NATIONAL HEALTH INVESTORS INC
Form 10-Q
May 06, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
(Mark One)
[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2016

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

For the transition period from _____________ to _____________

Commission File Number 001-10822
National Health Investors, Inc.
(Exact name of registrant as specified in its charter)

Maryland	62-1470956
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
222 Robert Rose Drive, Murfreesboro, Tennessee	37129
(Address of principal executive offices)	(Zip Code)

(615) 890-9100
(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes [x] 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 definition of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	[x]	Accelerated filer	[ ]
Non-accelerated filer	[ ]	Smaller reporting company	[ ]

(Do not check if a 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 [x]

There were 38,429,510 shares of common stock outstanding of the registrant as of May 4, 2016.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NATIONAL HEALTH INVESTORS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)

	March 31, 2016 (unaudited)	December 31, 2015
Assets:		
Real estate properties:		
Land	$140,634	$137,532
Buildings and improvements	1,954,537	1,945,323
Construction in progress	18,702	13,011
	2,113,873	2,095,866
Less accumulated depreciation	(272,783)	(259,059)
Real estate properties, net	1,841,090	1,836,807
Mortgage and other notes receivable, net	150,720	133,714
Cash and cash equivalents	28,808	13,286
Marketable securities	58,532	72,744
Straight-line rent receivable	65,062	59,777
Equity-method investment and other assets	15,022	15,544
Assets held for sale, net	—	1,346
Total Assets	$2,159,234	$2,133,218
Liabilities and Equity:		
Debt	$937,138	$914,443
Accounts payable and accrued expenses	24,805	19,397
Dividends payable	34,564	32,637
Lease deposit liabilities	21,275	21,275
Real estate purchase liabilities	750	750
Deferred income	1,013	2,256
Total Liabilities	1,019,545	990,758
Commitments and Contingencies		
National Health Investors Stockholders' Equity:		
Common stock, $.01 par value; 60,000,000 shares authorized; 38,403,978 and 38,396,727 shares issued and outstanding, respectively	384	384
Capital in excess of par value	1,085,896	1,085,136
Cumulative net income in excess of dividends	18,024	19,862
Accumulated other comprehensive income	26,268	27,910
Total National Health Investors Stockholders' Equity	1,130,572	1,133,292
Noncontrolling interest	9,117	9,168
Total Equity	1,139,689	1,142,460
Total Liabilities and Equity	$2,159,234	$2,133,218

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated financial statements. The Condensed Consolidated Balance Sheet at December 31, 2015 was derived from the audited consolidated financial statements at that date.

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NATIONAL HEALTH INVESTORS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except share and per share amounts)

	Three Months Ended March 31,	
	2016	2015
	(unaudited)	
Revenues:		
Rental income	$ 55,074	$ 52,495
Interest income from mortgage and other notes	3,092	2,121
Investment income and other	852	1,135
	59,018	55,751
Expenses:		
Depreciation	13,733	13,014
Interest, including amortization of debt discount and issuance costs	10,262	8,412
Legal	126	104
Franchise, excise and other taxes	283	226
General and administrative	2,929	3,845
	27,333	25,601
Income before equity-method investee, TRS tax benefit, investment and other gains and noncontrolling interest	31,685	30,150
Loss from equity-method investee	(402)	(229)
Income tax benefit attributable to taxable REIT subsidiary	161	92
Investment and other gains	1,665	—
Net income	33,109	30,013
Less: net income attributable to noncontrolling interest	(384)	(330)
Net income attributable to common stockholders	$ 32,725	$ 29,683
Weighted average common shares outstanding:		
Basic	38,401,647	37,558,067
Diluted	38,414,791	37,645,265
Earnings per common share:		
Net income attributable to common stockholders - basic	$ .85	$ .79
Net income attributable to common stockholders - diluted	$ .85	$ .79

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated financial statements.

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NATIONAL HEALTH INVESTORS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	Three Months Ended March 31,	
	2016	2015
	(unaudited)	
Net income	$33,109	$30,013
Other comprehensive income (loss):		
Change in unrealized gains on securities	2,825	883
Increase (decrease) in fair value of cash flow hedge	(5,480)	(4,242)
Less: reclassification adjustment for amounts recognized in net income	1,013	956
Total other comprehensive loss	(1,642)	(2,403)
Comprehensive income	31,467	27,610
Less: comprehensive income attributable to noncontrolling interest	(384)	(330)
Comprehensive income attributable to common stockholders	$31,083	$27,280

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated financial statements.

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NATIONAL HEALTH INVESTORS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Three Months Ended March 31,	
	2016	2015
	(unaudited)	
Cash flows from operating activities:		
Net income	$33,109	$30,013
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	13,733	13,014
Amortization	885	833
Straight-line rental income	(5,286)	(6,089)
Non-cash interest income on construction loan	(150)	—
Gain on sale of real estate	(1,654)	—
Gain on sale of marketable securities	(11)	—
Share-based compensation	979	1,464
Amortization of commitment fees	(68)	—
Loss from equity-method investee	402	229
Change in operating assets and liabilities:		
Equity-method investment and other assets	110	634
Accounts payable and accrued expenses	491	(3,290)
Deferred income	(1,243)	1,756
Net cash provided by operating activities	41,297	38,564
Cash flows from investing activities:		
Investment in mortgage and other notes receivable	(20,774)	(40,773)
Collection of mortgage and other notes receivable	3,985	2,619
Investment in real estate	(9,463)	(10)
Investment in real estate development	(7,640)	(3,202)
Investment in renovations of existing real estate	(453)	(1,695)
Proceeds from disposition of real estate properties	3,000	—
Proceeds from sales of marketable securities	17,049	—
Net cash used in investing activities	(14,296)	(43,061)
Cash flows from financing activities:		
Net change in borrowings under revolving credit facilities	22,000	(266,500)
Proceeds from issuance of secured debt	—	78,084
Borrowings on term loans	—	225,000
Payments on term loans	(189)	(183)
Debt issuance costs	—	(1,502)
Equity offering costs	—	(200)
Taxes paid on employee stock options exercised	(218)	—
Proceeds from exercise of stock options	—	1
Distributions to noncontrolling interest	(435)	(436)
Dividends paid to stockholders	(32,637)	(28,864)

Net cash provided by (used in) financing activities	(11,479)	5,400
Increase in cash and cash equivalents	15,522	903
Cash and cash equivalents, beginning of period	13,286	3,287
Cash and cash equivalents, end of period	$28,808	$4,190

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated financial statements.

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NATIONAL HEALTH INVESTORS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(in thousands)

	Three Months Ended March 31,	
	2016	2015
	(unaudited)	
Supplemental disclosure of cash flow information:		
Interest paid, net of amounts capitalized	$7,682	$7,194
Supplemental disclosure of non-cash investing and financing activities:		
Change in accounts payable related to investments in real estate development	$450	$893
Conversion of note balance into real estate investment	$—	$255

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated financial statements.

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NATIONAL HEALTH INVESTORS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY
(unaudited, in thousands except share and per share amounts)

	Common Stock							
	Shares	Amount	Capital in Excess of Par Value	Cumulative Net Income in Excess of Dividends	Accumulated Other Comprehensive Income	Total National Health Investors Stockholders' Equity	Noncontrolling Interest	Total Equity
Balances at December 31, 2015	38,396,727	$ 384	$ 1,085,136	$ 19,862	$ 27,910	$ 1,133,292	$ 9,168	$ 1,142,460
Total comprehensive income	—	—	—	32,725	(1,642)	31,083	384	31,467
Distributions to noncontrolling interest	—	—	—	—	—	—	(435)	(435)
Taxes paid on employee stock awards	—	—	(219)	—	—	(219)	—	(219)
Shares issued on stock options exercised, net of shares withheld	7,251	—	—	—	—	—	—	—
Share-based compensation	—	—	979	—	—	979	—	979
Dividends declared, $.90 per common share	—	—	—	(34,563)	—	(34,563)	—	(34,563)
Balances at March 31, 2016	38,403,978	$ 384	$ 1,085,896	$ 18,024	$ 26,268	$ 1,130,572	$ 9,117	$ 1,139,689

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated financial statements.

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NATIONAL HEALTH INVESTORS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2016
(unaudited)

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

We, the management of National Health Investors, Inc., ("NHI" or the "Company") believe that the unaudited condensed consolidated financial statements of which these notes are an integral part include all normal, recurring adjustments that are necessary to fairly present the condensed consolidated financial position, results of operations and cash flows of NHI in all material respects. The Condensed Consolidated Balance Sheet at December 31, 2015 has been derived from the audited consolidated financial statements at that date. We assume that users of these condensed consolidated financial statements have read or have access to the audited December 31, 2015 consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies, may be determined in that context. Accordingly, footnotes and other disclosures which would substantially duplicate those contained in our most recent Annual Report on Form 10-K for the year ended December 31, 2015 have been omitted. This condensed consolidated financial information is not necessarily indicative of the results that may be expected for a full year for a variety of reasons including, but not limited to, acquisitions and dispositions, changes in interest rates, rents and the timing of debt and equity financings. For a better understanding of NHI and its condensed consolidated financial statements, we recommend reading these condensed consolidated financial statements in conjunction with the audited consolidated financial statements for the year ended December 31, 2015, which are included in our 2015 Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission, a copy of which is available at our web site: www.nhireit.com.

Principles of Consolidation - The accompanying condensed consolidated financial statements include our accounts and the accounts of our wholly-owned subsidiaries, joint ventures, partnerships and consolidated variable interest entities ("VIE") where NHI controls the operating activities of the VIE, if any. All intercompany transactions and balances have been eliminated in consolidation. Net income is reduced by the portion of net income attributable to noncontrolling interests.

A VIE is broadly defined as an entity with one or more of the following characteristics: (a) the total equity investment at risk is insufficient to finance the entity's activities without additional subordinated financial support; (b) as a group, the holders of the equity investment at risk lack (i) the ability to make decisions about the entity's activities through voting or similar rights, (ii) the obligation to absorb the expected losses of the entity, or (iii) the right to receive the expected residual returns of the entity; or (c) the equity investors have voting rights that are not proportional to their economic interests, and substantially all of the entity's activities either involve, or are conducted on behalf of, an investor that has disproportionately few voting rights.

We apply Financial Accounting Standards Board ("FASB") guidance for our arrangements with variable interest entities ("VIEs") which requires us to identify entities for which control is achieved through means other than voting rights and to determine which business enterprise is the primary beneficiary of the VIE. In accordance with FASB guidance, management must evaluate each of the Company's contractual relationships which creates a variable interest in other entities. If the Company has a variable interest and the entity is a VIE, then management must determine whether or not the Company is the primary beneficiary of the VIE. If it is determined that the Company is the primary beneficiary, NHI consolidates the VIE. We identify the primary beneficiary of a VIE as the enterprise that has both: (i) the power to direct the activities of the VIE that most significantly impact the entity's economic performance; and (ii) the obligation to absorb losses or the right to receive benefits of the VIE that could be significant to the entity. We perform this analysis on an ongoing basis.

At March 31, 2016, we held an interest in five unconsolidated VIEs, consisting of 1) a start-up lessee in which NHI's variable interest consists of its leasehold interest, analogous to a financing arrangement, and of which we concluded that NHI was not the primary beneficiary (Note 2); 2) our joint venture in an operating company organized under provisions of the REIT Investment Diversification and Empowerment Act, ("RIDEA") of which we concluded that NHI was not the primary beneficiary (Note 3); 3) a note receivable from, a guarantee on a letter of credit for, and a purchase option with, a VIE of whom we concluded that NHI was not the primary beneficiary (Note 4); 4) two construction mortgage notes receivable aggregating $97,607,000 from a VIE of whom we concluded that NHI was not the primary beneficiary (Note 4); and 5) two development loans and our lease with a VIE of whom we concluded that NHI was not the primary beneficiary (Note 4). Our direct support of the above VIEs has been limited to the transactions described herein, including our commitments and contingencies described in Note 7, and any decision to furnish additional direct support would be at our discretion and not obligatory. We believe our exposure to loss as a result of our involvement with these unconsolidated VIEs would be limited to our carrying value of these investments, as adjusted for any unrealized loss carry-forwards, the amount of our loan commitments, and as guarantor under the letter of credit. We generally lack, either directly or through related parties, any material input in the activities that most significantly impact the economic performance of these entities.

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We apply FASB guidance related to investments in joint ventures based on the type of controlling rights held by the members' interests in limited liability companies that may preclude consolidation by the majority equity owner in certain circumstances in which the majority equity owner would otherwise consolidate the joint venture.

We structure our joint ventures to be compliant with the provisions of the REIT Investment Diversification and Empowerment Act of 2007 ("RIDEA") which permits NHI to receive rent payments through a triple-net lease between a property company and an operating company and is designed to give NHI the opportunity to capture additional value on the improving performance of the operating company through distributions to a taxable REIT subsidiary ("TRS"). Accordingly, the TRS holds our equity interest in an unconsolidated operating company, which we do not control, and provides an organizational structure that will allow the TRS to engage in a broad range of activities and share in revenues that would otherwise be non-qualifying income under the REIT gross income tests.

Marketable Securities. - Investments in marketable debt and equity securities must be categorized as trading, available-for-sale or held-to-maturity. Our investments in marketable equity securities are classified as available-for-sale securities. Unrealized gains and losses on available-for-sale securities are recorded in other comprehensive income. We evaluate our securities for other-than-temporary impairments on at least a quarterly basis. Realized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis.

A decline in the market value of any available-for-sale or held-to-maturity security below cost that is deemed to be other-than-temporary results in an impairment to reduce the carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is other-than-temporary, we consider whether we have the ability and intent to hold the investment until a market price recovery and consider whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to period-end and forecasted performance of the investment.

Equity-Method Investment - We report our TRS' investment in an unconsolidated entity, over whose operating and financial policies we have the ability to exercise significant influence but not control, under the equity method of accounting. Under this accounting method, our pro rata share of the entity's earnings or losses is included in our Condensed Consolidated Statements of Income. Additionally, we adjust our investment carrying amount to reflect our share of changes in an equity-method investee's capital resulting from its capital transactions.

The initial carrying value of our equity-method investment is based on the fair value of the net assets of the entity at the time we acquired our interest. We estimate fair values of the net assets of our equity-method investee based on discounted cash flow models. The inputs we use in these models are based on assumptions that are within a reasonable range of current market rates for the respective investments.

We evaluate our equity-method investment for impairment whenever events or changes in circumstances indicate that the carrying value of our investment may exceed the fair value. If it is determined that a decline in the fair value of our investment is not temporary, and if such reduced fair value is below its carrying value, an impairment is recorded. Determining fair value involves significant judgment. Our estimates consider all available evidence including the present value of expected future cash flows discounted at market rates, general economic conditions and other relevant factors.

