

FIVE STAR QUALITY CARE INC
Form 10-Q/A
April 16, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q/A

Amendment No. 1

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

For the quarterly period ended June 30, 2013

or

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

Commission File Number 001-16817

FIVE STAR QUALITY CARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

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Maryland

(State or Other Jurisdiction of Incorporation or Organization)

04-3516029

(IRS Employer Identification No.)

400 Centre Street, Newton, Massachusetts 02458

(Address of Principal Executive Offices) (Zip Code)

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

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Number of registrant's shares of common stock, \$.01 par value, outstanding as of July 30, 2013: 48,271,522.

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JUNE 30, 2013

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As used herein the terms “we”, “us” or “our” mean Five Star Quality Care, Inc. and its consolidated subsidiaries unless the context otherwise requires.

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EXPLANATORY NOTE

(dollars in thousands)

We are filing this Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, or this Amended Quarterly Report, to amend and restate financial statements and other financial information in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, or our Quarterly Report, which was filed with the Securities and Exchange Commission, or the SEC, on July 31, 2013.

As more fully described in Note 12 to the Notes to our Condensed Consolidated Financial Statements included in Item 1 of this Amended Quarterly Report, subsequent to the filing of our Quarterly Report our management and the Audit Committee of our Board of Directors, or our Audit Committee, concluded that our consolidated financial statements for the years ended December 31, 2012 and 2011 contained within our Annual Report on Form 10-K for the year ended December 31, 2012, or our 2012 Annual Report, and our condensed consolidated financial statements for the quarters ended March 31, 2013 and June 30, 2013 contained within our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 and our Quarterly Report, respectively, should be restated, and that those financial statements previously filed with the SEC should no longer be relied upon. We are restating our condensed consolidated financial statements for the three and six months ended June 30, 2013 and 2012 contained within this Amended Quarterly Report to correct certain errors in the accounting for income taxes and other errors. Specifically, the accounting for income tax errors relate to, among other things, the measurement of deferred tax assets for net operating losses and tax credits and the measurement of deferred tax assets and liabilities for temporary differences related to fixed assets, intangible assets and investments. In addition, as part of the restatement we have corrected certain other errors related to insurance receivables, security deposits, accrual of fixed asset additions, classification of senior living operating expenses and certain other immaterial items. The net impact of correcting the errors resulted in an increase to our shareholders' equity of \$7,031 and \$6,749 at June 30, 2013 and December 31, 2012, respectively, a decrease to net income of \$27 and an increase to net income of \$178 for the three and six months ended June 30, 2013, respectively, and an increase to net income of \$272 and \$375 for the three and six months ended June 30, 2012, respectively. We corrected the presentation and disclosure of our consolidated statements of cash flows to separately identify the net cash flows from discontinued operations, by category and in total and reflect the correction of other errors in the separate disclosures of cash flows for continuing operations and discontinued operations. These corrections increased cash provided by operating activities by \$1,602 and \$1,050 for the six months ended June 30, 2013 and 2012, respectively. We have also corrected the footnote presentation of the classification of \$11,656 and \$11,550 as of June 30, 2013 and December 31, 2012, respectively, of our available for sale debt securities from Level 1 assets to Level 2 assets as defined in the fair value hierarchy and corrected the disclosure of the fair value of our mortgage notes payable which increased \$9,469 and \$9,947 as of June 30, 2013 and December 31, 2012, respectively.

In the third quarter of 2013, in connection with entering into a purchase agreement with Senior Housing Properties Trust and certain unrelated parties, we reclassified our rehabilitation hospital business as discontinued operations and our rehabilitation hospital business is retrospectively presented as discontinued operations throughout this Amended Quarterly Report. Please see Note 12 to the Notes to our Condensed Consolidated Financial Statements included in Item 1 of this Amended Quarterly Report for more information regarding the effect of the retrospective adjustments to reflect discontinued operations and the correction of errors for the three and six months ended June 30, 2013 and 2012.

As a result of the errors described above, we determined that our disclosure controls and procedures were not effective as of June 30, 2013. In addition, we reassessed the effectiveness of our internal control over financial reporting as of December 31, 2012 and determined that we had material weaknesses in our internal controls over accounting for income taxes, that we lacked sufficient personnel with requisite technical accounting competencies and that we had an insufficient level of oversight in the financial statement close process. As a result, we concluded that our internal control over financial reporting was ineffective at December 31, 2012. Those material weaknesses continued to exist as of June 30, 2013.

