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ARV ASSISTED LIVING INC  
Form 10-Q  
November 14, 2001

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

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(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001

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: 0-26980

ARV ASSISTED LIVING, INC.  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

33-0160968  
(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

245 FISCHER AVENUE, D-1  
COSTA MESA, CA  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICE)

92626  
(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (714) 751-7400

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

The number of outstanding shares of the Registrant's Common Stock, no par value, as of November 1, 2001 was 17,459,689.

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PART I. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS.

ARV ASSISTED LIVING, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)  
(IN THOUSANDS)

ASSETS

	SEPTEMBER 30, 2001	DECEMBER 31, 2000
	-----	-----
Current assets:		
Cash and cash equivalents.....	\$15,773	\$16,817
Accounts receivable and amounts due from affiliates.....	693	829
Prepays and other current assets.....	5,620	5,547
Properties held for sale, net.....	1,306	3,545
	-----	-----
Total current assets.....	23,392	26,738
Property, furniture and equipment, net.....	101,153	100,461
Goodwill, net.....	18,500	18,939
Operating lease security deposits.....	9,329	9,778
Other non-current assets.....	10,688	10,024
	-----	-----
	\$163,062	\$165,940
	=====	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Accounts payable.....	\$813	\$2,645
Accrued liabilities.....	10,580	11,956
Notes payable, current portion.....	12,344	1,071
Accrued interest payable.....	907	599
	-----	-----
Total current liabilities.....	24,644	16,271
Notes payable, less current portion.....	87,071	99,130
Lease liabilities.....	1,934	1,752
Other non-current liabilities.....	678	789
	-----	-----
	114,327	117,942
	-----	-----
Minority interest in majority owned entities.	144	1,130
Shareholders' equity:		
Series A Preferred stock, convertible and redeemable; 2,000 shares authorized, none issued or outstanding at September 30, 2001 and December 31, 2000.....	--	--
Preferred stock, no par value. 8,000 shares authorized, none issued and outstanding...	--	--
Common stock, \$0.01 par value. Authorized 100,000 shares; 17,460 shares issued and outstanding at September 30, 2001 and		

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December 31, 2000.....	175	175
Additional paid in capital.....	145,337	145,337
Accumulated deficit.....	(96,921)	(98,644)
	-----	-----
Total shareholders' equity.....	48,591	46,868
	-----	-----
Commitments and contingent liabilities		
	\$163,062	\$165,940
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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ARV ASSISTED LIVING, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000  
(UNAUDITED)  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS EN SEPTEMBER 30	
	2001	2000	2001	
	-----	-----	-----	-----
Revenue:				
Assisted living community revenue:				
Rental revenue	\$ 29,689	\$ 27,658	\$ 87,246	\$
Assisted living and other services	6,240	5,878	18,224	
Skilled nursing facility revenue	508	692	1,703	
Management fee income	248	207	807	
	-----	-----	-----	-----
Total revenue	36,685	34,435	107,980	
	-----	-----	-----	-----
Operating expenses:				
Assisted living community				
Operating expense	22,245	21,210	65,333	
Skilled nursing facility	667	601	1,851	
Community lease expense	7,784	7,642	23,163	
General and administrative	2,376	2,638	7,637	
Depreciation and amortization	1,889	2,144	5,877	
	-----	-----	-----	-----
Total operating expenses	34,961	34,235	103,861	
	-----	-----	-----	-----
Income (loss) from operations	1,724	200	4,119	
Other income (expense):				
Interest income	199	373	951	
Other income (expense), net	(83)	69	(148)	
Gain on sale of assets	--	--	2,887	
Interest expense	(2,236)	(2,157)	(6,853)	
	-----	-----	-----	-----
Total other expense	(2,120)	(1,715)	(3,163)	
	-----	-----	-----	-----
Income (loss) before income tax expense, minority interest in				

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income of majority owned entities and extraordinary item	(396)	(1,515)	956
Income tax benefit (expense)	28	(3)	(10)
Minority interest in income of majority owned entities	(371)	(44)	(773)
	-----	-----	-----
Income (loss) before extraordinary item	(739)	(1,562)	173
Extraordinary gain from early extinguishment of debt, net of income tax	--	9	1,550
	-----	-----	-----
Net income (loss)	\$ (739)	\$ (1,553)	\$ 1,723
	=====	=====	=====
Basic and diluted income (loss) per common share:			
Income (loss) before extraordinary item	\$ (0.04)	\$ (0.09)	\$ 0.01
Extraordinary gain from early extinguishment of debt, net of income tax	--	--	0.09
	-----	-----	-----
Net income (loss)	\$ (0.04)	\$ (0.09)	\$ 0.10
	=====	=====	=====
Weighted average common shares outstanding	17,460	17,460	17,460
	=====	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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ARV ASSISTED LIVING, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000  
(UNAUDITED)  
(IN THOUSANDS)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
	-----	-----
Net cash provided by (used in) operating activities:	\$ 4,358	\$ (1,273)
Cash flows used in investing activities:		
Proceeds from the sale of partnerships, net of selling cost .....	2,887	--
Additions to property, furniture and equipment ....	(4,523)	(3,634)
Proceeds from the sale of properties, net of selling cost.....	730	455
Decrease in property held for sale .....	59	--
Decrease in operating lease security deposits .....	449	613
	-----	-----
Net cash provided by (used in) investing activities .....	(398)	(2,566)
	-----	-----
Cash flows provided by financing activities:		