Noncontrolling Interest - We present the portion of any equity that we do not own in entities that we control (and thus consolidate) as noncontrolling interest and classify such interest as a component of consolidated equity separate from total NHI stockholders' equity in our Condensed Consolidated Balance Sheets. In addition, we exclude net income attributable to the noncontrolling interest from net income attributable to common shareholders in our Condensed

Consolidated Statements of Income.

Use of Estimates - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Earnings Per Share - The weighted average number of common shares outstanding during the reporting period is used to calculate basic earnings per common share. Diluted earnings per common share assume the exercise of stock options using the treasury stock method, to the extent dilutive. Diluted earnings per share also incorporate the potential dilutive impact of our 3.25% convertible senior notes due 2021. We apply the treasury stock method to our convertible debt instruments, the effect of which is that conversion will not be assumed for purposes of computing diluted earnings per share unless the average share price for the period exceeds the conversion price per share.

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Reclassifications - We have reclassified, for all periods presented, certain loan commitment fees paid by our borrowers, which were previously accounted for on our Consolidated Balance Sheet at December 31, 2015, as deferred revenues. The fees are now presented on our consolidated balance sheets as a contra-asset to the related loan receivable balance. The effect has been to reduce total assets and total liabilities by $1,317,000 on our Condensed Consolidated Balance Sheet as of December 31, 2015.
New Accounting Pronouncements - In February 2015 the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis, which is generally effective for fiscal years and interim periods beginning after December 15, 2015. ASU 2015-02 changed the consolidation analysis for all reporting entities. The changes primarily affect the consolidation of limited partnerships and their equivalents (e.g., limited liability corporations), the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships, as well as structured vehicles such as collateralized debt obligations. We adopted the provisions of ASU 2015-02 in the first quarter of 2016. The adoption of ASU 2015-02 did not have a material effect on our consolidated financial statements.

In April 2015 the FASB issued ASU 2015-03, Interest-Imputation of Interest, whose primary effect as subsequently modified is to mandate that, except for revolving credit facilities (which may carry a zero balance), debt issuance costs be reported in the balance sheet as a direct deduction from the face amount of the related liability. Debt issuance costs have previously been presented among assets on the balance sheet. The standard does not affect the recognition and measurement of debt issuance costs. The ASU is effective for public business entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. In adopting ASU 2015-03 in the first quarter of 2016, we have chosen to deduct debt issuance costs from amounts owing under our line of credit arrangements, and we have restated prior periods for the effect of these reclassifications. The adoption had the effect of reducing total assets and total liabilities on our Condensed Consolidated Balance Sheet at December 31, 2015, by the amount of unamortized loan costs of $11,814,000.

In September 2015 the FASB issued ASU 2015-16 Simplifying the Accounting for Measurement Period Adjustments, whose principal provisions require that in a business combination an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments in ASU 2015-16 require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Previously, GAAP required that during the measurement period, the acquirer retrospectively adjust the provisional amounts recognized at the acquisition date with a corresponding adjustment to goodwill. To simplify the accounting for adjustments made to provisional amounts recognized in a business combination, the amendments in ASU 2015-16 eliminate the requirement to retrospectively account for those adjustments. For public business entities, the amendments in ASU 2015-16 are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. We adopted the provisions of ASU 2015-16 in the first quarter of 2016. The adoption of ASU 2015-16 did not have a material effect on our consolidated financial statements.
In January 2016 the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. Public companies will be required to apply 2016-01 for all accounting periods beginning after December 15, 2017. For public companies, the primary effects of 2016-01 are to:

- Require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

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Simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value.

- Eliminate the requirement to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet.

- Require the use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

- Require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.

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- Require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.

- Clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

We are considering what effect, if any, that adopting the provisions of ASU 2015-01 in 2018 will have on NHI.

In February 2016 the FASB issued ASU 2016-02, Leases. Public companies will be required to apply ASU 2016-02 for all accounting periods beginning after December 15, 2018 - for REITs this means application will be required beginning Jan. 1, 2019. Early adoption is permitted. All leases with lease terms greater than one year are subject to ASU 2016-02 , including leases in place as of the adoption date. Management expects that, because of the ASU 2016-02 's emphasis on lessee accounting, ASU 2016-02 will not have a material impact on our accounting for leases. Consistent with present standards, NHI will continue to account for lease revenue on a straight-line basis for most leases. Also consistent with NHI's current practice, under ASU 2016-02 only initial direct costs that are incremental to the lessor will be capitalized.

In March 2016 the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, as part of its simplification initiative. ASU 2016-09 is effective for public companies starting in fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted. The areas for simplification in ASU 2016-09 involve several aspects of accounting for share-based payment transactions, including related income tax consequences, classification of awards as either equity or liabilities, and classification of equity awards within the statement of cash flows. Because NHI is designed as a pass-through entity for purposes of Federal taxation, many of the provisions of ASU 2016-09 which deal with taxation will not have a material effect on our financial statements. Among the provisions with broader reach are simplifications as to treatment of forfeitures, which under current GAAP are based on the number of awards that are expected to vest. Upon adoption of ASU 2016-09, an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest, as in current GAAP, or account for forfeitures when they occur. Additionally, ASU 2016-09 clarifies that cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity. Our adoption, in the first quarter of 2016, of the provisions of ASU 2016-09 had no material effect on our consolidated financial statements.

In March 2016 the FASB issued ASU 2016-07, Contingent Put and Call Options in Debt Instruments, which clarifies how to assess whether contingent call (put) options that can accelerate the payment on debt instruments are clearly and closely related to their debt hosts. This assessment is necessary to determine if the options must be separately accounted for as derivatives. The ASU clarifies that an entity is required to assess the embedded options solely in accordance with a specific four-step decision sequence and is not also required to assess whether the contingency for exercising the options is indexed to interest rates or credit risk. The amendments are effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted. We adopted the provisions of ASU 2016-07 in the first quarter of 2016. The adoption of ASU 2016-07 did not have a material effect on our consolidated financial statements.

NOTE 2. REAL ESTATE

As of March 31, 2016, we owned 181 health care real estate properties located in 31 states and consisting of 115 senior housing communities, 61 skilled nursing facilities, 3 hospitals and 2 medical office buildings. Our senior housing properties include assisted living facilities, senior living campuses, independent living facilities, and entrance-fee communities. These investments (excluding our corporate office of $976,000) consisted of properties

with an original cost of approximately $2,112,897,000, rented under triple-net leases to 26 lessees.

Woodland Village

On January 15, 2016, we acquired a 98-unit independent living community in Chehalis, Washington, for $9,463,000 in cash inclusive of closing costs of $213,000 plus an additional commitment to fund $350,000 in specified capital improvements. We leased the facility to a partnership between Marathon Development and Village Concepts Retirement Communities for an initial lease term of 15 years. The lease provides for an initial annual lease rate of 7.25% plus escalators of 2.0% in year two, 2.5% in year three, and 3.0% annually thereafter. Because the facility was owner-occupied, the acquisition was accounted for as an asset purchase.

Bickford

As of March 31, 2016, we owned an 85% equity interest and Sycamore Street, LLC (“Sycamore”), an affiliate of Bickford Senior Living (“Bickford”), owned a 15% equity interest in our consolidated subsidiary (“PropCo”) which owns 32 assisted

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living/memory care facilities plus 5 facilities in pre-development and development. The facilities are leased to an operating company ("OpCo"), in which we retain a non-controlling 85% ownership interest. The facilities are managed by Bickford. Our joint venture is structured to comply with the provisions of RIDEA.

As of March 31, 2016, the annual contractual rent from OpCo to PropCo is $25,529,000, plus annual escalators of 3%. NHI has an exclusive right to Bickford's future acquisitions, development projects and refinancing transactions. Of our total revenues, $6,307,000 (11%) and $5,804,000 (10%) were recognized as rental income from Bickford for the three months ended March 31, 2016 and 2015, respectively.

Holiday

As of March 31, 2016, we leased 25 independent living facilities to an affiliate of Holiday Retirement ("Holiday"). The master lease term of 17 years began in December 2013 and provides for an annual escalator of 4.5% in 2017 and a minimum of 3.5% each year thereafter.

Of our total revenues, $10,954,000 (19%) and $10,954,000 (20%) were derived from Holiday for the three months ended March 31, 2016 and 2015, including $2,241,000 and $2,616,000 in straight-line rent, respectively. Our tenant operates the facilities pursuant to a management agreement with a Holiday-affiliated manager.

NHC

As of March 31, 2016, we leased 42 facilities under two master leases to National HealthCare Corporation ("NHC"), a publicly-held company and the lessee of our legacy properties. The facilities leased to NHC consist of 3 independent living facilities and 39 skilled nursing facilities (4 of which are subleased to other parties for whom the lease payments are guaranteed to us by NHC). These facilities are leased to NHC under the terms of an amended master lease agreement originally dated October 17, 1991 ("the 1991 lease") which includes our 35 remaining legacy properties and a master lease agreement dated August 30, 2013 ("the 2013 lease") which includes 7 skilled nursing facilities acquired from a third party.

The 1991 lease has been amended to extend the lease expiration to December 31, 2026. There are two additional 5-year renewal options, each at fair rental value of such leased property as negotiated between the parties and determined without including the value attributable to any improvements to the leased property voluntarily made by NHC at its expense. Under the terms of the lease, the base annual rental is $30,750,000 and rent escalates by 4% of the increase, if any, in each facility's revenue over a 2007 base year. The 2013 lease provides for a base annual rental of $3,450,000 and has a lease expiration of August 2028. Under the terms of the 2013 lease, rent escalates 4% of the increase in each facility's revenue over the 2014 base year. For both the 1991 lease and the 2013 lease, we refer to this additional rent component as "percentage rent." During the last three years of the 2013 lease, NHC will have the option to purchase the facilities for $49,000,000.

The following table summarizes the percentage rent income from NHC (in thousands):

	Three Months Ended March 31,	
	2016	2015
Current year	$733	$596
Prior year final certification[1]	547	94
Total percentage rent income	$1,280	$690

[1] For purposes of the percentage rent calculation described in the master lease Agreement, NHC's annual revenue by facility for a given year is certified to NHI by March 31st of the following year.

Of our total revenues, $9,817,000 (17%) and $9,227,000 (17%) were derived from NHC for the three months ended March 31, 2016 and 2015, respectively.

The chairman of our board of directors is also a director on NHC's board of directors. As of March 31, 2016, NHC owned 1,630,462 shares of our common stock.

Senior Living Communities

Beginning in December 2014 we leased eight retirement communities with 1,671 units to Senior Living Communities, LLC ("Senior Living"). The 15-year master lease contains two 5-year renewal options and provides for annual escalators of 4% in years two through four and 3% thereafter.

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Of our total revenue, $9,855,000 (17%) and $9,855,000 (18%) in lease revenue were derived from Senior Living for the three months ended March 31, 2016 and 2015, respectively, including $1,795,000 and $2,105,000, respectively, in straight-line rent.

East Lake VIE

On July 1, 2015, we acquired two senior living campuses in Nashville and Indianapolis and one assisted living/memory care facility in Charlotte for $66,900,000 in cash. At that time, we leased the facilities to an affiliate of East Lake Capital Management ("East Lake") for an initial term of 10 years, plus renewal options. Further, we committed to invest an additional $400,000 for specified capital improvements, for which no funds have been provided as of March 31, 2016. East Lake's relationship with NHI consists of its leasehold interest and is considered a variable interest, analogous to a financing arrangement. Because we neither control East Lake nor have any role in its day-to-day management, we have no material input into activities that most significantly impact the entity's economic performance, and we account for our transactions with East Lake at amortized cost. We are not obligated to provide further support to East Lake, and accordingly the maximum extent of our exposure to loss is limited to our investment in the facilities.

Disposition of Assets

On March 22, 2016, we sold a skilled nursing facility in Idaho for cash consideration of $3,000,000. The carrying value of the facility was $1,346,000, and we recorded a gain of $1,654,000. For the three months ended March 31, 2016 and 2015, lease income from the property was $73,000 and $80,000, respectively.

NOTE 3. EQUITY-METHOD INVESTMENT AND OTHER ASSETS

Our equity-method investment in OpCo and other assets consist of the following (in thousands):

	March 31, 2016	December 31, 2015
Equity-method investment in OpCo	$ 7,254	$ 7,657
Accounts receivable and other assets	3,985	3,256
Reserves for replacement, insurance and tax escrows	3,783	4,631
	$ 15,022	$ 15,544

Upon the acquisition of our equity method investment in OpCo in 2012, our purchase price was allocated to the assets acquired based upon their estimated relative fair values. Accounting guidance for equity method investments requires that we account for the difference between the cost basis of our investment in OpCo and our pro rata share of the amount of underlying equity in the net assets of OpCo as though OpCo were a consolidated subsidiary. Accordingly, the excess of the original purchase price over the fair value of identified tangible assets at acquisition of $8,986,000 is treated as implied goodwill and is subject to periodic review for impairment in conjunction with our equity method investment. When we acquired Bickford properties in June 2013, an assignment was entered into whereby the operations of the 17 facilities were conveyed by an affiliate of Bickford to OpCo. The transaction mandated the effective cut-off of operating revenues and expenses and the settlement of operating assets and liabilities as of the acquisition date. Specified remaining net tangible assets were assigned to OpCo at the transferor's carryover basis resulting in an adjustment, through NHI's capital in excess of par value to our equity method investment in OpCo, of $817,000. We monitor and periodically review our equity method investment in OpCo for impairment to determine whether a decline, if any, in the value of the investment is other-than temporary. We noted no decline in value as of March 31, 2016.

Reserves for replacement, insurance and tax escrows include amounts required to be held on deposit in accordance with regulatory agreements governing our Fannie Mae and HUD mortgages.

With the adoption of ASU 2015-03, Interest-Imputation of Interest, in the first quarter of 2016, the balance in Equity Method Investment and Other Assets was reduced to reflect the reclassification of our unamortized loan costs which are now being offset against the loan balances as shown in Note 6.

NOTE 4. MORTGAGE AND OTHER NOTES RECEIVABLE

At March 31, 2016, we had net investments in mortgage notes receivable with a net carrying value of $114,021,000, secured by real estate and UCC liens on the personal property of 9 facilities, and other notes receivable with a carrying value of $36,699,000, guaranteed by significant parties to the notes or by cross-collateralization of properties with the same owner. No allowance for doubtful accounts was considered necessary at March 31, 2016 or December 31, 2015.

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Timber Ridge

In February 2015, we entered into an agreement to lend up to $154,500,000 to LCS-Westminster Partnership III LLP ("LCS-WP"), an affiliate of Life Care Services ("LCS") . The loan agreement conveys a mortgage interest and will facilitate the construction of Phase II of Timber Ridge at Talus ("Timber Ridge"), a Type-A Continuing Care Retirement Community in Issaquah, WA managed by LCS.

