on a recurring and non recurring basis at June 30, 2012, categorized by the level of inputs used in the valuation of each asset and liability.

Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Long lived assets held for sale (1)	\$ 8,354	\$	\$ 8,354
Long lived assets of discontinued operations (2)	8,401		8,401
Cash equivalents (3)	19,636	19,636	
Available for sale securities (4)			
Equity securities			
Financial services industry	6,661	6,661	
REIT industry	498	498	