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Borrowing under refinancing for owned communities..	16,427	11,209
Borrowing under non-secured credit line .....	--	7,000
Payments of partnership obligations .....	(2,887)	--
Repayments of notes payable .....	(10,334)	(5,797)
Repayments of subordinated debt .....	(5,250)	(9,013)
Distributions to minority partners .....	(2,345)	(204)
Mortgage insurance .....	(200)	(701)
Loan fees .....	(415)	(176)
	-----	-----
Net cash provided by (used in) financing activities .....	(5,004)	2,318
	-----	-----
Net decrease in cash and cash equivalents ....	(1,044)	(1,521)
Cash and cash equivalents at beginning of period ....	16,817	14,570
	-----	-----
Cash and cash equivalents at end of period .....	\$ 15,773	\$ 13,049
	=====	=====
Supplemental schedule of cash flow information:		
Cash paid during the period for:		
Interest .....	\$ 6,545	\$ 6,227
	=====	=====
Supplemental schedule of non-cash investing activities:		
Conversion of subordinated notes to common stock ..	\$ --	\$ 1,232
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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ARV ASSISTED LIVING, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2001

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

We prepared the accompanying condensed consolidated financial statements of ARV Assisted Living, Inc. and subsidiaries ("the Company" or "ARV") following the requirements of the Securities and Exchange Commission ("SEC") for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by accounting principles generally accepted in the United States of America ("GAAP") can be condensed or omitted.

The financial statements include all normal and recurring adjustments that we consider necessary for the fair presentation of our financial position and operating results. These are condensed financial statements. To obtain a more detailed understanding of our results, you should also read the financial statements and notes in our Form 10-K for fiscal year ended December 31, 2000, which is on file with the SEC.

The results of operations can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year.

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### PRINCIPLES OF CONSOLIDATION

The condensed consolidated financial statements include the accounts of the Company and our subsidiaries. Subsidiaries, which include limited partnerships in which we have controlling interests, have been consolidated into the financial statements. All significant intercompany balances and transactions have been eliminated in consolidation.

### CARRYING VALUE OF REAL ESTATE

Property, furniture and equipment are stated at cost less accumulated depreciation which is charged to expense on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings and improvements.....	27.5 to 35 years
Leasehold property and improvements....	Lease term
Furniture, fixtures and equipment.....	3 to 7 years

### USE OF ESTIMATES

In preparing the financial statements conforming with GAAP, we have made estimates and assumptions that affect the following:

- reported amounts of assets and liabilities at the date of the financial statements;
- disclosure of contingent assets and liabilities at the date of the financial statements; and
- reported amounts of revenue and expenses during the reporting period.

Actual results could differ from those estimates.

### CASH AND EQUIVALENTS

For purposes of reporting cash flows, we consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

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### EARNINGS (LOSS) PER SHARE

Basic earnings per share ("EPS") excludes all dilution and is based upon the weighted average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised, or converted into common stock. The effect of fully dilutive securities was 381,613 shares for the nine months ended September 30, 2001 but, is not considered material. Potentially dilutive securities include convertible notes and stock options and warrants, which convert to 2,322,726 and 3,990,300 shares of common stock for the three-month, and nine-month periods ended September 30, 2001, and 2000, respectively.

### ACCOUNTING FOR LONG-LIVED ASSETS

We review our long-lived assets, including goodwill, for impairment when events or changes in circumstances indicate that the carrying amount of the assets may

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not be recoverable. In reviewing recoverability, we estimate the future cash flows expected to result from using the assets and eventually disposing of them. Cash flows are reviewed at the community level which is the lowest level of identifiable cash flows. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized based upon the asset's fair value. For long-lived assets held for sale fair value is reduced for costs to sell.

### REVENUE RECOGNITION

We recognize rental, assisted living services and skilled nursing facility revenue from owned and leased communities on a monthly basis as earned. We receive fees for property management and partnership administration services from managed communities and recognize such fees as earned.

### ASSISTED LIVING COMMUNITY SALE-LEASEBACK TRANSACTIONS

Certain communities were sold subject to leaseback provisions under operating leases. Gains where recorded were deferred and amortized into income over the lives of the leases.

### RESTATEMENT

In the fourth quarter 2000 we determined that costs related to the early extinguishment of debt in prior quarters had not been written off. Accordingly, the extraordinary gain and net income previously reported for the nine months ended September 30, 2000, was decreased by \$777,000. In addition, we reclassified the skilled nursing facility operations as a separate line item in the revenue and expenses of our normal operations, as compared to presenting the operations as a net amount in other income and expense. The September 30, 2000, information has been restated for the aforementioned items.

### RECLASSIFICATIONS

We have reclassified certain prior period amounts to conform to the September 30, 2001, presentation.

### ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations", SFAS No. 142, "Goodwill and Other Intangible Assets," and SFAS No. 143 "Accounting for Asset Retirement Obligations". SFAS 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. SFAS 141 did not have an impact on the Company's financial position, results of operations, or cash flows. The provisions of SFAS 142 eliminate the amortization of goodwill and identifiable intangible assets with indefinite lives and require an impairment assessment at least annually by applying a fair-value-based test. The Company is required to adopt SFAS 142 on January 1, 2002. Management has not determined the impact the elimination of goodwill amortization or the other provisions of the

statement will have on the Company's financial position, results of operations, or cash flows. SFAS 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The Company is required to adopt SFAS 143 on January 1, 2002. Management believes the adoption of SFAS 143 will not have a material effect on the Company's financial position, results of operations, or cash flows. On October 3, 2001 the FASB issued SFAS 144

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"Accounting for the Impairment and Disposal of Long Lived Assets". SFAS 144 supercedes SFAS 121, "Accounting for the Impairment of Long-lived Assets and Long-lived Assets to be Disposed Of". However, SFAS 144 retains the fundamental provisions of SFAS 121 for (a) recognition and measurement of the impairment of long-lived assets to be held and used and (b) measurement of long-lived assets to be disposed of by sale. The Company is required to adopt SFAS 144 on January 1, 2002. Management has not determined the impact SFAS 144 will have on the Company's financial position, results of operations, or cash flows.