The loan takes the form of two notes under a master credit agreement. The senior note ("Note A") totals $60,000,000 at a 6.75% interest rate with 10 basis-point escalators after year three, and has a term of 10 years. We have funded $28,000,000 of Note A as of March 31, 2016. Note A is interest-only and is locked to prepayment for three years. After year three, the prepayment penalty starts at 5% and declines 1% per year. The second note ("Note B") is a construction loan for up to $94,500,000 at an annual interest rate of 8% and a 5 year maturity. We anticipate funding Note B through December 2016 and anticipate substantial repayment with new resident entrance fees upon the opening of Phase II. The total amount funded on Note B was $70,855,000 as of March 31, 2016.

NHI has a purchase option on the entire Timber Ridge property for the greater of fair market value or $115,000,000 during a purchase option window of 120 days that will contingently open in year five or upon earlier stabilization of the development, as defined. The current basis of our investment in Timber Ridge loans is $97,607,000, but we are obligated to complete the funding of both Notes A and B of up to $154,500,000 which represents the maximum exposure to loss of NHI due to our relationship with Timber Ridge. Because we neither control the entity, nor have any role in its day-to-day management, we account for our investment in LCS-WP at amortized cost.

Senior Living Communities

In connection with the acquisition in December 2014 of the properties leased to Senior Living we provided a $15,000,000 revolving line of credit to Senior Living, the maturity of which mirrors the 15-year term of the master lease. Borrowings are used to finance construction projects within the Senior Living portfolio, including building additional units. Up to $5,000,000 of the facility may be used to meet general working capital needs. Amounts outstanding under the facility, $9,227,000 at March 31, 2016, bear interest at an annual rate equal to the 10-year U.S. Treasury rate, 1.78% at March 31, 2016, plus 6%.

In March 2016, we extended mezzanine loans of $12,000,000 and $2,000,000 to affiliates of Senior Living Communities, LLC, to partially fund construction of a 186-unit senior living campus on Daniel Island in South Carolina. The loans convey a second mortgage interest, bear interest payable monthly at a 10% annual rate, and mature in March 2021. The loans have a total balance of $1,203,000 at March 31, 2016.

Our loans to Senior Living Communities, LLC, and its subsidiaries represent a variable interest as does our lease, which is considered to be analogous to a financing arrangement. Senior Living is structured to limit liability for potential claims for damages and is appropriately capitalized for that purpose. Accordingly, NHI holds guarantees that reach to the underlying ownership interests. Because we neither control Senior Living Communities, nor have any role in its day-to-day management, we have no material input into activities that most significantly impact the entity's economic performance, and we account for our transactions with Senior Living Communities and its subsidiaries at amortized cost. We are not obligated to provide support beyond our stated commitments to Senior Living Communities, LLC, and accordingly the maximum extent of our exposure to loss is limited to our investment in the facilities and the amount of our commitments, as discussed above.

Sycamore

In July 2013 we provided a $9,200,000 loan to our joint venture partner, Sycamore, to fund a portion of their acquisition from a third party of six senior housing communities consisting of 342 units. The loan is guaranteed by principals of Bickford and bears interest at 12%. As a result of the loan, PropCo acquired a $97,000,000 purchase option exercisable over the term of the loan, covering all of the properties, in whole or in part. Terms of the loan and the purchase option have been extended through June 2018. In June 2014 we entered into a $500,000 revolving loan to Sycamore to fund pre-development expenses related to potential future projects. Interest is payable monthly at 10% and the note, as extended, matures in June 2018. At March 31, 2016, the revolving loan had an outstanding balance of $479,000. Sycamore is intended to be self-financing, and our direct support has been limited to the loans described herein and a $3,930,000 letter of credit for the benefit of Sycamore. We are not obligated to extend support to Sycamore beyond our current basis in the loans and letter of credit to them; accordingly our investment in this extension of credit represents our maximum exposure to loss. However, because we do not control Sycamore, nor do we have any role in the day-to-day management, we account for loans provided to Sycamore at amortized cost.

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NOTE 5. INVESTMENTS IN MARKETABLE SECURITIES

Our investments in marketable securities include available-for-sale securities which are reported at fair value and investments in marketable debt securities, also classified as available-for-sale, which consist of U.S. government agency debt and long-term certificates of deposit. Unrealized gains and losses on available-for-sale securities are presented as a component of accumulated other comprehensive income. Realized gains and losses from securities sales are determined based upon specific identification of the securities. Marketable securities consist of the following (in thousands):

	March 31, 2016		December 31, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Common stock of other healthcare REITs	$21,040	$58,532	$21,040	$55,815
Debt securities	$—	$—	$17,037	$16,929

Net unrealized gains related to available-for-sale securities were $37,492,000 at March 31, 2016 and $34,667,000 at December 31, 2015.

NOTE 6. DEBT

Debt consists of the following (in thousands):

	March 31, 2016	December 31, 2015
Convertible senior notes - unsecured (net of discount of $5,580 and $5,862)	194,420	194,138
Revolving credit facility - unsecured	56,000	34,000
Bank term loans - unsecured	250,000	250,000
Private placement term loans - unsecured	325,000	325,000
HUD mortgage loans (net of discount of $1,552 and $1,573)	44,867	45,035
Fannie Mae term loans - secured, non-recourse	78,084	78,084
Unamortized loan costs	(11,233)	(11,814)
	$937,138	$ 914,443

Aggregate principal maturities of debt as of March 31, 2016 for each of the next five years and thereafter are as follows (in thousands):

Twelve months ended March 31	
2017	$775
2018	801
2019	828
2020	856
2021	306,885
Thereafter	645,358
	955,503
Less: discount	(7,132)
Less: unamortized loan costs	(11,233)
	$937,138

In November 2015 we issued $50,000,000 of 8-year notes with a coupon of 3.99% and $50,000,000 of 10-year notes with a coupon of 4.33% to a private placement lender. The notes are unsecured and require quarterly payments of interest only until maturity. We used the proceeds from the notes to pay down borrowings on our revolving credit

facility. Terms and conditions of the new financing are similar to those under our bank credit facility with the exception of provisions regarding prepayment premiums.

In June 2015 we entered into an amended $800,000,000 senior unsecured credit facility with a group of banks. The facility can be expanded, subject to certain conditions, up to an additional $250,000,000. The amended credit facility provides for: (1) a $550,000,000 revolving credit facility that matures in June 2020 (inclusive of an embedded 1-year extension option) with interest at 150 basis points over LIBOR (44 bps at March 31, 2016); (2) an existing $130,000,000 term loan that matures in June 2020 with interest at 175 basis points over LIBOR; and (3) two existing term loans which remain in place totaling $120,000,000, maturing

in June 2020 and bearing interest at 175 basis points over LIBOR. At closing, the new facility replaced a smaller credit facility last amended in March 2014 that provided for $700,000,000 of total commitments. The employment of interest rate swaps for our fixed term debt leaves only our revolving credit facility exposed to variable rate risk. Our swaps and the financial instruments to which they relate are described in the table below, under the caption "Interest Rate Swap Agreements."

At March 31, 2016 we had $494,000,000 available to draw on the revolving portion of the credit facility. The unused commitment fee is 40 basis points per annum. The unsecured credit facility agreement requires that we maintain certain financial ratios within limits set by our creditors. To date, these ratios, which are calculated quarterly, have been within the limits required by the credit facility agreements.

Pinnacle Bank, which is a participating member of our banking group, is a wholly owned subsidiary and the primary active business of the bank holding company, Pinnacle Financial Partners, Inc. The chairman of Pinnacle Financial Partners' board of directors is also a director on NHI's board and is chairman of our audit committee. NHI's local banking transactions are conducted primarily through Pinnacle Bank.

In March 2015 we obtained $78,084,000 in Fannie Mae financing. The term debt financing consists of interest-only payments at an annual rate of 3.79% and a 10-year maturity. The mortgages are non-recourse and secured by thirteen properties in NHI's joint venture with Bickford. Proceeds were used to reduce borrowings on our revolving bank credit facility. The notes are secured by the facilities previously pledged as security on Fannie Mae term debt that was retired in December 2014.

In January 2015 we issued $125,000,000 of 8-year notes with a coupon of 3.99% and $100,000,000 of 12-year notes with a coupon of 4.51% to a private placement lender. The notes are unsecured and require quarterly payments of interest only until maturity. We used the proceeds from the notes to pay down borrowings on our revolving credit facility. Terms and conditions of the new financing are similar to those under our bank credit facility with the exception of provisions regarding prepayment premiums.

In March 2014 we issued $200,000,000 of 3.25% senior unsecured convertible notes due April 2021 (the "Notes"). Interest is payable April 1st and October 1st of each year. The Notes are convertible at an initial conversion rate of 13.926 shares of common stock per $1,000 principal amount, representing a conversion price of approximately $71.81 per share for a total of approximately 2,785,200 underlying shares. The conversion rate is subject to adjustment upon the occurrence of certain events, as defined in the indenture governing the Notes, but will not be adjusted for any accrued and unpaid interest except in limited circumstances. The conversion option is considered an "optional net-share settlement conversion feature," meaning that upon conversion, NHI's conversion obligation may be satisfied, at our option, in cash, shares of common stock or a combination of cash and shares of common stock. Because the conversion price is in excess of the average stock price for the quarter, the impact of the conversion option is currently anti-dilutive to the earnings per share calculation and as such has no effect on our earnings per share.

The embedded conversion options (1) do not require net cash settlement, (2) are not conventionally convertible but can be classified in stockholders' equity under ASC 815-40, and (3) are considered indexed to NHI's own stock. Therefore, the conversion feature satisfies the conditions to qualify for an exception to the derivative liability rules, and the Notes are split into debt and equity components. The value of the debt component is based upon the estimated fair value of a similar debt instrument without the conversion feature at the time of issuance and was estimated to be approximately $192,238,000. The $7,762,000 difference between the contractual principal on the debt and the value allocated to the debt was recorded as an equity component and represents the estimated value of the conversion feature of the instrument. The excess of the contractual principal amount of the debt over its estimated fair value, the original issue discount, is amortized to interest expense using the effective interest method over the estimated term of the Notes. The effective interest rate used to amortize the debt discount and the liability component of the debt issue costs

was approximately 3.9% based on our estimated non-convertible borrowing rate at the date the Notes were issued.

The total cost of issuing the Notes was $6,063,000, $275,000 of which was allocated to the equity component and $5,788,000 of which was allocated to the debt component and subject to amortization over the estimated term of the notes. The remaining unamortized balance at March 31, 2016, was $3,927,000.

Our HUD mortgage loans are secured by ten properties in our joint venture with Bickford. Nine mortgage notes require monthly payments of principal and interest from 4.65% to 4.75% in the first year and from 4.3% to 4.4% thereafter (inclusive of mortgage insurance premium) and mature in August and October 2049. An additional HUD mortgage loan assumed in 2014 requires monthly payments of principal and interest of 2.9% (inclusive of mortgage insurance premium) and matures in October 2047. The loan has an outstanding principal balance of $9,262,000 and an estimated fair value of $7,710,000.

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The following table summarizes interest expense (in thousands):

	Three Months Ended March 31,	
	2016	2015
Interest expense at contractual rates	$9,515	$7,712
Capitalized interest	(121)	(120)
Amortization of debt issuance costs and debt discount	868	820
Total interest expense	$10,262	$8,412

Interest Rate Swap Agreements

To mitigate our exposure to interest rate risk, we have entered into the following interest rate swap contracts on our bank term loans as of March 31, 2016 (dollars in thousands):

Date Entered	Maturity Date	Fixed Rate	Rate Index	Notional Amount	Fair Value
May 2012	April 2019	3.29%	1-month LIBOR	$40,000	$(897)
June 2013	June 2020	3.86%	1-month LIBOR	$80,000	$(3,865)
March 2014	June 2020	3.91%	1-month LIBOR	$130,000	$(6,522)

See Note 11 for fair value disclosures about our variable and fixed rate debt and interest rate swap agreements.

NOTE 7. COMMITMENTS AND CONTINGENCIES

Bickford

In February 2015 our joint venture with Bickford announced plans to develop five senior housing facilities in Illinois and Virginia. Each community will be managed by Bickford and consist of 60 private-pay assisted living and memory care units. These five properties will represent the culmination of plans announced in 2012 between NHI and Bickford to construct a total of eight facilities. The first three communities, all in Indiana, opened in 2013 and 2014. Pre-development and land acquisition on the five facilities started in mid-2015 with openings planned beginning in late 2016. The total estimated project cost is $55,000,000. As of March 31, 2016, land and development costs incurred on the project totaled $25,626,000.

In February 2014 we entered into a commitment on a letter of credit for the benefit of Sycamore which holds a minority interest in PropCo. At March 31, 2016 our commitment on the letter of credit totaled $3,930,000.

In June 2014 we entered into a $500,000 revolving loan with Sycamore to fund pre-development expenses related to potential future projects. Interest is payable monthly at 10% and the note, as extended, matures in June 2018. At March 31, 2016, the revolving loan had an outstanding balance of $479,000.

Chancellor

At March 31, 2016, we had a continuing commitment with Chancellor Health Care ("Chancellor") to provide up to $650,000 for renovations and improvements related to a recently acquired senior housing community in Oregon. Renovations began on this property during the second quarter of 2015, and we have funded $51,000 as of March 31, 2016.

Discovery

As a lease inducement, we have a contingent commitment to fund a series of payments up to $2,500,000 in connection with our September 2013 lease to Discovery Senior Living (“Discovery”) of a senior living campus in Rainbow City, Alabama. Discovery would earn the contingent payments upon attaining, and maintaining, a specified lease coverage ratio. Payments were assessed for funding in an amount of $750,000 in September 2015 with the residual potentially due later in 2016. As of March 31, 2016, incurring the contingent payments was not considered probable. Accordingly, no provision for these payments is reflected in the condensed consolidated financial statements.

East Lake

In connection with our July 2015 lease of three senior housing properties, NHI has committed to East Lake certain lease incentive payments of $8,000,000 contingent on reaching and maintaining certain metrics, a contingent earnout of $750,000 payable to the

seller upon attaining certain metrics, and the funding of an additional $400,000 for specified capital improvements. At acquisition, we estimated the seller contingent earnout payment to be probable and accordingly, have reflected that amount in our Condensed Consolidated Balance Sheet at March 31, 2016. Contingent payments earned will be included in the lease base when funded.

Life Care Services

See Note 4 for a discussion of our loan commitments to Timber Ridge, an affiliate of Life Care Services.

Santé

We are committed to fund a $3,500,000 expansion and renovation program at our Silverdale, Washington senior living campus and as of March 31, 2016, had funded $2,621,000, which was added to the basis on which the lease amount is calculated. In addition, we have a contingent commitment to fund two lease inducement payments of $1,000,000 each. Santé would earn the payments upon attaining and sustaining a specified lease coverage ratio. If earned, the first payment would be due following calendar year 2015 and the second payment would be due following calendar year 2016. At acquisition, incurring the contingent payments was not considered probable. No change to our initial assessment has been made as a result of 2015 operations, and accordingly, no provision for these payments is reflected in the condensed consolidated financial statements.