Amendments to our Quarterly Report included in this Amended Quarterly Report

The following sections of our Quarterly Report are amended and being filed in their entirety in this Amended Quarterly Report:

- Part I, Item 1. Condensed Consolidated Financial Statements;
- Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations;
- Part I, Item 4. Controls and Procedures; and
- Part II, Item 6. Exhibits.

This Amended Quarterly Report contains only the items and exhibits to our Quarterly Report that are being amended and restated, and unaffected items are not included herein.

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FIVE STAR QUALITY CARE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

(unaudited)

	June 30, 2013 (Restated)	December 31, 2012 (Restated)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 19,311	\$ 24,638
Accounts receivable, net of allowance of \$3,905 and \$2,792 at June 30, 2013 and December 31, 2012, respectively	44,440	39,205
Due from related persons	5,810	6,881
Investments in available for sale securities, of which \$3,699 and \$3,684 are restricted at June 30, 2013 and December 31, 2012, respectively	16,352	12,920
Restricted cash	11,202	6,548
Prepaid expenses and other current assets	28,522	38,318
Assets of discontinued operations	20,205	30,100
Total current assets	145,842	158,610
Property and equipment, net	330,685	337,494
Equity investment in Affiliates Insurance Company	5,703	5,629
Restricted cash	11,196	12,166
Restricted investments in available for sale securities	6,979	10,580
Goodwill and other intangible assets	27,122	27,708
Other long term assets	40,736	40,382
	\$ 568,263	\$ 592,569
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Revolving credit facility, secured, principally by real estate	\$	\$
Revolving credit facility, secured, principally by accounts receivable		
Convertible senior notes	24,872	24,872
Accounts payable	24,737	38,035
Accrued expenses	20,754	28,010
Accrued compensation and benefits	38,346	35,302
Due to related persons	19,790	19,484
Mortgage notes payable	1,125	1,092
Accrued real estate taxes	10,200	10,723
Security deposit liability	8,754	9,057

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Other current liabilities	18,294	14,775
Liabilities of discontinued operations, of which \$0 and \$7,547 relate to mortgage notes payable at June 30, 2013 and December 31, 2012, respectively	8,255	16,977
Total current liabilities	175,127	198,327
Long term liabilities:		
Mortgage notes payable	37,050	37,621
Continuing care contracts	1,681	1,708
Accrued self-insurance obligations	31,786	34,647
Other long term liabilities	5,775	6,712
Total long term liabilities	76,292	80,688
Commitments and contingencies		
Shareholders' equity:		
Common stock, par value \$.01; 75,000,000 shares authorized, 48,271,522 and 48,234,022 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	482	482
Additional paid in capital	354,752	354,164
Accumulated deficit	(41,517)	(44,455)
Accumulated other comprehensive income	3,127	3,363
Total shareholders' equity	316,844	313,554
	\$ 568,263	\$ 592,569

See accompanying notes.

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FIVE STAR QUALITY CARE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
	(Restated)	(Restated)	(Restated)	(Restated)
Revenues:				
Senior living revenue	\$ 268,827	\$ 269,093	\$ 538,067	\$ 535,898
Management fee revenue	2,281	1,302	4,583	2,390
Reimbursed costs incurred on behalf of managed communities	52,153	26,098	104,211	49,503
Total revenues	323,261	296,493	646,861	587,791
Operating expenses:				
Senior living wages and benefits	130,390	130,252	262,817	262,062
Other senior living operating expenses	65,752	63,797	132,090	128,057
Costs incurred on behalf of managed communities	52,153	26,098	104,211	49,503
Rent expense	48,279	47,431	96,292	94,792
General and administrative	15,451	15,434	30,583	30,933
Depreciation and amortization	6,585	6,203	12,955	12,021
Gain on settlement		(3,365)		(3,365)
Total operating expenses	318,610	285,850	638,948	574,003
Operating income	4,651	10,643	7,913	13,788
Interest, dividend and other income	211	234	408	439
Interest and other expense	(1,355)	(1,605)	(2,811)	(3,031)
Acquisition related costs	(41)		(41)	
Gain on early extinguishment of debt		45		45
Loss on sale of available for sale securities reclassified from other comprehensive income	(117)		(30)	(1)
Income from continuing operations before income taxes and equity in earnings of				
Affiliates Insurance Company	3,349	9,317	5,439	11,240
Provision for income taxes	(1,131)	(3,817)	(356)	(4,618)
Equity in earnings of Affiliates Insurance Company	79	76	155	121
Income from continuing operations	2,297	5,576	5,238	6,743
Loss from discontinued operations	(1,499)	(666)	(2,300)	(1,361)
Net income	\$ 798	\$ 4,910	\$ 2,938	\$ 5,382
Weighted average shares outstanding - basic	48,253	47,914	48,244	47,906
Weighted average shares outstanding - diluted	50,166	49,953	50,157	50,360