### (2) NOTES PAYABLE

Notes payable consist of the following at September 30, 2001, and December 31, 2000 (in thousands except per share data):

	SEPTEMBER 30, 2001 -----
Convertible subordinated notes due April 1, 2006 with interest at 6.75%. The notes require semi-annual payments of interest and are convertible to common stock at \$18.57 per share. The notes may be called by us at declining premiums starting at 110% of the principal amount.....	\$ 8,253
Notes payable, bearing interest at a fixed rate of 9.15%, payable in monthly installments of principal and interest totaling \$34.1 collateralized by property, maturing in January 2002.....	3,922
Notes payable, bearing interest at floating rates of 30 day LIBOR (2.6% at September 30, 2001) plus points between 2.25 and 3.60 payable in monthly installments of principal and interest averaging \$168.8 collateralized by Owned ALCs, maturities ranging from August 2002 through September 2004.....	23,904
Notes payable, bearing interest at rates of 8.00% and 8.53%, payable in monthly installments of principal and interest totaling \$373.4 collateralized by property, maturities ranging from July 2010 to March 2036.....	50,923
Notes payable to shareholder bearing interest beginning April 2001 at 30-day Treasury rate (2.63% at September 30, 2001) with principal due and payable April 2002.....	1,413
Note payable bearing interest at a fixed rate of 7.00% interest only until December 2006 principal and interest thereafter with a maturity date of December 2010.....	1,000
Notes payable to shareholder bearing interest at 30 day LIBOR (2.6% at September 30, 2001) plus 10% payable in monthly installments of interest only, maturing April 2003.....	10,000
	-----
	99,415
Less amounts payable in the next year.....	12,344
	-----
	\$87,071
	=====

The future annual principal payments of the notes payable at September 30, 2001, are as follows (in thousands):



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Twelve month period ending September 30, 2002.....	\$12,344
Twelve month period ending September 30, 2003.....	22,623
Twelve month period ending September 30, 2004.....	5,511
Twelve month period ending September 30, 2005.....	485
Twelve month period ending September 30, 2006.....	9,779
Thereafter.....	48,673
	-----
	\$99,415
	=====

In the quarter ended March 31, 2001, certain notes payable were refinanced and the prior debt extinguished, resulting in an extraordinary loss due to the remaining deferred financing costs that were written off at the time of the refinancing. In the quarter ended June, 30 2001, \$7.0 million of convertible subordinated notes were repurchased resulting in an extraordinary gain of \$1.6

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million offset in part by the write-off of loan issuance costs related to the \$7.0 million convertible subordinated note. In the quarter ended September 30, 2001 the \$2.3 million promissory note from the repurchase of the subordinated debt was repaid. In addition, during the quarter ended September 30, 2001 we completed a \$5.2 million refinancing for LIBOR plus 3.6% due September 2004 with principal and interest payable monthly.

### (3) LIQUIDITY

We believe that our existing liquidity, our ability to sell ALCs and land sites which do not meet our financial objectives or geographic clustering strategy and our ability to refinance certain owned ALCs and investments will provide us with adequate resources to meet our current operating and investing needs. We do not currently generate sufficient cash from operations to fund recurring working capital and capital expenditure requirements. We will be required from time to time to incur additional indebtedness or issue additional debt or equity securities to finance our strategy, including the rehabilitation of ALCs as well as other capital expenditures. We anticipate that we will be able to obtain the additional financing; however, we cannot assure you that we will be able to obtain financing on favorable terms.

### (4) COMMITMENTS AND CONTINGENT LIABILITIES

#### COMMITMENTS

We have guaranteed the indebtedness at September 30, 2001, of certain unconsolidated affiliated partnerships for \$15.3 million. With respect to loans totaling \$15.3 million, we are the general partner of certain limited partnerships that serve as the sole members of the three borrowing entities formed as limited liability companies. Although a member of a limited liability company is not personally liable for any contract or other obligation of that entity, we delivered limited guaranties in connection with the loans. Due to the limited guaranties, we assumed liability for repayment of the loan indebtedness as a result of fraudulent or intentional misconduct regarding the mortgaged properties, an unconsented transfer of a mortgaged property, a change of control by borrower, or violation of hazardous materials covenants. Also, we guaranteed the borrower's obligation to rebalance the loans upon breach of debt service coverage obligations.

The Company has guaranteed to fund any operating deficits incurred in connection with the operation of five joint venture projects, operating as Limited

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Liability Companies ("LLC"), up to a maximum amount of \$9.0 million. The advances, which are considered capital contributions, are non-interest bearing and will be repaid in accordance with the terms of the operating agreement. These agreements will remain in effect from the commencement of operations of the project until the earlier to occur of 18 months after the project has achieved stabilization, the sale of the project to a third-party or the purchase by the Company of the membership interests of the project owner. As of September 30, 2001 operating deficit advances of \$1.2 million had been funded since inception in 1998. The Company has declined to purchase two of the joint venture properties therefore, as pursuant to the operating agreements the Company is no longer a manager of the LLCs and our obligation to fund operating deficits for said LLCs will expire in January 2002.

In our opinion, no claims may be currently asserted under any of the aforementioned guarantees based on the terms of the respective agreements, other than those already accrued.