Senior Living Communities

See Note 4 for a discussion of our loan commitments to Senior Living Communities, LLC and its affiliates.

Litigation

Our facilities are subject to claims and suits in the ordinary course of business. Our lessees and borrowers have indemnified, and are obligated to continue to indemnify us, against all liabilities arising from the operation of the facilities, and are further obligated to indemnify us against environmental or title problems affecting the real estate underlying such facilities. While there may be lawsuits pending against certain of the owners and/or lessees of the facilities, management believes that the ultimate resolution of all such pending proceedings will have no material adverse effect on our financial condition, results of operations or cash flows.

NOTE 8. INVESTMENT AND OTHER GAINS

The following table summarizes our investment and other gains (in thousands):

	Three Months Ended March 31,	
	2016	2015
Gain on sale of real estate	1,654	—
Gains on sales of marketable securities	11	—
	$ 1,665	$ —

NOTE 9. SHARE-BASED COMPENSATION

We recognize share-based compensation for all stock options granted over the requisite service period using the fair value of these grants as estimated at the date of grant using the Black-Scholes pricing model, and all restricted stock

granted over the requisite service period using the market value of our publicly-traded common stock on the date of grant.

Share-Based Compensation Plans

The Compensation Committee of the Board of Directors ("the Committee") has the authority to select the participants to be granted options; to designate whether the option granted is an incentive stock option ("ISO"), a non-qualified option, or a stock appreciation right; to establish the number of shares of common stock that may be issued upon exercise of the option; to establish the vesting provision for any award; and to establish the term any award may be outstanding. The exercise price of any ISO's granted will not be less than 100% of the fair market value of the shares of common stock on the date granted, and the term of an ISO may not be more than ten years. The exercise price of any non-qualified options granted will not be less than 100% of the fair market value of the shares of common stock on the date granted unless so determined by the Committee.

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In May 2012, our stockholders approved the 2012 Stock Incentive Plan (“the 2012 Plan”) pursuant to which 1,500,000 shares of our common stock were made available to grant as share-based payments to employees, officers, directors or consultants. Through a vote of our shareholders on May 7, 2015, we increased the maximum number of shares under the plan from 1,500,000 shares to 3,000,000 shares; increased the automatic annual grant to non-employee directors from 15,000 shares to 20,000 shares; and limited the Company’s ability to re-issue shares under the Plan. As of March 31, 2016, there were 1,446,668 shares available for future grants under the 2012 Plan. The individual restricted stock and option grant awards vest over periods up to five years. The term of the options under the 2012 Plan is up to ten years from the date of grant.

In May 2005, our stockholders approved the NHI 2005 Stock Option Plan (“the 2005 Plan”) pursuant to which 1,500,000 shares of our common stock were made available to grant as share-based payments to employees, officers, directors or consultants. As of March 31, 2016, the 2005 Plan has expired and no additional shares may be granted under the 2005 Plan. The individual restricted stock and option grant awards vest over periods up to ten years. The term of the options outstanding under the 2005 Plan is up to ten years from the date of grant.

Compensation expense is recognized only for the awards that ultimately vest. Accordingly, forfeitures that were not expected will result in the reversal of previously recorded compensation expense. The compensation expense reported for the three months ended March 31, 2016 and 2015 was $980,000 and $1,464,000, respectively, and is included in general and administrative expense in the Consolidated Statements of Income.

At March 31, 2016, we had, net of expected forfeitures, $1,151,000 of unrecognized compensation cost related to unvested stock options which is expected to be expensed over the following periods: 2016 - $752,000, 2017 - $360,000 and 2018 - $39,000. Stock-based compensation is included in general and administrative expense in the Condensed Consolidated Statements of Income.

The weighted average fair value per share of options granted was $3.65 and $4.74 for 2016 and 2015, respectively.

The fair value of each grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2016	2015
Dividend yield	5.9%	4.7%
Expected volatility	19.1%	17.8%
Expected lives	2.9 years	2.8 years
Risk-free interest rate	0.91%	0.98%

The following table summarizes our outstanding stock options:

	Three Months Ended March 31,	
	2016	2015
Options outstanding January 1,	741,676	871,671
Options granted under 2012 Plan	470,000	450,000
Options granted under 2005 Plan	—	20,000
Options exercised under 2012 Plan	(126,666)	(421,657)
Options exercised under 2005 Plan	—	(50,002)
Options outstanding, March 31,	1,085,010	870,012
Exercisable at March 31,	731,662	596,664

NOTE 10. EARNINGS AND DIVIDENDS PER SHARE

The weighted average number of common shares outstanding during the reporting period is used to calculate basic earnings per common share. Diluted earnings per common share assume the exercise of stock options and the conversion of our convertible debt using the treasury stock method, to the extent dilutive. If our average stock price for the period increases over the conversion price of our convertible debt, the conversion feature will be considered dilutive.

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The following table summarizes the average number of common shares and the net income used in the calculation of basic and diluted earnings per common share (in thousands, except share and per share amounts):

	Three Months Ended March 31,	
	2016	2015
Net income attributable to common stockholders	$ 32,725	$ 29,683
BASIC:		
Weighted average common shares outstanding	38,401,649	37,558,067
DILUTED:		
Weighted average common shares outstanding	38,401,649	37,558,067
Stock options	13,144	68,257
Convertible subordinated debentures	—	18,941
Average dilutive common shares outstanding	38,414,793	37,645,265
Net income per common share - basic	$ .85	$ .79
Net income per common share - diluted	$ .85	$ .79
Incremental shares excluded since anti-dilutive:		
Net share effect of stock options with an exercise price in excess of the average market price for our common shares	75,050	5,666
Regular dividends declared per common share	$ .90	$ .85

NOTE 11. FAIR VALUE OF FINANCIAL INSTRUMENTS

Our financial assets and liabilities measured at fair value (based on the hierarchy of the three levels of inputs described in Note 1 to the consolidated financial statements contained in our most recent Annual Report on Form 10-K) on a recurring basis include marketable securities, derivative financial instruments and contingent consideration arrangements. Marketable securities consist of common stock of other healthcare REITs. Derivative financial instruments include our interest rate swap agreements. Contingent consideration arrangements relate to certain provisions of recent real estate purchase agreements involving both business combinations.

Marketable securities. We utilize quoted prices in active markets to measure debt and equity securities; these items are classified as Level 1 in the hierarchy and include the common and preferred stock of other healthcare REITs.

Derivative financial instruments. Derivative financial instruments are valued in the market using discounted cash flow techniques. These techniques incorporate Level 1 and Level 2 inputs. The market inputs are utilized in the discounted cash flow calculation considering the instrument's term, notional amount, discount rate and credit risk. Significant inputs to the derivative valuation model for interest rate swaps are observable in active markets and are classified as Level 2 in the hierarchy.

Contingent consideration. Contingent consideration arrangements are classified as Level 3 and are valued using unobservable inputs about the nature of the contingent arrangement and the counter-party to the arrangement, as well as our assumptions about the probability of full settlement of the contingency.

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Assets and liabilities measured at fair value on a recurring basis are as follows (in thousands):

	Balance Sheet Classification	Fair Value Measurement March 31, 2016	December 31, 2015
Level 1			
Common stock of other healthcare REITs	Marketable securities	$58,532	$ 55,815
Debt securities	Marketable securities	$—	$ 16,929
Level 2			
Interest rate swap liability	Accounts payble and accrued expenses	$11,284	$ 6,730

Carrying values and fair values of financial instruments that are not carried at fair value at March 31, 2016 and December 31, 2015 in the Condensed Consolidated Balance Sheets are as follows (in thousands):

	Carrying Amount		Fair Value Measurement	
	2016	2015	2016	2015
Level 2				
Variable rate debt	$302,024	$279,745	$306,000	$284,000
Fixed rate debt	$635,114	$634,698	$665,402	$641,066
Level 3				
Mortgage and other notes receivable	$150,720	$133,714	$161,398	$141,408

The fair value of mortgage and other notes receivable is based on credit risk and discount rates that are not observable in the marketplace and therefore represents a Level 3 measurement.

Fixed rate debt. Fixed rate debt is classified as Level 2 and its value is based on quoted prices for similar instruments or calculated utilizing model derived valuations in which significant inputs are observable in active markets.

Carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to their short-term nature. The fair value of our borrowings under our revolving credit facility are reasonably estimated at their carrying value at March 31, 2016 and December 31, 2015, due to the predominance of floating interest rates, which generally reflect market conditions.

NOTE 12. SUBSEQUENT EVENTS

On April 1, 2016, we purchased eight skilled nursing facilities totaling 931 beds in Texas for $118,500,000. The facilities are currently operated by NHI's existing tenant, Legend Healthcare ("Legend"). Concurrent with the acquisition, we amended in-place leases covering our nine other skilled nursing facilities operated by Legend, extending their provisions to the new facilities. The amendment also replaced purchase options that provided for equal sharing of any appreciation in value, within a specified range with purchase options with a price determined at fair value, exercisable at the end of the lease term. Based on our tentative analysis of the in-place options, approximately $6,000,000 of the consideration in the acquisition will likely attach to the canceled provisions.

Legend elected to transition its current skilled nursing operations to a new operator on May 1, 2016, and NHI entered into a new 15-year master lease with affiliates of The Ensign Group, Inc. ("Ensign") on 15 of the former Legend facilities for an initial annual amount of $17,750,000, plus an annual escalator based on inflation. The lease has two 5-year renewal options. Upon entering the new lease, NHI agreed to sell two existing skilled nursing facilities

previously under lease to Legend in Texas totaling 245 beds to Ensign for $24,600,000. The new lease, which includes a corporate guaranty from Ensign, replaces the Legend lease, and, accordingly, the purchase options held by Legend have terminated. For accounting purposes, the transition of our lease from Legend to Ensign will require a non-cash write-off related to the approximate $6,000,000 fair value assigned to the former Legend purchase options and $8,247,000 of accumulated straight-line rent receivable.

As part of this transaction, NHI has committed to purchase four skilled nursing facilities in Texas from Legend for $56,000,000 and lease them to Ensign. The facilities are in various stages of development and the purchase window for the first facility is expected to open in 2017.

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

Forward Looking Statements

References throughout this document to NHI or the Company include National Health Investors, Inc., and its consolidated subsidiaries. In accordance with the Securities and Exchange Commission's "Plain English" guidelines, this Quarterly Report on Form 10-Q has been written in the first person. In this document, the words "we", "our", "ours" and "us" refer only to National Health Investors, Inc. and its consolidated subsidiaries and not any other person. Unless the context indicates otherwise, references herein to "the Company" include all of our consolidated subsidiaries.

This Quarterly Report on Form 10-Q and other materials we have filed or may file with the Securities and Exchange Commission, as well as information included in oral statements made, or to be made, by our senior management contain certain "forward-looking" statements as that term is defined by the Private Securities Litigation Reform Act of 1995. All statements regarding our expected future financial position, results of operations, cash flows, funds from operations, continued performance improvements, ability to service and refinance our debt obligations, ability to finance growth opportunities, and similar statements including, without limitation, those containing words such as "may," "will," "believes," "anticipates," "expects," "intends," "estimates," "plans," and other similar expressions are forward-l statements.

Forward-looking statements involve known and unknown risks and uncertainties that may cause our actual results in future periods to differ materially from those projected or contemplated in the forward-looking statements as a result of, but not limited to, the following factors:

* We depend on the operating success of our tenants and borrowers for collection of our lease and interest income;

* Certain tenants in our portfolio account for a significant percentage of the rent we expect to generate and the failure of any of these tenants to meet their obligations to us could materially adversely affect our business, financial condition and results of operations and our ability to make distributions to our stockholders.

* We are exposed to the risk that the cash flows of our tenants and borrowers would be adversely affected by increased liability claims and liability insurance costs;

* We are exposed to risks related to governmental regulations and payors, principally Medicare and Medicaid, and the effect that lower reimbursement rates would have on our tenants' and borrowers' business;

* We are exposed to the risk that our tenants and borrowers may become subject to bankruptcy or insolvency proceedings;

* We depend on the success of our future acquisitions and investments;

* We depend on our ability to reinvest cash in real estate investments in a timely manner and on acceptable terms;

* We depend on the success of property development and construction activities, which may fail to achieve the operating results we expect;

* We are exposed to risks associated with our investments in unconsolidated entities, including our lack of sole decision-making authority and our reliance on the financial condition of other interests;

*

We are exposed to the risk that the illiquidity of real estate investments could impede our ability to respond to adverse changes in the performance of our properties;

* We are exposed to the risk that our assets may be subject to impairment charges;

* We depend on revenues derived mainly from fixed rate investments in real estate assets, while a portion of our debt capital used to finance those investments bears interest at variable rates. This circumstance creates interest rate risk to the Company;

* We may need to refinance existing debt or incur additional debt in the future, which may not be available on terms acceptable to us;

* We have covenants related to our indebtedness which impose certain operational limitations and a breach of those covenants could materially adversely affect our financial condition and results of operations;

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* We are exposed to risks related to environmental laws and the costs associated with liabilities related to hazardous substances;

* We are exposed to the risk that we may not be fully indemnified by our lessees and borrowers against future litigation;

* We depend on the ability to continue to qualify for taxation as a real estate investment trust;

* We have ownership limits in our charter with respect to our common stock and other classes of capital stock which may delay, defer or prevent a transaction or a change of control that might involve a premium price for our common stock or might otherwise be in the best interests of our stockholders;

* We are subject to certain provisions of Maryland law and our charter and bylaws that could hinder, delay or prevent a change in control transaction, even if the transaction involves a premium price for our common stock or our stockholders believe such transaction to be otherwise in their best interests.

See the notes to the annual audited consolidated financial statements in our most recent Annual Report on Form 10-K for the year ended December 31, 2015, and “Business” and “Risk Factors” under Item 1 and Item 1A therein for a further discussion of these and of various governmental regulations and other operating factors relating to the healthcare industry and the risk factors inherent in them. You should carefully consider these risks before making any investment decisions in the Company. These risks and uncertainties are not the only ones facing the Company. There may be additional risks that we do not presently know of or that we currently deem immaterial. If any of the risks actually occur, our business, financial condition, results of operations, or cash flows could be materially adversely affected. In that case, the trading price of our shares of stock could decline and you may lose part or all of your investment. Given these risks and uncertainties, we can give no assurance that these forward-looking statements will, in fact, occur and, therefore, caution investors not to place undue reliance on them.