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Basic income per share from:							
Continuing operations	\$	0.05	\$	0.12	\$	0.11	\$ 0.14
Discontinued operations		(0.03)		(0.02)		(0.05)	(0.03)
Net income per share - basic	\$	0.02	\$	0.10	\$	0.06	\$ 0.11
Diluted income per share from:							
Continuing operations	\$	0.05	\$	0.11	\$	0.11	\$ 0.14
Discontinued operations		(0.03)		(0.01)		(0.05)	(0.03)
Net income per share - diluted	\$	0.02	\$	0.10	\$	0.06	\$ 0.11

See accompanying notes.

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FIVE STAR QUALITY CARE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
	(Restated)	(Restated)	(Restated)	(Restated)
Net income	\$ 798	\$ 4,910	\$ 2,938	\$ 5,382
Other comprehensive income				
Unrealized (loss) gain on investments in available for sale securities, net of tax	(233)	56	(173)	168
Unrealized loss on equity investment in Affiliates Insurance Company	(73)	(3)	(81)	(4)
Realized loss on investments in available for sale securities reclassified and included in net income, net of tax	70		18	1
Other comprehensive (loss) income	(236)	53	(236)	165
Comprehensive income	\$ 562	\$ 4,963	\$ 2,702	\$ 5,547

See accompanying notes.

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FIVE STAR QUALITY CARE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six months ended June 30,	
	2013 (Restated)	2012 (Restated)
Cash flows from operating activities:		
Net income	\$ 2,938	\$ 5,382
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	12,955	12,021
Gain on early extinguishment of debt		(45)
Loss from discontinued operations	3,902	2,411
Loss on sale of available for sale securities	30	1
Equity in earnings of Affiliates Insurance Company	(155)	(121)
Stock-based compensation	588	579
Provision for losses on receivables	2,740	1,828
Changes in assets and liabilities:		
Accounts receivable	(7,975)	(1,883)
Prepaid expenses and other assets	9,560	3,443
Accounts payable and accrued expenses	(15,750)	1,865
Accrued compensation and benefits	3,044	4,800
Due from (to) related persons, net	1,377	(2,622)
Other current and long term liabilities	(1,132)	775
Cash provided by operating activities	12,122	28,434
Cash flows from investing activities:		
Acquisition of property and equipment	(23,712)	(25,288)
Payments from restricted cash and investment accounts, net	(3,684)	(3,890)
Purchase of available for sale securities	(5,333)	(4,554)
Proceeds from disposition of property and equipment held for sale	13,334	11,067
Proceeds from sale of available for sale securities	5,213	772
Cash used in investing activities	(14,182)	(21,893)
Cash flows from financing activities:		
Proceeds from borrowings on credit facilities	20,000	47,500
Repayments of borrowings on credit facilities	(20,000)	(10,000)
Repayments of borrowings on bridge loan from Senior Housing Properties Trust		(38,000)
Purchase and retirement of convertible senior notes		(12,038)
Repayments of mortgage notes payable	(538)	(506)
Cash used in financing activities	(538)	(13,044)
Cash flows from discontinued operations:		
Net cash (used in) provided by operating activities	(3,822)	2,125
Net cash provided by (used in) investing activities	8,627	(291)
Net cash used in financing activities	(7,534)	(70)
Net cash (used in) provided by discontinued operations	(2,729)	1,764
Change in cash and cash equivalents during the period	(5,327)	(4,739)

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Cash and cash equivalents at beginning of period		24,638		28,374
Cash and cash equivalents at end of period	\$	19,311	\$	23,635
Supplemental cash flow information:				
Cash paid for interest	\$	1,788	\$	2,751
Cash paid for income taxes	\$	1,394	\$	1,235