### CONTINGENCIES

We have entered into four long-term leases of assisted living communities ("ALCs"), the acquisition and construction of which have been or are being financed by tax exempt multi-unit housing revenue bonds. In order to meet the lease obligations and to allow the landlord to continue to qualify for favorable tax treatment of the interest payable on the bonds, the ALCs must comply with certain federal income tax requirements. These requirements principally pertain to the maximum income level of a specified portion of the residents. Should we elect to execute additional leases for ALCs to be constructed with bond financing, we anticipate that the same and possibly additional restrictions will be imposed. Failure to satisfy these requirements will constitute an event of default under the leases, thereby permitting the landlord to accelerate their termination. Failure to obtain low-income residents in the sequence and time required could materially affect the lease-up schedule and, therefore, cash flow from such ALCs.

### LITIGATION

We are from time to time subject to lawsuits and other matters in the normal course of business. While we cannot predict the results with certainty, we do not believe that any liability from any such lawsuits or other matters will have a material effect on our financial position, results of operations, or liquidity.

### (5) RELATED PARTY TRANSACTIONS

On April 24, 2000, the Company entered into a Term Loan Agreement with LFSRI II Assisted Living LLC ("LFSRI"), an affiliate of Prometheus, Assisted Living, LLC ("Prometheus"). As of July 26, 2001, Prometheus beneficially owned approximately 47.8% of the Company's outstanding Common Stock. Pursuant to the Term Loan Agreement, the company may borrow up to \$10,000,000 from LFSRI with a maturity date of April 24, 2003. The outstanding amount under the loan bears interest at the annual rate equal to the LIBOR rate for each interest period

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plus a 10% margin. At September 30, 2001, there was \$10,000,000 outstanding. In connection with the Term Loan Agreement, the company issued to LFSRI a warrant to purchase up to 750,000 shares of the Company's Common Stock at a price of \$3.00 per share, subject to various adjustments exercisable until April 24, 2005. The Company also amended its stockholder rights agreement to prevent shares that Prometheus may be deemed to beneficially own by reason of LFSRI's rights under the warrant from causing Prometheus to become an "Acquiring Person"

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and thus causing a triggering event under the rights agreement.

### (6) SALE OF ASSETS

In January 2001, the Company sold its partnership interest in five tax credit apartment partnerships to an unrelated third party. The Company previously signed guarantees requiring the Company to meet certain federal income tax requirements. These requirements principally pertain to the maximum income level of all its residents. Consequently, the Company is still liable for compliance of the community with these requirements for the period of time we operated the facilities.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

### FACTORS AFFECTING FUTURE RESULTS AND FORWARD-LOOKING STATEMENTS

This 10-Q report contains forward-looking statements, including statements regarding, among other items:

- our business strategy;
- our liquidity requirements and ability to obtain financing;
- the impact of future acquisitions and developments;
- the level of future capital expenditures;
- the impact of inflation and changing prices; and
- the outcome of certain litigation matters.

These forward-looking statements are based on our expectations and are subject to a number of risks and uncertainties, some of which are beyond our control. These risks and uncertainties include, but are not limited to:

- access to capital necessary for acquisitions and development;
- our ability to manage growth;
- the successful integration of ALCs into our portfolio;
- governmental regulations;
- competition; and
- other risks associated with the assisted living industry.

Although we believe we have the resources required to achieve our objectives, actual results could differ materially from those anticipated by these forward-looking statements. There can be no assurances that events anticipated by these forward-looking statements will in fact transpire as expected.

### OVERVIEW

ARV Assisted Living, Inc. ("ARV" or the "Company"), a Delaware corporation, originally formed in 1980 as California Retirement Villas and is currently one of the largest operators of licensed assisted living communities ("ALCs") in the United States. We are a fully integrated provider of assisted living accommodations and services that operates, acquires and develops ALCs. We have been involved in the senior housing business for more than 20 years. Our operating objective is to provide high quality, personalized assisted living

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services to senior residents in a cost-effective manner, while maintaining residents' independence, dignity and quality of life. Our ALCs offer a combination of housing and personalized support services in a non-institutional setting. Our ALCs are designed to respond to the individual needs of elderly residents who require assistance with certain activities of daily living, but who do not require the intensive nursing care provided in a skilled nursing facility.

As of September 30, 2001, we operated a total of 54 ALCs containing 6,542 units, 15 of which are owned by us, 33 that are leased by us and 6 that are managed by us. Owned ALCs ("Owned ALCs") are owned by us directly, or by affiliated limited partnerships or limited liability companies for which we serve as managing general partner or member and community manager and in which we have a majority ownership interest ("Affiliated Partnerships"). Leased ALCs ("Leased ALCs") are operated by us under long-term

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operating leases for our own account or for Affiliated Partnerships in which we have a majority ownership interest. Managed ALCs are operated by us on behalf of an affiliated partnership (in which we do not have a majority ownership), a joint venture or an unrelated third-party. We believe that this blend of ownership, leasehold and management interest in our ALCs allows us to fund our operations in a balanced, efficient manner.

The Company is the managing general partner of American Retirement Villas Properties III, L.P. ("ARVP III"). On October 4, 2001, C3 Capital, LLC., a California limited liability company ("C3 Capital"), commenced a hostile tender offer, which was later withdrawn, to purchase up to 10,000 limited partnership units of the Partnership at a net cash purchase price of \$300 per unit (the "Hostile Offer"), and also filed with the SEC a preliminary consent solicitation pursuant to which C3 Capital seeks to remove the Company as the managing general partner, and elect C3 Capital as the general partner of ARVP III. No definitive consent solicitation has been filed or mailed to ARVP III unit-holders at this time.