Executive Overview

National Health Investors, Inc., established in 1991 as a Maryland corporation, is a self-managed real estate investment trust (“REIT”) specializing in sale-leaseback, joint-venture, mortgage and mezzanine financing of need-driven and discretionary senior housing and medical investments. Our portfolio consists of real estate investments in independent living facilities, assisted living facilities, entrance-fee communities, senior living campuses, skilled nursing facilities, specialty hospitals and medical office buildings. Other investments include mortgages and other notes, marketable securities, and a joint venture structured to comply with the provisions of the REIT Investment Diversification Empowerment Act of 2007 (“RIDEA”). Through a RIDEA joint venture, we invest in facility operations managed by independent third-parties. We fund our real estate investments primarily through: (1) operating cash flow, (2) debt offerings, including bank lines of credit and term debt, both unsecured and secured, and (3) the sale of equity securities.

Portfolio

At March 31, 2016, we had investments in real estate and mortgage and other notes receivable involving 190 facilities located in 31 states. These investments involve 118 senior housing properties, 67 skilled nursing facilities, 3 hospitals, 2 medical office buildings and other notes receivable. These investments (excluding our corporate office of $976,000) consisted of properties with an original cost of approximately $2,112,897,000, rented under triple-net leases to 26 lessees, and $150,720,000 aggregate carrying value of mortgage and other notes receivable due from 13 borrowers.

Our investments in real estate and mortgage loans are secured by real estate located within the United States. We are managed as one unit for internal reporting and decision making. Therefore, our reporting reflects our financial position and operations as a single segment.

We classify all of the properties in our portfolio as either senior housing or medical properties. Because our leases represent different underlying revenue sources and result in differing risk profiles, we further classify our senior housing communities as either need-driven (assisted and memory care communities and senior living campuses) or discretionary (independent living and entrance-fee communities.) For the table below, three parcels of land acquired have been included in their intended category.

Senior Housing – Need-Driven includes assisted living and memory care communities (“ALF”) and senior living campuses (“SLC”) which primarily attract private payment for services from residents who require assistance with activities of daily living. Need-driven properties are subject to regulatory oversight.

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Senior Housing – Discretionary includes independent living (“ILF”) and entrance-fee communities (“EFC”) which primarily attract private payment for services from residents who are making the lifestyle choice of living in an age-restricted multi-family community that offers social programs, meals, housekeeping and in some cases access to healthcare services. Discretionary properties are subject to limited regulatory oversight. There is a correlation between demand for this type of community and the strength of the housing market.

Medical Properties within our portfolio primarily receive payment from Medicare, Medicaid and health insurance. These properties include skilled nursing facilities (“SNF”), medical office buildings (“MOB”) and hospitals that attract patients who have a need for acute or complex medical attention, preventative medicine, or a need for rehabilitation services. Medical properties are subject to state and federal regulatory oversight and, in the case of hospitals, JCAHO accreditation.

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The following tables summarize our investments in real estate, mortgage and other notes receivable and year-to-date revenue for each asset type as of March 31, 2016 (dollars in thousands):

Real Estate Properties	Properties	Beds/Sq. Ft.*	Revenue	%	Investment
Senior Housing - Need-Driven					
Assisted Living	70	3,377	$ 11,726	20.2 %	$ 512,893
Senior Living Campus	9	1,224	3,347	5.8 %	134,570
Total Senior Housing - Need-Driven	79	4,601	15,073	25.9 %	647,463
Senior Housing - Discretionary					
Independent Living	29	3,212	11,464	19.7 %	512,074
Entrance-Fee Communities	7	1,587	9,672	16.6 %	467,160
Total Senior Housing - Discretionary	36	4,799	21,136	36.4 %	979,234
Total Senior Housing	115	9,400	36,209	62.3 %	1,626,697
Medical Facilities					
Skilled Nursing Facilities	61	8,001	16,618	28.6 %	424,581
Hospitals	3	181	1,923	3.3 %	51,131
Medical Office Buildings	2	88,517 *	250	0.4 %	10,487
Total Medical Facilities	66		18,791	32.3 %	486,199
Total Real Estate Properties	181		$ 55,000	94.7 %	$ 2,112,896
Mortgage and Other Notes Receivable					
Senior Housing - Need-Driven	2	190	$ 194	0.4 %	$ 3,579
Senior Housing - Discretionary	1	400	1,696	2.9 %	97,607
Medical Facilities	6	450	296	0.5 %	12,835
Other Notes Receivable	—	—	906	1.5 %	36,699
Total Mortgage and Other Notes Receivable	9	1,040	3,092	5.3 %	150,720
Total Portfolio	190		$ 58,092	100.0 %	$ 2,263,616

Portfolio Summary	Properties	Beds/Sq. Ft.*	Revenue	%	Investment
Real Estate Properties	181		$ 55,000	94.7 %	2,112,896
Mortgage and Other Notes Receivable	9		3,092	5.3 %	150,720
Total Portfolio	190		$ 58,092	100.0 %	2,263,616
Summary of Facilities by Type					
Senior Housing - Need-Driven					
Assisted Living	72	3,567	$ 11,920	20.5 %	$ 516,472
Senior Living Campus	9	1,224	3,347	5.8 %	134,570
Total Senior Housing - Need-Driven	81	4,791	15,267	26.3 %	651,042
Senior Housing - Discretionary					
Entrance-Fee Communities	8	1,987	11,368	19.6 %	564,767
Independent Living	29	3,212	11,464	19.7 %	512,074
Total Senior Housing - Discretionary	37	5,199	22,832	39.3 %	1,076,841
Total Senior Housing	118	9,990	38,099	65.6 %	1,727,883
Medical Facilities					
Skilled Nursing Facilities	67	8,451	16,914	29.1 %	437,417
Hospitals	3	181	1,923	3.3 %	51,131
Medical Office Buildings	2	88,517 *	250	0.4 %	10,486

Total Medical	72	19,087	32.8 %	499,034
Other	—	906	1.6 %	36,699
Total Portfolio	190	$ 58,092	100.0 %	2,263,616
Portfolio by Operator Type				
Public	53	$ 12,167	20.9 %	$ 235,749
National Chain (Privately-Owned)	27	11,654	20.1 %	521,139
Regional	99	30,959	53.3 %	1,374,434
Small	11	3,312	5.7 %	132,295
Total Portfolio	190	$ 58,092	100.0 %	2,263,617

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For the three months ended March 31, 2016, operators of facilities which provided more than 3% of our total revenues were (in alphabetical order): Bickford Senior Living; Health Services Management; Holiday Retirement; Legend Healthcare; National HealthCare Corp; and Senior Living Communities.

As of March 31, 2016, our average effective annualized rental income was $8,308 per bed for skilled nursing facilities, $10,937 per unit for senior living campuses, $13,889 per unit for assisted living facilities, $14,384 per unit for independent living facilities, $24,379 per unit for entrance fee communities, $42,499 per bed for hospitals, and $11 per square foot for medical office buildings.

We invest a portion of our funds in the common shares of other publicly-held healthcare REITs. At March 31, 2016, such investments had a carrying value of $58,532,000.

Areas of Focus

We are evaluating and will potentially make additional investments during the remainder of 2016 while we continue to monitor and improve our existing properties. We seek tenants who will become mission-oriented partners in relationships where our business goals are aligned. This approach fuels steady, and thus, enduring growth for those partners and for NHI. Within the context of our growth model, we rely on a cost-effective access to debt and equity capital to finance acquisitions that will drive our earnings. While debt costs have risen modestly, stock prices appear to have reached an equilibrium in recent months presumably in response to a diminished concern over rising interest rates. Large-scale portfolios continue to command premium pricing, due to the continued abundance of private and foreign buyers seeking to invest in healthcare real estate. This combination of circumstances places a premium on our ability to execute those larger transactions that will generate meaningful earnings growth.

With lower capitalization rates for existing healthcare facilities, there has been increased interest in constructing new facilities in hopes of generating better returns on invested capital. Using our relationship-driven model, we continue to look for opportunities to support new and existing tenants and borrowers with the capital needed to expand existing facilities and to initiate ground-up development of new facilities. We concentrate our efforts in those markets where there is both a demonstrated demand for a particular product type and where we perceive we have a competitive advantage. The projects we agree to finance have attractive upside potential and are expected to provide above-average returns to our shareholders to mitigate the risks inherent with property development and construction.

Longer term borrowing rates are expected to increase in the U.S. As a result, there will be pressure on the spread between our cost of capital and the returns we earn. We expect that pressure to be partially mitigated by market forces that would tend to result in higher capitalization rates for healthcare assets and higher lease rates indicative of historical levels. Our cost of capital has increased over the past year as we transition some of our short term revolving borrowings into debt instruments with longer maturities and fixed interest rates. Managing long-term risk involves trade-offs with the competing alternative goal of maximizing short-term profitability. Our intention is to strike an appropriate balance between these competing interests within the context of our investor profile. Due to more favorable pricing, we presently prefer private placement debt over an offering of bond debt.

For the three months ended March 31, 2016, approximately 29% of our revenue from continuing operations was derived from operators of our skilled nursing facilities that receive a significant portion of their revenue from governmental payors, primarily Medicare and Medicaid. Such revenues are subject annually to statutory and regulatory changes, and in recent years, have been reduced due to federal and state budgetary pressures. Over the past five years, we have selectively diversified our portfolio by directing a significant portion of our investments into properties which do not rely primarily on Medicare and Medicaid reimbursement, but rather on private pay sources (assisted living and memory care facilities, senior living campuses, independent living facilities and entrance-fee communities). We will occasionally acquire skilled nursing facilities in good physical condition with a proven

operator and strong local market fundamentals, because diversification implies a periodic rebalancing, but our recent investment focus has been on acquiring need-driven and discretionary senior housing assets.

Considering individual tenant lease revenue as a percentage of total revenue, Bickford Senior Living is our largest assisted living tenant, an affiliate of Holiday Retirement is our largest independent living tenant, National HealthCare Corporation is our largest skilled nursing tenant and Senior Living Communities is our largest entrance-fee community tenant. Our shift toward private payor facilities, as well as our expansion into the discretionary senior housing market, has further resulted in a portfolio whose current composition is relatively balanced between medical facilities, need-driven and discretionary senior housing.

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We manage our business with a goal of increasing the regular annual dividends paid to shareholders. Our Board of Directors approves a regular quarterly dividend which is reflective of expected taxable income on a recurring basis. Our transactions that are infrequent and non-recurring that generate additional taxable income have been distributed to shareholders in the form of special dividends. Taxable income is determined in accordance with the Internal Revenue Code and differs from net income for financial statements purposes determined in accordance with U.S. generally accepted accounting principles. Our goal of increasing annual dividends requires a careful balance between identification of high-quality lease and mortgage assets in which to invest and the cost of our capital with which to fund such investments. We consider the competing interests of short and long-term debt (interest rates, maturities and other terms) versus the higher cost of new equity. We accept some level of risk associated with leveraging our investments. We intend to continue to make new investments that meet our underwriting criteria and where the spreads over our cost of capital will generate sufficient returns to our shareholders.

Our projected dividends for the current year and actual dividends for the last two years are as follows:

2016[1]	2015	2014
$3.60	$3.40	$3.08

[1] Based on $.90 per common share for the first quarter of 2016, annualized

Our investments in healthcare real estate have been partially accomplished by our ability to effectively leverage our balance sheet. However, we continue to maintain a relatively low-leverage balance sheet compared with many in our peer group. We believe that our fixed charge coverage ratio, which is the ratio of Adjusted EBITDA (earnings before interest, taxes, depreciation and amortization, including amounts in discontinued operations, excluding real estate asset impairments and gains on dispositions) to fixed charges (interest expense at contractual rates net of capitalized interest and principal payments on debt), and the ratio of consolidated net debt to Adjusted EBITDA are meaningful measures of our ability to service our debt. We use these two measures as a useful basis to compare the strength of our balance sheet with those in our peer group. We also believe this gives us a competitive advantage when accessing debt markets.

We calculate our fixed charge coverage ratio as approximately 5.7x for the three months ended March 31, 2016 (see our discussion of Adjusted EBITDA and a reconciliation to our net income on page 41). On an annualized basis, our consolidated net debt-to-Adjusted EBITDA ratio is approximately 4.1x.

According to current projections by the U.S. Department of Health and Human Services, the number of Americans 65 and older is expected to grow 36% between 2010 and 2020, compared to a 9% growth rate for the general population. An increase in this age demographic is expected to increase demand for senior housing properties of all types in the coming decades. There is increasing demand for private-pay senior housing properties in countries outside the U.S., as well. We therefore consider real estate and note investments with U.S. entities who seek to expand their senior housing operations into countries where local-market demand is sufficiently demonstrated.

Strong demographic trends provide the context for continued growth in 2016 and the years ahead. We plan to fund any new real estate and mortgage investments during 2016 using our liquid assets and debt financing. Should the weight of additional debt as a result of new acquisitions suggest the need to rebalance our capital structure, we would then expect to access the capital markets through an ATM or other equity offerings. Our disciplined investment strategy implemented through measured increments of debt and equity sets the stage for annual dividend growth, continued low leverage, a portfolio of diversified, high-quality assets, and business relationships with experienced operators, who we make our priority, continue to be the key drivers of our business plan.

Critical Accounting Policies

See our most recent Annual Report on Form 10-K for a discussion of critical accounting policies including those concerning revenue recognition, our status as a REIT, principles of consolidation, evaluation of impairments and allocation of property acquisition costs.

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Significant Operators

As discussed in Note 2 to the condensed consolidated financial statements, we have four operators from whom we individually derive at least 10% of our rental income as follows (dollars in thousands):

	Asset Class	Investment Amount	Rental Income Three Months Ended March 31, 2016		2015		Lease Renewal
Holiday Retirement	ILF	$493,378	$10,954	20%	$10,954	21%	2031
Senior Living Communities	EFC	476,000	9,855	18%	9,855	19%	2029
National HealthCare Corporation	SNF	171,297	9,817	18%	9,227	17%	2026
Bickford Senior Living	ALF	281,974	6,307	11%	5,804	11%	2019
All others	Various	690,248	18,141	33%	16,655	32%	Various
		$2,112,897	$55,074		$52,495		

Joint Venture

As of March 31, 2016, we owned an 85% equity interest and Sycamore Street, LLC ("Sycamore"), an affiliate of Bickford, owned a 15% equity interest in our consolidated subsidiary ("PropCo") which owns 32 assisted living/memory care facilities, plus 5 facilities under development. The facilities are leased to an unconsolidated operating company, ("OpCo"), in which we also retain an 85/15 non-controlling ownership interest with Sycamore. This joint venture is structured to comply with the provisions of RIDEA. As of March 31, 2016, the annual contractual rent from OpCo to PropCo is $25,529,000, plus fixed annual escalators. NHI has an exclusive right to Bickford's future acquisitions, development projects and refinancing transactions. Of our total revenues, $6,307,000 (11%) and $5,804,000 (10%) were recognized as rental income from Bickford for the three months ended March 31, 2016 and 2015, respectively.