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

General

The accompanying condensed consolidated financial statements of Five Star Quality Care, Inc. and its subsidiaries, which we refer to as we, us or our, have been prepared without audit. Certain information and disclosures required by U.S. generally accepted accounting principles for complete financial statements have been condensed or omitted. We believe the disclosures made are adequate to make the information presented not misleading. However, the accompanying financial statements should be read in conjunction with the financial statements and notes contained in our Amendment No. 1 to our Annual Report on Form 10-K/A for the year ended December 31, 2012, or our Amended 2012 Annual Report. In the opinion of our management, all adjustments, which include only normal recurring adjustments, considered necessary for a fair presentation have been included. All material intercompany transactions and balances have been eliminated. Our operating results for interim periods are not necessarily indicative of the results that may be expected for the full year. Reclassifications have been made to the prior year's condensed consolidated financial statements to conform to the current year's presentation.

We operate senior living communities, including independent living communities, assisted living communities and skilled nursing facilities, or SNFs. As of June 30, 2013, we operated 250 senior living communities (excluding those senior living communities we have classified as discontinued operations) located in 31 states containing 29,698 living units, including 219 primarily independent and assisted living communities with 26,876 living units and 31 SNFs with 2,822 living units. As of June 30, 2013, we owned and operated 30 communities (2,946 living units), we leased and operated 181 communities (20,074 living units) and we managed 39 communities (6,678 living units). These 250 senior living communities included 10,319 independent living apartments, 14,190 assisted living suites and 5,189 skilled nursing units. We have classified as discontinued operations one assisted living community owned and operated by us containing 32 living units as well as seven SNFs and four assisted living communities we lease from Senior Housing Properties Trust or its subsidiaries, or SNH, and operate containing 824 living units.

As of June 30, 2013, we also leased and operated two rehabilitation hospitals with 321 beds that provide inpatient rehabilitation services to patients at the two hospitals and at three satellite locations. In addition, as of that date, we leased and operated 13 outpatient clinics affiliated with these rehabilitation hospitals. In the third quarter of 2013, in connection with entering into a purchase agreement with SNH and certain unrelated parties, we reclassified our rehabilitation hospital business as discontinued operations and our rehabilitation hospital business is retrospectively presented as discontinued operations throughout this Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, or this Amended Quarterly Report.

Restatement of Previously Issued Financial Statements

As discussed further in Note 12, we are restating our condensed consolidated financial statements for the three and six months ended June 30, 2013 and 2012 contained within our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, or our Quarterly Report, to correct certain errors in the accounting for income taxes. In addition, as part of the restatement we have corrected certain other errors related to insurance receivables, security deposits, accrual of fixed asset additions, classification of senior living operating expenses and certain other immaterial items. We corrected the presentation and disclosure of our consolidated statements of cash flows to separately identify the net cash flows from discontinued operations, by category and in total. We have also corrected the footnote presentation of certain of our available for sale debt securities from Level 1 assets to Level 2 assets as defined in the fair value hierarchy and corrected the disclosure of the fair value of our mortgage notes payable.

Recently Issued Accounting Pronouncements

In April 2014, the FASB issued Accounting Standards Update 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*, or ASU 2014-08. ASU 2014-08 changes the criteria for reporting a discontinued operation. Under the new pronouncement, a disposal of a part of an organization that has a major effect on its operations and financial results is a discontinued operation. We are required to adopt ASU 2014-08 prospectively for all disposals or components of our business classified as held for sale during fiscal periods beginning after December 15, 2014 and are currently evaluating what impact, if any, its adoption will have to the presentation of our condensed consolidated financial statements.

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FIVE STAR QUALITY CARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

(unaudited)

Segment Information

We have three operating segments: senior living communities, rehabilitation and wellness and rehabilitation hospitals. In the senior living community segment, we operate for our own account or manage for the account of SNH independent living communities, assisted living communities and SNFs that are subject to centralized oversight and provide housing and services to elderly residents. Our rehabilitation and wellness operating segment does not meet any of the quantitative thresholds of a reportable segment as prescribed under Financial Accounting Standards Board, or FASB, *Accounting Standards Codification*TM, or ASC, Topic 280, and as discussed further in Note 10, our rehabilitation hospital operating segment has been reclassified as discontinued operations. After the reclassification of our rehabilitation hospital business as discontinued operations, our business is comprised of one reportable segment, senior living.

Note 2. Property and Equipment

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

	June 30, 2013 (Restated)		December 31, 2012 (Restated)
Land	\$ 21,714	\$	21,714