In response to the Hostile Offer and the consent solicitation, we, through ARVP Acquisition, L.P., a California limited partnership wholly-owned by us, commenced a tender offer on October 18, 2001 for 10,000 outstanding partnership units of ARVP III for \$360 per unit. We amended the tender offer on October 31, 2001 and increased the offer price to \$400 per unit from \$360 per unit, increased the number of Units we are seeking to purchase from 10,000 units to all outstanding Units, and reduced the minimum number of Units that must be tendered before we are required to purchase any units to 30% of the outstanding Units (the "Amended Offer"). The amendment to our original offer was in response to C3 Capital's withdrawal of its tender offer, and receipt of a highly conditional offer from Vintage Senior Housing, LLC ("Vintage"), an affiliate of C3 Capital, to purchase all of ARVP III's non-cash assets for \$19.5 million. Vintage's offer is subject to, among other things, significant due diligence and financing contingencies. In addition, on November 9, 2001 we received a revised offer from Vintage increasing the purchase price for the assets of ARVP III to \$20 million. The Company responded to Vintage's offer and its revised offer by asking Vintage to provide specific evidence as to its ability to finance and close the proposed transaction.

Subsequent to September 30, 2001 we were awarded four management contracts, two in Texas totaling 143 units and two in New Mexico totaling 92 units.

Since commencing operation of ALCs for our own account in April 1994, we have focused our growth efforts on the acquisition and development of additional ALCs and expansion of services to our residents while they reside in our communities.

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As of September 30, 2001, a substantial portion of our business and operations were conducted in California, where 37 of the 54 ALCs we operate are located. We intend to continue to make California the primary focus of our geographic clustering strategy. We are focusing greater attention on enhancing the profitability of our existing core operations and on leasing up new developments at an increased rate. In addition, we plan to divest ALCs that do not expand or enhance one of our geographic clusters or do not meet our financial objectives.

Newly opened ALCs are expected to incur operating losses until sufficient occupancy levels and operating efficiencies are achieved. Based upon historical experience, we believe that a typical community will achieve its targeted occupancy levels 18 - 24 months from the commencement of operations. Accordingly, we require substantial amounts of liquidity to maintain the operations of newly opened ALCs. If sufficient occupancy levels are not achieved within reasonable periods, our results of operations, financial position and liquidity could be materially and adversely impacted.

### RESULTS OF OPERATIONS

THREE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED WITH THREE MONTHS ENDED SEPTEMBER 30, 2000

The following table sets forth a comparison of the three months ended September 30, 2001, and the three months ended September 30, 2000.

Operating Results Before Extraordinary Item and Income Tax  
For the Three Months Ended September 30, 2001 and 2000  
(Unaudited)  
(In millions)

(DOLLARS IN MILLIONS)	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		INCREASE/ (DECREASE)
	2001	2000	-----
	-----	-----	-----
Revenue:			
Assisted living community revenue .....	\$ 35.9	\$ 33.5	7.1%
Skilled nursing facility revenue .....	0.5	0.7	(26.6)%
Management fees from affiliates and others	0.3	0.2	19.8%
	-----	-----	-----
Total revenue .....	36.7	34.4	6.5%
	-----	-----	-----
Operating expenses:			
Assisted living community operating expense .....	22.2	21.2	4.9%
Skilled nursing facility expenses .....	0.7	0.6	11.0%
Community lease expense .....	7.8	7.6	1.9%
General and administrative .....	2.4	2.7	(9.9)%
Depreciation and amortization .....	1.9	2.1	(11.9)%
	-----	-----	-----
Total operating expenses .....	35.0	34.2	2.1%
	-----	-----	-----
Income (loss) from operations .....	1.7	0.2	762.0%

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Other income (expense):			
Interest income .....	0.2	0.4	(46.7)%
Other income (expense) .....	(0.1)	0.1	(220.3)%
Interest expense .....	(2.2)	(2.2)	3.7%
	-----	-----	-----
Total other income (expense) .....	(2.1)	(1.7)	(23.6)%
	-----	-----	-----
Loss before minority interest in income of majority owned entities, and extraordinary item.....	(0.4)	(1.5)	(73.9)%
Minority interest in income of majority owned entities .....	(0.3)	(0.1)	743.2%
	-----	-----	-----
Loss before extraordinary item ...	\$ (0.7)	\$ (1.6)	(52.4)%
	=====	=====	=====

Total revenue for the three months ended September 30, 2001, increased \$2.3 million to \$36.7 million from \$34.4 million for the three months ended September 30, 2000. This increase was primarily due to an increase in assisted living community revenue as described below.

Assisted living community revenue increased \$2.4 million to \$35.9 million for the three months ended September 30, 2001, from \$33.5 million for the three months ended September 30, 2000.

The increase in assisted living community revenue is attributable to the following:

- An increase in average rate per occupied unit for ALCs, which we owned and leased in both periods to \$2,306 for the 2001 quarter as compared to \$2,183 for the 2000 quarter;
- Higher occupancy rates for the quarters ended September 30, of 87.8% for 2001 compared to 86.7% for 2000; and
- An increase in assisted living penetration rate for the quarters ended September 30, to 47.0% in 2001 from 46.3% in 2000.

Management fees from affiliates remained relatively constant.