At March 31, 2016, the carrying value of our investment in the operating company, OpCo, was $7,254,000 plus a deferred asset of $868,000 related to the carry-forward of net operating losses for tax purposes. The excess of the original purchase price over the fair value of identified tangible assets at acquisition is treated as implied goodwill and is subject to periodic review for impairment in conjunction with our equity method investment as a whole.

The income statements for OpCo include the operating results of 31 same-store properties and 1 focus property that was added to the portfolio within the last 12 months. Focus properties receive increased management oversight because they have not reached cash flow stabilization or are new additions to the portfolio. For accounting purposes we are required to expense the pre-opening expenses and operating losses of newly-developed properties.

Unaudited summarized income statements for OpCo are presented below (in thousands):

	Three Months Ended March 31, 2016	2015
Revenues	$20,791	$18,467
Operating expenses, including management fees	14,632	12,692
Lease expense, including straight-line rent	6,432	5,880
Depreciation and amortization	200	165
Net Loss	$(473)	$(270)

OpCo is intended to be self-financing, and aside from initial investments therein, no direct support has been provided by NHI to OpCo since inception on September 30, 2012. While PropCo's rental revenues associated with the related properties are sourced from OpCo, a decision to furnish additional direct support would be at our discretion and not obligatory. As a result, we believe our maximum exposure to loss at March 31, 2016, due to our investment in OpCo, would be limited to our equity interest as adjusted for any unrealized loss carry-forwards. We have concluded that OpCo meets the accounting criteria to be considered a VIE. However, because we do not control the entity, nor do we have any role in its day-to-day management, we are not the primary beneficiary of the entity, and we account for our investment using the equity method. There have been no distributions declared from OpCo since its inception.

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In July 2013, we extended a $9,200,000 loan to Sycamore to fund a portion of their acquisition of six senior housing communities consisting of 342 units. The loan is guaranteed by principals of Bickford and bears a 12% annual interest rate. As a result of this transaction and existing agreements governing our business relationship with Bickford, PropCo has acquired a $97,000,000 purchase option on the properties which is exercisable over the term of the loan. In 2015, we granted an extension of the loan through June 2018 in return for the extension of the purchase option over the same period. Essential terms of the extended loan remain the same. We are monitoring the performance of this portfolio which currently has an NOI that would presume a capitalization rate on PropCo's purchase option price of approximately 7.6%. The loan and the purchase option create variable interests in Sycamore, which is a VIE. However, because NHI is not its primary beneficiary, Sycamore is not subject to consolidation.

Investment Highlights

Since January 1, 2016, we have made or announced the following real estate and loan investments ($ in thousands):

	Properties	Asset Class	Amount
Lease Investments			
Ensign Group	8	SNF	$118,500
Woodland Village	1	SHO	9,813
Note Investments			
Senior Living Communities	1	SLC	14,000
			$142,313

Ensign Group

On April 1, 2016, we purchased eight skilled nursing facilities totaling 931 beds in Texas for $118,500,000 with borrowings on our revolving credit facility. The facilities are currently operated by NHI's existing tenant, Legend Healthcare ("Legend"). Concurrent with the acquisition, we amended in-place leases covering our nine other skilled nursing facilities operated by Legend, extending their provisions to the new facilities. The amendment also replaced purchase options that provided for equal sharing of any appreciation in value, within a specified range with purchase options with a price determined at fair value, exercisable at the end of the lease term. Based on our tentative analysis of the in-place options, approximately $6,000,000 of the consideration in the acquisition will likely attach to the canceled provisions.

Legend elected to transition its current skilled nursing operations to a new operator on May 1, 2016, and NHI entered into a new 15-year master lease with affiliates of The Ensign Group, Inc. ("Ensign") on 15 of the former Legend facilities for an initial annual amount of $17,750,000, plus an annual escalator based on inflation. The lease has two 5-year renewal options. Upon entering the new lease, NHI agreed to sell two existing skilled nursing facilities previously under lease to Legend in Texas totaling 245 beds to Ensign for $24,600,000. The new lease, which includes a corporate guaranty from Ensign, replaces the Legend lease, and, accordingly, the purchase options held by Legend have terminated. For accounting purposes, the transition of our lease from Legend to Ensign will require a non-cash write-off related to the approximate $6,000,000 fair value assigned to the former Legend purchase options and $8,247,000 of accumulated straight-line rent receivable.

As part of this transaction, NHI has committed to purchase four skilled nursing facilities in Texas from Legend for $56,000,000 and lease them to Ensign. The facilities are in various stages of development and the purchase window for the first facility is expected to open in 2017.

Woodland Village

On January 15, 2016, we acquired a 98-unit independent living community in Chehalis, Washington, for $9,463,000 in cash inclusive of closing costs of $213,000 plus an additional commitment to fund $350,000 in specified capital improvements. We leased the facility to a partnership between Marathon Development and Village Concepts Retirement Communities for an initial lease term of 15 years. The lease provides for an initial annual lease rate of 7.25% plus escalators of 2.0% in year two, 2.5% in year three, and 3.0% annually thereafter. Because the facility was owner-occupied, the acquisition was accounted for as an asset purchase.

Senior Living Communities

In March 2016, we extended mezzanine loans of $12,000,000 and $2,000,000 to affiliates of Senior Living Communities, LLC, to partially fund construction of a 186-unit senior living campus on Daniel Island in North Carolina. The loans convey a second mortgage interest, bear interest payable monthly at 10% per annum, and mature in March 2021. The loans, having a total balance

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of $1,203,000 at March 31, 2016, are in addition to the $15,000,000 revolving line of credit we provided Senior Living in connection with our 2014 lease of 8 retirement communities.

Other Portfolio Activity

Our leases are typically structured as “triple net leases” on single-tenant properties having an initial leasehold term of 10 to 15 years with one or more 5-year renewal options. As such, there may be reporting periods in which we experience few, if any, lease renewals or expirations. During the three months ended March 31, 2016, we did not have any renewing or expiring leases.

Most of our existing leases contain annual escalators in rent payments. For financial statement purposes, rental income is recognized on a straight-line basis over the term of the lease. Certain of our operators hold purchase options allowing them to acquire properties they currently lease from NHI. For options open or coming open in 2016, we are engaged in preliminary negotiations to continue as lessor or in some other capacity.

In January 2016 we received full payment from an affiliate of our current lessee Discovery Senior Living on a $2,500,000 second mortgage loan we originally provided in October 2013 for the construction of a senior housing community in Naples, Florida.

Real Estate and Mortgage Write-downs

Our borrowers and tenants experience periods of significant financial pressures and difficulties similar to other health care providers. Governments at both the federal and state levels have enacted legislation to lower, or at least slow, the growth in payments to health care providers. Furthermore, the cost of professional liability insurance has increased significantly during this same period.

Since inception, a number of our facility operators and mortgage loan borrowers have undergone bankruptcy. Others have been forced to surrender properties to us in lieu of foreclosure or, for certain periods, have failed to make timely payments on their obligations to us.

We believe that the carrying amounts of our real estate properties are recoverable and that mortgage notes receivable are realizable and supported by the value of the underlying collateral. However, it is possible that future events could require us to make significant adjustments to these carrying amounts.

Potential Effects of Medicare Reimbursement

Our tenants who operate skilled nursing facilities receive a significant portion of their revenues from governmental payors, primarily Medicare (federal) and Medicaid (states). Changes in reimbursement rates and limits on the scope of services reimbursed to skilled nursing facilities could have a material impact on the operators’ liquidity and financial condition. On April 21, 2016, the Centers for Medicare & Medicaid Services (“CMS”) released a proposed rule outlining a 1.6% increase in their Medicare reimbursement for fiscal 2017 beginning on October 1, 2016. We currently estimate that our borrowers and lessees will be able to withstand this nominal Medicare increase due to their credit quality, profitability and their debt or lease coverage ratios, although no assurances can be given as to what the ultimate effect that similar Medicare increases on an annual basis would have on each of our borrowers and lessees. According to industry studies, state Medicaid funding is not expected to keep pace with inflation. Federal legislative policies have been adopted and continue to be proposed that would reduce Medicare and/or Medicaid payments to skilled nursing facilities. Accordingly, for the near-term, we are treating as cautionary the Federal Government’s recent re-commitment, after debating a ‘chained CPI’ indexing, to fully index Social Security to inflation. In this cautious approach, any near-term acquisitions of skilled nursing facilities are planned on a selective basis, with emphasis on

operator quality and newer construction.

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Results of Operations

The significant items affecting revenues and expenses are described below (in thousands):

	Three Months Ended March 31,		Period Change	
	2016	2015	$	%
Revenues:				
Rental income				
1 ALF and 2 SLCs leased to East Lake Capital Management	$1,171	$—	$1,171	NM
ALFs leased to RIDEA joint venture with Bickford	6,371	5,704	667	11.7 %
Percentage rent received from National HealthCare Corporation	1,280	690	590	85.5 %
ILFs leased to an affiliate of Holiday Retirement	8,713	8,338	375	4.5 %
ALFs leased to Chancellor Health Care	1,150	814	336	41.3 %
Other new and existing leases	31,103	30,860	243	0.8 %
	49,788	46,406	3,382	7.3 %
Straight-line rent adjustments, new and existing leases	5,286	6,089	(803)	(13.2)%
Total Rental Income	55,074	52,495	2,579	4.9 %
Interest income from mortgage and other notes				
Timber Ridge mortgage and construction loans	1,696	357	1,339	NM
Senior Living Communities construction loan	149	66	83	125.8 %
Sante Mesa construction loan	—	297	(297)	NM
Other new and existing mortgages	1,247	1,401	(154)	(11.0)%
Total Interest Income from Mortgage and Other Notes	3,092	2,121	971	45.8 %
Investment income and other	852	1,135	(283)	(24.9)%
Total Revenue	59,018	55,751	3,267	5.9 %
Expenses:				
Depreciation				
1 ALF and 2 SLCs leased to East Lake Capital Management	445	—	445	NM
ALFs leased to RIDEA joint venture with Bickford	2,050	1,852	198	10.7 %
ALFs leased to Chancellor Health Care	358	243	115	47.3 %
Other new and existing assets	10,880	10,919	(39)	(0.4)%
Total Depreciation	13,733	13,014	719	5.5 %
Interest expense and amortization of debt issuance costs and discounts	10,262	8,412	1,850	22.0 %
Legal	126	104	22	21.2 %
Franchise, excise and other taxes	283	226	57	25.2 %
Payroll and related compensation expenses	1,051	1,509	(458)	(30.4)%
Non-cash compensation expense	979	1,464	(485)	(33.1)%
Other expenses	899	872	27	3.1 %
	27,333	25,601	1,732	6.8 %
Income before equity-method investee, TRS tax benefit, investment and other gains and noncontrolling interest	31,685	30,150	1,535	5.1 %
Loss from equity-method investee	(402)	(229)	(173)	75.5 %
Income tax benefit attributable to taxable REIT subsidiary	161	92	69	75.0 %
Investment and other gains	1,665	—	1,665	NM
Income from continuing operations	33,109	30,013	3,096	10.3 %
Gain on sale of real estate	—	—	—	NM
Net income	33,109	30,013	3,096	10.3 %
Less: net income attributable to noncontrolling interest	(384)	(330)	(54)	16.4 %

Net income attributable to common stockholders	$32,725	$29,683	$3,042	10.2 %

NM - not meaningful

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Financial highlights of the quarter ended March 31, 2016, compared to 2015 were as follows:

- Rental income increased $2,579,000 primarily as a result of the volume and timing of investments funded in 2015. The increase in rental income included an $803,000 decrease in straight-line rent adjustments. Generally accepted accounting principles require rental income to be recognized on a straight-line basis over the term of the lease to give effect to scheduled rent escalators. Future increases in rental income depend on our ability to make new investments which meet our underwriting criteria.

- Interest income from mortgage and other notes increased $971,000 primarily due to borrowings on our mortgage and construction loan commitment to the Timber Ridge entrance fee community as described in Investment Highlights. We expect total interest income from our loan portfolio to increase as we continue to fund these loans to Timber Ridge on a monthly basis through the remainder of 2016 up to a maximum commitment of $154,500,000. We estimate substantial repayment of our construction loan of $94,500,000 to Timber Ridge during 2017. Interest income from our loan portfolio is subject to decrease due to normal maturities, scheduled principal amortization and early payoffs of individual loans.

- Depreciation expense increased $719,000 primarily due to new real estate investments completed since March 2015.

- Interest expense, including amortization of debt issuance costs and discounts, increased $1,850,000 primarily as a result of the timing and amount of new borrowings since March 2015, and our strategic focus to refinance short-term borrowings on our revolving credit facility at variable interest rates with long-term debt at fixed rates. This strategy helps to mitigate the risk of rising interest rates and lock in the investment spread between our lease revenue and our cost of debt capital.

- Payroll and related expenses decreased $458,000 due primarily to reduced compensation accruals resulting from the departure of our former President and CEO in 2015. Non-cash stock-based compensation expense also decreased $485,000 when compared to the prior year due to a lower estimated fair value for current year option grants based on the Black-Scholes pricing model.

- Our 85% share of the loss from our equity method investee of $402,000 reflects $170,000 in depreciation and amortization and higher labor costs in many of OpCo’s 32 market areas.

- Investment and other gains includes $1,654,000 resulting from the sale of a skilled nursing facility in Grangeville, Idaho.

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Liquidity and Capital Resources

Sources and Uses of Funds

Our primary sources of cash include rent payments, principal and interest payments on mortgage and other notes receivable, dividends received on our investments in the common and preferred shares of other REITs, proceeds from the sales of real property and borrowings from various debt capital sources and the proceeds from the issuance of our common shares. Our primary uses of cash include dividend distributions to our shareholders, debt service payments (both principal and interest), new investments in real estate and notes and for general corporate overhead.

These sources and uses of cash are reflected in our Condensed Consolidated Statements of Cash Flows as summarized below (dollars in thousands):

	Three Months Ended March 31,		One Year Change	
	2016	2015	$	%
Cash and cash equivalents at beginning of period	$13,286	$3,287	$9,999	304.2 %
Net cash provided by operating activities	41,297	38,564	2,733	7.1 %
Net cash used in investing activities	(14,296)	(43,061)	28,765	(66.8)%
Net cash provided by (used in) financing activities	(11,479)	5,400	(16,879)	(312.6)%
Cash and cash equivalents at end of period	$28,808	$4,190	$24,618	587.5 %

Operating Activities – Net cash provided by operating activities for the three months ended March 31, 2016 increased as compared to 2015 primarily as a result of the collection of lease payments on new real estate investments since March 2015.

Investing Activities – Net cash used in investing activities for the three months ended March 31, 2016 decreased primarily due to the liquidation of certain debt security investments during the first quarter of 2016.

Financing Activities – The change in net cash related to financing activities for the three months ended March 31, 2016 compared to the same period in 2015 is primarily the result of debt transactions, commenced during the first quarter of 2015, to pay down our revolving credit facility and fund our acquisitions. Dividends paid to stockholders increased $3,773,000 over the same period in 2015 due to a 5.9% increase in our per share dividend and the issuance of 918,076 additional shares, 830,506 of which were issued as part of our ATM program in 2015.

Liquidity

At March 31, 2016, our liquidity was strong, with $522,808,000 available in cash and borrowing capacity on our revolving credit facility.

Our ATM program, begun in 2015 and discussed below, and our marketable securities, carried at fair value of approximately $58,532,000 at March 31, 2016, represent additional sources of liquidity. Traditionally, debt financing and cash resulting from operating and financing activities, which are derived from proceeds of lease and mortgage collections, loan payoffs and the recovery of previous write-downs, have been used to satisfy our operational and investing needs and to provide a return to our shareholders. Those operational and investing needs reflect the resources necessary to maintain and cultivate our funding sources and have generally fallen into three categories: debt service, REIT operating expenses, and new real estate investments.

In June 2015, we entered into an amended $800,000,000 senior unsecured credit facility with a group of banks. The facility can be expanded, subject to certain conditions, up to an additional $250,000,000. The amended credit facility

provides for: (1) a $550,000,000 revolving credit facility that matures in June 2020 (inclusive of an embedded 1-year extension option) with interest at 150 basis points over LIBOR (44 bps at March 31, 2016); (2) an existing $130,000,000 term loan that matures in June 2020 with interest at 175 basis points over LIBOR of which interest of 3.91% is fixed with an interest rate swap agreement; and (3) two existing term loans which also remain in place totaling $120,000,000, maturing in June 2020 and bearing interest at 175 basis points over LIBOR,with a notional amount of $40,000,000 being fixed at 3.29% until 2019 and $80,000,000 being fixed at 3.86% until 2020.

At March 31, 2016, we had $494,000,000 available to draw on the revolving portion of the credit facility. The unused commitment fee is 40 basis points per annum. The unsecured credit facility requires that we maintain certain financial ratios within limits set by our creditors. To date, these ratios, which are calculated quarterly, have been within the limits required by the credit facility agreements.

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In 2015 we utilized our at-the-market equity program (“ATM”) through which we may sell our common shares on an as-needed basis. Accordingly, in November and December 2015, we raised $49,389,000 in new common equity capital, after underwriting discounts and offering expenses, by issuing 830,506 common shares at an average price of $60.33 per share. We used these funds to pay down our line of credit, the additional capital immediately serving to rebalance our leverage and keep our options flexible for further expansion. We continue to explore various other funding sources including bank term loans, convertible debt, traditional equity placement, unsecured bonds and senior notes, debt private placement and secured government agency financing.

We expect that borrowings on our revolving credit facility, liquidation of our marketable securities and our ATM program will allow us to continue to make real estate investments in 2016 without effecting a further amendment and expansion of the senior unsecured credit facility during the year, absent unusual opportunities.

We intend to use the net proceeds from the ATM program for general corporate purposes, which may include future acquisitions and repayment of indebtedness, including borrowings under our credit facility. The offering will be made pursuant to a prospectus supplement dated February 17, 2015 and a related prospectus dated March 18, 2014, which constitute a part of NHI’s effective shelf registration statement that was previously filed with the Securities and Exchange Commission.

To mitigate our exposure to interest rate risk, we have entered into the following interest rate swap contracts on three of our term loans as of March 31, 2016 (dollars in thousands):

Date Entered	Maturity Date	Fixed Rate	Rate Index	Notional Amount	Fair Value
May 2012	April 2019	3.29%	1-month LIBOR	$40,000	$(897)
June 2013	June 2020	3.86%	1-month LIBOR	$80,000	$(3,865)
March 2014	June 2020	3.91%	1-month LIBOR	$130,000	$(6,522)

We plan to refinance the borrowings on our revolving credit facility into longer-term debt instruments. We will consider secured debt from U.S. Govt. agencies, including HUD, private placements of unsecured debt, and public offerings of debt and equity. We anticipate that our historically low cost of debt capital will rise in the near to mid-term, as the federal government transitions away from quantitative easing.

If we modify or replace existing debt, we would incur debt issuance costs. These fees would be subject to amortization over the term of the new debt instrument and may result in the write-off of fees associated with debt which has been replaced or modified. Sustaining long-term dividend growth will require that we consider all forms of capital mentioned above, with the goal of maintaining a low-leverage balance sheet as mitigation against potential adverse changes in the business of our tenants and borrowers.

We intend to comply with REIT dividend requirements that we distribute at least 90% of our annual taxable income for the year ending December 31, 2016 and thereafter. During the first quarter of 2016, we declared a quarterly dividend of $.90 per common share to shareholders of record on March 31, 2016, payable on May 10, 2016.

Off Balance Sheet Arrangements

We currently have no outstanding guarantees. For additional information on our letter of credit with Sycamore, an affiliate of Bickford, see our discussion in this section under Contractual Obligations and Contingent Liabilities below.

Our equity method investment in OpCo is intended to be self-financing, and aside from initial investments therein, no direct support has been provided to OpCo since inception on September 30, 2012. We have concluded that OpCo meets the accounting criteria to be considered a VIE. However, because we do not control the entity, nor do we have any role in the day-to-day management, we are not the primary beneficiary of the entity, and we account for our investment using the equity method. We have no material obligation arising from our investment in OpCo, and we believe our maximum exposure to loss at March 31, 2016, due to this involvement, would be limited to our equity interest and a related deferred tax asset of $868,000 at March 31, 2016. Our loans to LCS-WP and our lease with East Lake represent variable interests in those enterprises. However, because we do not control these entities, nor do we have any role in their day-to-day management, we are not their primary beneficiary. Except as discussed below under Contractual Obligations and Contingent Liabilities, we have no further material obligations arising from transactions with these entities, and we believe our maximum exposure to loss at March 31, 2016, due to this involvement would be limited to our contractual commitments and contingent liabilities and the amount of our current investments with them, as detailed further in Notes 2, 4 and 7 to the consolidated financial statements.

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Contractual Obligations and Contingent Liabilities

As of March 31, 2016, our contractual payment obligations and contingent liabilities are more fully described in the notes to the consolidated financial statements and were as follows (in thousands):

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Debt, including interest[1]	$1,236,817	$37,672	$114,877	$577,422	$506,845
Real estate purchase liabilities	750	750	—	—	—
Construction commitments	31,623	31,623	—	—	—
Loan commitments	74,074	74,074	—	—	—
	$1,343,264	$144,119	$114,877	$577,422	$506,845

[1] Interest is calculated based on the weighted average interest rate of outstanding debt balances as of March 31, 2016. The calculation also includes an unused commitment fee of .40%.

Commitments and Contingencies

	Asset Class	Type	Total	Funded	Remaining
Commitments:					
Life Care Services	SHO	Construction Loan	$154,500,000	$(98,855,000)	$55,645,000
Bickford Senior Living	SHO	Construction	$55,000,000	$(25,626,000)	$29,374,000
Senior Living Communities	SHO	Revolving Credit	$29,000,000	$(10,571,000)	$18,429,000
Santé Partners	SHO	Renovation	$3,500,000	$(2,621,000)	$879,000
Chancellor Health Care	SHO	Construction	$650,000	$(51,000)	$599,000
Sycamore Street (Bickford affiliate)	SHO	Revolving Credit	$500,000	$(479,000)	$21,000
East Lake Capital Management	SHO	Renovation	$400,000	$—	$400,000
Woodland Village	SHO	Renovation	$350,000	$—	$350,000
Contingencies:					
East Lake Capital Management	SHO	Lease Inducement	$8,000,000	$—	$8,000,000
East Lake Capital Management	SHO	Seller Earnout	$750,000	$—	$750,000
Sycamore Street (Bickford affiliate)	SHO	Letter-of-credit	$3,930,000	$—	$3,930,000
Discovery Senior Living	SHO	Lease Inducement	$2,500,000	$—	$2,500,000
Santé Partners	SHO	Lease Inducement	$2,000,000	$—	$2,000,000

Bickford

In February 2015 our joint venture with Bickford announced plans to develop five senior housing facilities in Illinois and Virginia. Each community will be managed by Bickford and consist of 60 private-pay assisted living and memory care units. These five properties will represent the culmination of plans announced in 2012 between NHI and Bickford to construct a total of eight facilities. The first three communities, all in Indiana, opened in 2013 and 2014. Pre-development and land acquisition on the five facilities started in mid-2015 with openings planned beginning in late 2016. The total estimated project cost is $55,000,000. As of March 31, 2016, land and pre-development costs incurred on the project totaled $25,626,000.

In February 2014 we entered into a commitment on a letter of credit for the benefit of Sycamore which holds a minority interest in PropCo. At March 31, 2016 our commitment on the letter of credit totaled $3,930,000.

In June 2014 we entered into a $500,000 revolving loan with Sycamore to fund pre-development expenses related to potential future projects. Interest is payable monthly at 10% and the note matures in August 2015. At March 31, 2016,

the revolving loan had an outstanding balance of $479,000.

Chancellor

At March 31, 2016, we have a continuing commitment with Chancellor Health Care ("Chancellor") to provide up to $650,000 for renovations and improvements related to a recently acquired senior housing community in Oregon. Renovations began on this property during the second quarter of 2015, and we have funded $51,000 as of March 31, 2016.

Discovery

As a lease inducement, we have a contingent commitment to fund a series of payments up to $2,500,000 in connection with our September 2013 lease to Discovery Senior Living ("Discovery") of a senior living campus in Rainbow City, Alabama. Discovery would earn the contingent payments upon attaining, and maintaining, a specified lease coverage ratio. Payments were assessed for funding in the amount of $750,000 in September 2015 with the residual potentially due later in 2016. As of March 31, 2016, incurring the contingent payments was not considered probable. Accordingly, no provision for these payments is reflected in the consolidated financial statements.

East Lake

In connection with our July 2015 lease of three senior housing properties, NHI has committed to East Lake certain lease incentive payments of $8,000,000 contingent on reaching and maintaining certain metrics, a contingent earnout of $750,000 payable to the seller upon attaining certain metrics, and the funding of an additional $400,000 for specified capital improvements. At acquisition, we estimated the seller contingent earnout payment to be probable and, accordingly, have reflected that amount in our Condensed Consolidated Balance Sheet at March 31, 2016. Contingent payments earned will be included in the lease base when funded.

Life Care Services

See Note 4 of Notes to Condensed Consolidated Financial Statements for a discussion of our loan commitments to Timber Ridge, an affiliate of Life Care Services.

Santé

We are committed to fund a $3,500,000 expansion and renovation program at our Silverdale, Washington senior living campus and as of March 31, 2016, had funded $2,621,000, which was added to the basis on which the lease amount is calculated. In addition, we have a contingent commitment to fund two lease inducement payments of $1,000,000 each. Santé would earn the payments upon attaining and sustaining a specified lease coverage ratio. If earned, the first payment would be due following calendar year 2015 and the second payment would be due following calendar year 2016. At acquisition, incurring the contingent payments was not considered probable. No change to our initial assessment has been made as a result of 2015 operations, and accordingly, no provision for these payments is reflected in the condensed consolidated financial statements.

Senior Living Communities

See Note 4 for a discussion of our loan commitments to Senior Living Communities, LLC and its affiliates.

Woodland Village

See Note 2 for a discussion of our renovation commitment to Village Concepts Retirement Communities.

Litigation

Our facilities are subject to claims and suits in the ordinary course of business. Our lessees and borrowers have indemnified, and are obligated to continue to indemnify us, against all liabilities arising from the operation of the facilities and are further obligated to indemnify us against environmental or title problems affecting the real estate underlying such facilities. While there may be lawsuits pending against certain of the owners and/or lessees of our facilities, management believes that the ultimate resolution of all such pending proceedings will have no material

adverse effect on our financial condition, results of operations or cash flows.

FFO, AFFO & FAD

These supplemental operating performance measures may not be comparable to similarly titled measures used by other REITs. Consequently, our Funds From Operations ("FFO"), Normalized FFO, Normalized Adjusted Funds From Operations ("AFFO") and Normalized Funds Available for Distribution ("FAD") may not provide a meaningful measure of our performance as compared to that of other REITs. Since other REITs may not use our definition of these operating performance measures, caution should be exercised when comparing our Company's FFO, Normalized FFO, Normalized AFFO and Normalized FAD to that of other REITs. These financial performance measures do not represent cash generated from operating activities in accordance with generally accepted accounting principles ("GAAP") (these measures do not include changes in operating assets and liabilities) and therefore

should not be considered an alternative to net earnings as an indication of operating performance, or to net cash flow from operating activities as determined by GAAP as a measure of liquidity, and are not necessarily indicative of cash available to fund cash needs.

Funds From Operations - FFO

Our FFO and normalized FFO per diluted common share for the three months ended March 31, 2016 increased $0.03 (2.7%) over the same period in 2015. FFO and normalized FFO increased primarily as the result of our new real estate investments since March 2015. FFO, as defined by the National Association of Real Estate Investment Trusts ("NAREIT") and applied by us, is net income (computed in accordance with GAAP), excluding gains (or losses) from sales of real estate property, plus real estate depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures, if any. The Company's computation of FFO may not be comparable to FFO reported by other REITs that do not define the term in accordance with the current NAREIT definition or have a different interpretation of the current NAREIT definition from that of the Company; therefore, caution should be exercised when comparing our Company's FFO to that of other REITs. Diluted FFO assumes the exercise of stock options and other potentially dilutive securities. Normalized FFO excludes from FFO certain items which, due to their infrequent or unpredictable nature, may create some difficulty in comparing FFO for the current period to similar prior periods, and may include, but are not limited to, impairment of non-real estate assets, gains and losses attributable to the acquisition and disposition of assets and liabilities, and recoveries of previous write-downs.

FFO and normalized FFO are important supplemental measures of operating performance for a REIT. Because the historical cost accounting convention used for real estate assets requires depreciation (except on land), such accounting presentation implies that the value of real estate assets diminishes predictably over time. Since real estate values instead have historically risen and fallen with market conditions, presentations of operating results for a REIT that uses historical cost accounting for depreciation could be less informative, and should be supplemented with a measure such as FFO. The term FFO was designed by the REIT industry to address this issue.

Adjusted Funds From Operations - AFFO

Our normalized AFFO per diluted common share for the three months ended March 31, 2016 increased $0.05 (5.1%) over the same period in 2015 due primarily to the impact of real estate investments completed since March 2015. In addition to the adjustments included in the calculation of normalized FFO, normalized AFFO excludes the impact of any straight-line rent revenue, amortization of the original issue discount on our convertible senior notes and amortization of debt issuance costs.