Assisted living community operating expenses increased \$1.0 million to \$22.2 million for the three months ended September 30, 2001, from \$21.2 million for the three months ended September 30, 2000. These increases were due to the following:

- increased utility costs;
- Increase in overtime due to labor shortages and additional personnel needed to support the assisted living operations;
- Increase in California's minimum wage and cost of living increases in wages and food;
- Increase in worker's compensation insurance expense, and
- Increase in general liability insurance.

Assisted living community lease expenses increased \$0.2 million to \$7.8 million

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for the three months ended September 30, 2001, from \$7.6 million for the three months ended September 30, 2000, due to contracted rate increases.

General and administrative expenses decreased \$0.3 million to \$2.4 million for the three months ended September 30, 2001, from \$2.7 million for the three months ended September 30, 2000, primarily as a result of decreased legal and consulting expenses.

Depreciation and amortization expenses decreased \$0.2 million to \$1.9 million for the three months ended September 30, 2001, from \$2.1 million for the three months ended September 30, 2000. The decrease was primarily due to reduced amortization from syndication cost related to the retirement of public debt.

Interest income decreased \$0.2 million to \$0.2 million at September 30, 2001, from \$0.4 million at September 30, 2000, due to the lower interest rates during the three months ended September 30, 2001 offset in part by higher cash and cash equivalent balances.

Interest expense remained relatively constant at \$2.2 million for the three months ended September 30, 2001, compared with \$2.2 million for the three months ended September 30, 2000.

Other income and expense increased \$0.2 million primarily due to the write off of operating deficit loans.

NINE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 2000

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The following information concerning the operating results of the Company for the nine-month periods ended September 30, 2001, and 2000 is presented in order to provide the reader with additional information concerning the Company's operations.

Operating Results before Extraordinary Item and Income Taxes  
For the Nine Months Ended September 30, 2001 and 2000  
(Unaudited)  
(In millions)

(DOLLARS IN MILLIONS)	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		INCREASE/ (DECREASE)
	2001	2000	-----
	-----	-----	-----
Revenue:			
Assisted living community revenue.....	\$105.5	\$102.4	3.0%
Skilled nursing facility revenue.....	1.7	1.3	32.3%
Management fees from affiliates and others.	0.8	0.6	34.5%
	-----	-----	-----
Total revenue.....	108.0	104.3	3.5%
	-----	-----	-----
Operating expenses:			
Assisted living community operating expense.....	65.3	65.8	(0.7)%
Skilled nursing facility expenses.....	1.9	1.3	38.0%
Community lease expense.....	23.2	23.9	(3.1)%
General and administrative.....	7.6	8.4	(8.8)%
Depreciation and amortization.....	5.9	6.4	(8.1)%

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Total operating expenses.....	103.9	105.8	(1.9)%
Income (loss) from operations.....	4.1	(1.5)	370.5%
Other income (expense):			
Interest income.....	1.0	1.1	(15.9)%
Other income (expense).....	(0.2)	(0.1)	27.6%
Gain on sale of assets.....	2.9	--	100.0%
Interest expense.....	(6.9)	(6.0)	13.5%
Total other income (expense).....	(3.2)	(5.0)	(37.0)%
Income (loss) before minority interest in income of majority owned entities, and extraordinary item.....	0.9	(6.5)	114.6%
Minority interest in income of majority owned entities.....	(0.7)	(0.1)	(490.1)%
Income (loss) before extraordinary item.....	\$ 0.2	\$ (6.6)	102.6%
	=====	=====	=====

Total revenue for the nine months ended September 30, 2001, increased \$3.7 million to \$108.0 million from \$104.3 million for the nine months ended September 30, 2000.

Assisted living community revenue increased \$3.1 million to \$105.5 million for the nine months ended September 30, 2001, from \$102.4 million for the three months ended September 30, 2000.

The increase in assisted living community revenue is attributable to the following:

- Increases in the average rate per occupied unit to \$2,249 for the nine months ended September 30, 2001, from \$2,149 for the nine months ended September 30, 2000;
- Higher occupancy rates of 88.1% for 2001 compared to 85.7% for 2000; and
- An increase in assisted living penetration rate to 47.0% in 2001 from 46.3% in 2000, offset by;
- The sales of three ALCs in April 2000 which were determined to be non-strategic.

Community expenses decreased \$0.6 million to \$90.4 million for the nine months ended September 30, 2001, from \$91.0 million for the nine months ended September 30, 2000. Of these decreases, \$0.5 million related to ALC operating expense, \$0.7 million lease expense partially offset by an increase of \$0.6 million for the skilled nursing facility. The various categories of expense decreases are as follows:

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- The sale of three non-strategic communities in April 2000, offset by;
- Increase in California's minimum wage and cost of living increases in wages and food;



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- Increases in utilities and general liability insurance; and
- The increase in skilled nursing facility expense is primarily due to the increase in payroll due to required staffing levels.

General and administrative expenses decreased \$0.8 million due to:

- Continuing efforts to reduce staff at our corporate office; and
- Reduction in legal expenses, recruiting, severance and consulting costs.

Depreciation and amortization expenses decreased \$0.5 million due to the sale of three ALCs in April 2000 and reduced amortization of syndication costs due to the retirement of public debt.

Interest income decreased \$0.1 million to \$1.0 million for the nine months ended September 30, 2001, from \$1.1 million for the nine months ended September 30, 2000. The decrease was due to the lower interest rates during the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000 offset in part by higher cash and cash equivalent balances.

Gain on sale of assets of \$2.9 million was the result of the sale of our interest in five tax credit apartment partnerships that we had previously anticipated selling at a loss.

Interest expense increased \$0.9 million to \$6.9 million for the nine months ended September 30, 2001, compared with \$6.0 million for the nine months ended September 30, 2000, due to refinancing of owned communities offset somewhat by the retirement of a portion of the 6-3/4%, convertible subordinated notes. Interest expense consisted primarily of interest incurred on our remaining 6-3/4%, convertible subordinated notes due 2006, the loans from Lazard Freres as well as mortgage interest on owned ALCs.

### LIQUIDITY AND CAPITAL RESOURCES

Our unrestricted cash balances were \$15.8 million and \$16.8 million at September 30, 2001, and December 31, 2000, respectively. The decrease was due primarily to cash used to retire our 6-3/4%, convertible subordinated notes due 2006 during the second quarter of 2001 partially off-set by net cash provided by operating activities.

Working capital at September 30, 2001, was a negative \$1.3 million due to the reclassification to current liabilities of three mortgage loans on owned ALCs. Two of the loans for \$3.9 million are due January 2002 for which we have received loan commitments for 35-year loans which we anticipate closing prior to December 31, 2001. The third mortgage loan is due in August 2002 and is also in the process of being refinanced.

Cash provided by operating activities was \$4.4 million for the nine months ended September 30, 2001, compared to \$1.3 million used for the nine-month period ended September 30, 2000. The primary components of cash provided by operating activities for the nine months ended September 30, 2001, were:

- Income before extraordinary items for the nine months ended September 30, 2001, of \$0.2 million;
- Non-cash charges of \$5.9 million for depreciation and amortization;
- Minority interest in income of majority owned entities, of \$0.8 million;

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- Net change in assets and liabilities of \$0.3 million, offset by;
- Gain on sale of assets of \$2.9 million for the sale of the tax credit apartments,

Cash used in investing activities was \$0.4 million for the nine months ended September 30, 2001, compared to net cash used in investing activities of \$2.6 million for the nine months ended September 30, 2000. The primary components of cash used in investing activities for the nine months ended September 30, 2001, were:

- \$0.7 million for the sale of property deemed non-strategic; and
- \$2.9 million for the proceeds from the sale of our partnership interest in five senior apartments;
- \$0.5 million decrease in security deposits, offset by;
- \$4.5 million used for purchases of property, furniture and equipment.

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Net cash used by financing activities was \$5.0 million for the nine months ended September 30, 2001, compared to net cash provided in financing activities of \$2.3 million for the nine months ended September 30, 2000. The primary components of cash provided by financing activities for the nine months ended September 30, 2001, were:

- \$10.3 million for repayments of notes payable;
- \$5.3 million for repayment of subordinated debt;
- \$2.9 million for repayment of partnership obligations;
- \$2.3 million for distributions to minority partners;
- \$0.2 for expenses associated with loans; and
- \$0.4 million for payment of loan fees on refinancings and new debt, offset by;
- Debt proceeds of \$16.4 million for the refinancing of owned ALCs.

The various debt and lease agreements contain restrictive covenants requiring us to maintain certain financial ratios, including current ratio, working capital, minimum net worth, and debt service coverage, among others. At September 30, 2001, we were in compliance with all covenants.

In our fiscal year ended December 31, 1999, we began retiring portions of our 6-3/4% convertible subordinated debt from time to time. During 1999, we issued a total of 799,566 shares of our common stock and paid a total of \$1.0 million to some of our bondholders in exchange for a total of \$9.2 million principal amount of the subordinated notes due 2006 that were held by those bondholders. These transactions resulted in an extraordinary gain of \$6.8 million net of tax for the fiscal year ended December 31, 1999. During 2000, we issued a total of 781,025 shares of our common stock and paid a total of \$9.6 million to additional bondholders in exchange for a total of \$33.0 million in principal amount of the subordinated notes held by those bondholders. These transactions resulted in an extraordinary gain of \$20.6 million net of tax and costs for the year ended December 31, 2000. In the nine months ended September 30, 2001, we

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retired an additional \$7.0 million of the subordinated notes held by bondholders. This generated an extraordinary gain of \$1.6 million net of tax and costs. Through these transactions, we have retired a total of \$49.2 million of our public debt resulting in extraordinary gains of \$29.0 million to date.

In 2000 we obtained a \$10.0 million unsecured revolving line of credit with our major shareholder Lazard Freres to be used for retirement of the subordinated 6-3/4% public debt. At September 30, 2001, we had \$10.0 million outstanding on the line of credit at LIBOR plus 10% interest payable monthly.

The Company has guaranteed to fund any operating deficits incurred in connection with the operation of five joint venture projects, operating as Limited Liability Companies ("LLC"), up to a maximum amount of \$9.0 million. The advances, which are considered capital contributions, are non-interest bearing and will be repaid in accordance with the terms of the operating agreement. These agreements will remain in effect from the commencement of operations of the project until the earlier to occur of 18 months after the project has achieved stabilization, the sale of the project to a third-party or the purchase by the Company of the membership interests of the project owner. As of September 30, 2001 operating deficit advances of \$1.2 million had been funded since inception in 1998. The Company has declined to purchase two of the joint venture properties therefore, as pursuant to the operating agreements the Company is no longer a manager of the LLCs and our obligation to fund operating deficits for said LLCs will expire in January 2002.

We believe that our existing liquidity, our ability to sell ALCs and land sites which do not meet our financial objectives or geographic clustering strategy and our ability to refinance certain owned ALCs and investments will provide us with adequate resources to meet our current operating and investing needs. We do not currently generate sufficient cash from operations to fund recurring working capital and capital expenditure requirements. We may be required from time to time to incur additional indebtedness or issue additional debt or equity securities to finance our strategy, including the rehabilitation of ALCs as well as other capital expenditures. We anticipate that we will be able to obtain the additional financing; however, we cannot assure you that we will be able to obtain financing on favorable terms.

### IMPACT OF INFLATION AND CHANGING PRICES

Operating revenue from ALCs we operate is the primary source of our revenue. These ALCs are affected by rental rates which are highly dependent upon market conditions and the competitive environments where the communities are located. Employee compensation is the principal cost element of property operations. Although there can be no assurance that we will be able to continue to do so, we have historically been able to offset the effects of inflation on salaries and other operating expenses by increasing rental and assisted living rates.

### ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations", SFAS No. 142, "Goodwill and Other Intangible Assets," and SFAS No. 143 "Accounting for Asset Retirement Obligations". SFAS 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. SFAS 141 did not have an impact on the Company's financial position, results of operations, or cash flows. The provisions of SFAS 142 eliminate the amortization of goodwill and identifiable intangible assets with indefinite lives and require an impairment assessment at least annually by applying a fair-value-based test. The Company is required to adopt SFAS 142 on January 1, 2002. Management has not determined the impact the elimination of goodwill amortization or the other provisions of the statement will have on the Company's financial position, results of operations, or cash flows. SFAS 143

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requires that the fair value of

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a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The Company is required to adopt SFAS 143 on January 1, 2002. Management believes the adoption of SFAS 143 will not have a material effect on the Company's financial position, results of operations, or cash flows. On October 3, 2001 the FASB issued SFAS 144 "Accounting for the Impairment and Disposal of Long Lived Assets". SFAS 144 supercedes SFAS 121, "Accounting for the Impairment of Long-lived Assets and Long-lived Assets to be Disposed of". However SFAS 144 retains the fundamental provisions of SFAS 121 for (a) recognition and management of long-lived assets to be disposed of by sale. The Company is required to adopt SFAS 144 on January 1, 2002. Management has not determined the impact SFAS 144 will have on the Company's financial position, results of operations, or cash flows.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk related to fluctuations in interest rates on our notes payable. Currently, we do not utilize interest rate swaps. The purpose of the following analysis is to provide a framework to understand our sensitivity to hypothetical changes in interest rates as of September 30, 2001. You should be aware that many of the statements contained in this section are forward looking and should be read in conjunction with our disclosures herein.

For fixed-rate debt, changes in interest rates generally affect the fair market value of the debt instrument, but not our earnings or cash flows. Conversely, for variable rate debt, changes in interest rates generally do not impact the fair market value of the debt instrument, but do affect our future earnings and cash flows. We do not have an obligation to prepay fixed-rate debt prior to maturity, and as a result, interest rate risk and changes in fair market value should not have a significant impact on the fixed-rate debt until we would be required to refinance such debt. Holding the variable rate debt balance constant, each one percentage point increase in interest rates would result in an increase in variable rate interest incurred for the coming year of approximately \$350,000.

The table below details the principal amount and the average interest rates of notes payable in each category based upon the maturity dates. The fair value estimates for notes payable are based upon future discounted cash flows of similar type notes or quoted market prices for similar loans. The carrying value of our variable rate debt approximates fair value due to the frequency of re-pricing of this debt. Our fixed-rate debt consists of convertible subordinated notes payable and mortgage payables. The fixed rate-debt bears interest at rates that approximate current market rates.

	EXPECTED MATURITY DATE -- SEPTEMBER 30,						
	2002	2003	2004	2005	2006	THEREAFTER	TOTAL
	-----	-----	-----	-----	-----	-----	-----
	(DOLLARS IN THOUSANDS)						
Fixed rate debt	\$4,302	\$412	\$447	\$485	\$9,779	\$48,673	\$64,098
Average interest rate	8.04%	8.01%	7.94%	7.87%	7.97%	7.97%	
Variable rate debt	\$8,042	\$22,211	\$5,064	\$--	\$--	\$--	\$35,317
Average interest rate	7.59%	7.71%	6.24%				

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We do not believe that the future market rate risks related to the above securities will have a material adverse impact on our financial position, results of operations or liquidity.

### PART II: OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

We are from time to time subject to lawsuits and other matters in the normal course of business. While we cannot predict the results with certainty, we do not believe that any liability from any such lawsuits or other matters will have a material effect on our financial position, results of operations, or liquidity.

#### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None

#### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

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None

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

#### ITEM 5. OTHER INFORMATION

None

#### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

##### (a) EXHIBITS

- 2.2 Schedule 14D-9 filed on October 18, 2001 by American Retirement Villas Properties III, L.P.
- 2.3 Schedule 14D-9 amendment number one filed on October 31, 2001 by American Retirement Villas Properties III, L.P.
- 2.4 ARVP Acquisition, L.P. filed Schedule TO on October 18, 2001 an offer to purchase for cash up to 10,000 of the outstanding limited partnership units.
- 3.3 ARVP Acquisition, L.P.'s certificate of limited partnership.

##### (b) REPORTS ON FORM 8-K

No Form 8-Ks were filed during the quarter ended September 30, 2001.

#### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the

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registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ARV ASSISTED LIVING, INC.

By: /s/ Douglas M. Pasquale

-----  
Douglas M. Pasquale  
Chief Executive Officer  
(Duly authorized officer)

Date: November 14, 2001

By: /s/ Abdo H. Khoury

-----  
Abdo H. Khoury  
President and Chief Financial Officer  
(Duly authorized officer)

Date: November 14, 2001

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EXHIBIT INDEX

Exhibit Number -----	Description -----
2.2	Schedule 14D-9 filed on October 18, 2001 by American Retirement Villas Properties III, L.P.
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