Normalized AFFO is an important supplemental measure of operating performance for a REIT. GAAP requires a lessor to recognize contractual lease payments into income on a straight-line basis over the expected term of the lease. This straight-line adjustment has the effect of reporting lease income that is significantly more or less than the contractual cash flows received pursuant to the terms of the lease agreement. GAAP also requires the original issue discount of our convertible senior notes and debt issuance costs to be amortized as non-cash adjustments to earnings. Normalized AFFO is useful to our investors as it reflects the growth inherent in the contractual lease payments of our real estate portfolio.

Funds Available for Distribution - FAD

Our normalized FAD per diluted common share for the three months ended March 31, 2016 increased $0.04 (3.9%) over the same period in 2015, due primarily to the impact of real estate investments completed since March 2015. In addition to the adjustments included in the calculation of normalized AFFO, normalized FAD excludes the impact of non-cash stock based compensation. Normalized FAD is an important supplemental measure of operating

performance for a REIT as a useful indicator of the ability to distribute dividends to shareholders.

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The following table reconciles net income attributable to common stockholders, the most directly comparable GAAP metric, to FFO, Normalized FFO, Normalized AFFO and Normalized FAD and is presented for both basic and diluted weighted average common shares (in thousands, except share and per share amounts):

	Three Months Ended March 31,	
	2016	2015
Net income attributable to common stockholders	$32,725	$ 29,683
Elimination of certain non-cash items in net income:		
Depreciation	13,733	13,014
Depreciation related to noncontrolling interest	(307)	(278)
Net gain on sales of real estate	(1,654)	—
NAREIT FFO attributable to common stockholders	44,497	42,419
Normalizing items	—	—
Normalized FFO	44,497	42,419
Straight-line lease revenue, net	(5,286)	(6,089)
Straight-line lease revenue, net, related to noncontrolling interest	(10)	15
Amortization of original issue discount	282	271
Amortization of debt issuance costs	586	549
Amortization of debt issuance costs related to noncontrolling interest	(9)	(4)
Normalized AFFO	40,060	37,161
Non-cash share based compensation	979	1,464
Normalized FAD	$41,039	$ 38,625
BASIC		
Weighted average common shares outstanding	38,401,647	37,558,067
NAREIT FFO per common share	$1.16	$ 1.13
Normalized FFO per common share	$1.16	$ 1.13
Normalized AFFO per common share	$1.04	$ .99
Normalized FAD per common share	$1.07	$ 1.03
DILUTED		
Weighted average common shares outstanding	38,414,791	37,645,265
NAREIT FFO per common share	$1.16	$ 1.13
Normalized FFO per common share	$1.16	$ 1.13
Normalized AFFO per common share	$1.04	$ .99
Normalized FAD per common share	$1.07	$ 1.03

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Adjusted EBITDA

We consider Adjusted EBITDA to be an important supplemental measure because it provides information which we use to evaluate our performance and serves as an indication of our ability to service debt. We define Adjusted EBITDA as consolidated earnings before interest, taxes, depreciation and amortization, including amounts in discontinued operations, excluding real estate asset impairments and gains on dispositions and certain items which, due to their infrequent or unpredictable nature, may create some difficulty in comparing Adjusted EBITDA for the current period to similar prior periods, and may include, but are not limited to, impairment of non-real estate assets, gains and losses attributable to the acquisition and disposition of assets and liabilities, and recoveries of previous write-downs. Since others may not use our definition of Adjusted EBITDA, caution should be exercised when comparing our Adjusted EBITDA to that of other companies.

The following table reconciles net income, the most directly comparable GAAP metric, to Adjusted EBITDA:

	Three Months Ended March 31,	
	2016	2015
Net income	$33,109	$30,013
Interest expense at contractual rates	9,515	7,712
Franchise, excise and other taxes	283	226
Income tax (benefit) of taxable REIT subsidiary	(161)	(92)
Depreciation	13,733	13,014
Amortization of debt issuance costs and bond discount	868	820
Net gain on sales of real estate	(1,654)	—
Adjusted EBITDA	$55,693	$51,693
Interest expense at contractual rates	$9,515	$7,712
Principal payments	189	183
Fixed Charges	$9,704	$7,895
Fixed Charge Coverage	5.7x	6.5x

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

At March 31, 2016, we were exposed to market risks related to fluctuations in interest rates on approximately $56,000,000 of variable-rate indebtedness (excludes $250,000,000 of variable-rate debt that has been hedged through interest-rate swap contracts) and on our mortgage and other notes receivable. The unused portion ($494,000,000 at March 31, 2016) of our credit facility, should it be drawn upon, is subject to variable rates.

Interest rate fluctuations will generally not affect our future earnings or cash flows on our fixed rate debt and loans receivable unless such instruments mature or are otherwise terminated. However, interest rate changes will affect the fair value of our fixed rate instruments. Conversely, changes in interest rates on variable rate debt and investments would change our future earnings and cash flows, but not significantly affect the fair value of those instruments. Assuming a 50 basis point increase or decrease in the interest rate related to variable-rate debt, and assuming no change in the outstanding balance as of March 31, 2016, net interest expense would increase or decrease annually by approximately $280,000 or $.01 per common share on a diluted basis.

We use derivative financial instruments in the normal course of business to mitigate interest rate risk. We do not use derivative financial instruments for speculative purposes. Derivatives are included in the Consolidated Balance Sheets at their fair value. We may engage in hedging strategies to manage our exposure to market risks in the future, depending on an analysis of the interest rate environment and the costs and risks of such strategies.

The following table sets forth certain information with respect to our debt (dollar amounts in thousands):

	March 31, 2016				December 31, 2015			
	Balance[1]	% of total		Rate[5]	Balance[1]	% of total		Rate[5]
Fixed rate:								
Convertible senior notes	$200,000	20.9	%	3.25%	$200,000	21.4	%	3.25%
Unsecured term loans[2]	575,000	60.2	%	4.03%	575,000	61.6	%	4.03%
HUD mortgage loans[3]	46,419	4.8	%	4.04%	46,608	5.0	%	4.04%
Secured mortgage loans[4]	78,084	8.2	%	3.79%	78,084	8.4	%	3.79%
Variable rate:								
Unsecured revolving credit facility	56,000	5.9	%	1.94%	34,000	3.6	%	1.93%
	$955,503	100.0	%	3.73%	$933,692	100.0	%	3.77%

[1] Differs from carrying amount due to unamortized discount and debt issuance costs.
[2] Includes five term loans in 2015; rate is a weighted average.
[3] Includes 10 HUD mortgages; rate is a weighted average inclusive of a mortgage insurance premium
[4] Includes 13 Fannie Mae mortgages
[5] Total is weighted average rate

The unsecured term loans in the table above reflect the effect of $40,000,000, $80,000,000, and $130,000,000 notional amount interest rate swaps with maturities of April 2019, June 2020 and June 2020, respectively, that effectively converts variable rate debt to fixed rate debt. These loans bear interest at LIBOR plus a spread, currently 175 basis points, based on our Consolidated Coverage Ratio, as defined.

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To highlight the sensitivity of our convertible senior notes and secured mortgage debt to changes in interest rates, the following summary shows the effects on fair value ("FV") assuming a parallel shift of 50 basis points ("bps") in market interest rates for a contract with similar maturities as of March 31, 2016 (dollar amounts in thousands):

	Balance	Fair Value[1]	FV reflecting change in interest rates	
Fixed rate:			-50 bps	+50 bps
Private placement term loans - unsecured	$325,000	$335,424	$348,399	$323,016
Convertible senior notes	200,000	202,004	207,162	196,981
Fannie Mae mortgage loans	78,084	79,064	82,218	76,046
HUD mortgage loans	46,419	48,910	52,647	45,535

[1] The change in fair value of our fixed rate debt was due primarily to the overall change in interest rates.

At March 31, 2016, the fair value of our mortgage notes receivable, discounted for estimated changes in the risk-free rate, was approximately $161,398,000. A 50 basis point increase in market rates would decrease the estimated fair value of our mortgage loans by approximately $3,227,000, while a 50 basis point decrease in such rates would increase their estimated fair value by approximately $3,350,000.

Equity Price Risk

We are exposed to equity price risk, which is the potential change in fair value due to a change in quoted market prices. We account for our investments in marketable securities, with a fair value of $58,532,000 at March 31, 2016, as available-for-sale securities. Increases and decreases in the fair market value of our investments in other marketable securities are unrealized gains and losses that are presented as a component of other comprehensive income. The investments in marketable securities are recorded at their fair value based on quoted market prices. Thus, there is exposure to equity price risk. We monitor our investments in marketable securities to consider evidence of whether any portion of our original investment is likely not to be recoverable, at which time we would record an impairment charge to operations. A hypothetical 10% change in quoted market prices would result in a related $5,853,000 change in the fair value of our investments in marketable securities.

Item 4. Controls and Procedures.

Evaluation of Disclosure Control and Procedures. As of March 31, 2016, an evaluation was performed under the supervision and with the participation of our management, including the Chief Executive Officer ("CEO") and Chief Accounting Officer ("CAO"), of the effectiveness of the design and operation of management's disclosure controls and procedures (as defined in rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934) to ensure information required to be disclosed in our filings under the Securities and Exchange Act of 1934, is (i) recorded, processed, summarized, and reported within the time periods specified in the SEC rules and forms; and (ii) accumulated and communicated to our management, including our CEO and our CAO, as appropriate, to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving desired control objectives, and management is necessarily required to apply its judgment when evaluating the cost-benefit relationship of potential controls and procedures. Based upon the evaluation, the CEO and CAO concluded that the design and operation of these disclosure controls and procedures were effective as of March 31, 2016.

There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant

deficiencies and material weaknesses.

Changes in Internal Control over Financial Reporting. There were no changes in our internal control over financial reporting identified in management’s evaluation during the three months ended March 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Our health care facilities are subject to claims and suits in the ordinary course of business. Our lessees and borrowers have indemnified, and are obligated to continue to indemnify us, against all liabilities arising from the operation of the facilities, and are further obligated to indemnify us against environmental or title problems affecting the real estate underlying such facilities. While there may be lawsuits pending against certain of the owners and/or lessees of our facilities, management believes that the ultimate resolution of all such pending proceedings will have no material adverse effect on our financial condition, results of operations or cash flows.

Item 1A. Risk Factors.

During the three months ended March 31, 2016, there were no material changes to the risk factors that were disclosed in Item 1A of National Health Investors, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2015.

Item 6. Exhibits.

Exhibit No.	Description
3.1	Articles of Incorporation (incorporated by reference to Exhibit 3.1 to Form S-11 Registration Statement No. 33-41863)
3.2	Amendment to Articles of Incorporation (incorporated by reference to Exhibit A to the Company's Definitive Proxy Statement filed March 23, 2009)
3.3	Amendment to Articles of Incorporation approved by shareholders on May 2, 2014 (incorporated by reference to Exhibit 3.3 to the Form 10-Q filed August 4, 2014)
3.4	Restated Bylaws (incorporated by reference to Exhibit 3.3 to Form 10-K filed February 15, 2013)
3.5	Amendment No. 1 to Restated Bylaws dated February 14, 2014 (incorporated by reference to Exhibit 3.4 to Form 10-K filed February 14, 2014)
4.1	Form of Common Stock Certificate (incorporated by reference to Exhibit 39 to Form S-11 Registration Statement No. 33-41863)
4.2	Indenture, dated as of March 25, 2014, between National Health Investors, Inc. and The Bank of New York Mellon Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 4.1 to Form 8-K filed March 31, 2014)
4.3	First Supplemental Indenture, dated as of March 25, 2014, to the Indenture, dated as of March 25, 2014, between National Health Investors, Inc. and The Bank of New York Mellon Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 4.2 to Form 8-K filed March 31, 2014)
10.1	Purchase and Sale Agreement, dated as of April 1, 2016, between Texas NHI Investors, LLC and Gladewater Real Estate, LP, Firehole River Real Estate Holdings - Granite Mesa, Ltd, Firehole River Real Estate Holdings - Sonterra, Ltd, Firehole River Real Estate Holdings - West San Antonio, Ltd, RGV Real Estate Holdings, Ltd, Firehole River Real Estate Holdings - Euless, LP, and Firehole River Real Estate Holdings - Katy, LLC, and Legend Healthcare, LLC
31.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document
101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB XBRL Taxonomy Extension Label Linkbase Document
101.PRE XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF XBRL Taxonomy Extension Definition Linkbase Document

* As provided in Rule 406T of Regulation S-T, this information shall not be deemed “filed” for purposes of Sections 11 and 12 of the Securities Act and Section 18 of the Securities Exchange Act or otherwise subject to liability under those sections.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NATIONAL HEALTH INVESTORS, INC.
(Registrant)

Date: May 5, 2016 /s/ D. Eric Mendelsohn
D. Eric Mendelsohn
President and Chief Executive Officer,

Date: May 5, 2016 /s/ Roger R. Hopkins
Roger R. Hopkins
Chief Accounting Officer
(Principal Financial Officer and Principal Accounting Officer)

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Total impairment charges active stores	500	30,109	389	16,106	394	12,126
Total impairment charges closed facilities	53	2,038	27	1,113	35	2,312
Total impairment charges all locations	553	$32,147	416	$17,219	429	$14,438

(1) These charges are related to stores that were impaired for the first time in prior periods. Most active stores, requiring an impairment charge, are fully impaired in the first period that they do not meet their asset recoverability test. However, we do often make capital additions to certain stores to improve their operating results or to meet geographical competition, which if later are deemed to be unrecoverable, will be impaired in future periods. Of this total, 424, 351 and 369 stores for fiscal years 2017, 2016 and 2015 respectively have been fully impaired. Also included in these charges are an insignificant number of stores, which were only partially impaired in prior years based on our analysis that supported a reduced net book value greater than zero, but now require additional charges.

(2) These charges are related to new stores (open at least 3 years) and relocated stores (relocated in the last 2 years) and significant strategic remodels (remodeled in the last year) that did not meet their recoverability test during the current period. These stores have not met their original return on investment projections and have a historical loss of at least 2 years. Their future cash flow projections do not recover their current carrying value. Of this total, 18, 3 and 1 stores for fiscal years 2017, 2016 and 2015 respectively have been fully impaired.

(3) These charges are related to the remaining active stores that did not meet the recoverability test during the current period. These stores have a historical loss of at least 2 years. Their future cash flow projections do not recover their current carrying value. Of this total, 48, 27 and 14 stores for fiscal years 2017, 2016 and 2015 respectively have been fully impaired.

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

5. Lease Termination and Impairment Charges (Continued)

The primary drivers of its impairment charges are each store's current and historical operating performance and the assumptions that the Company makes about each store's operating performance in future periods. Projected cash flows are updated based on the next year's operating budget which includes the qualitative factors noted above. The Company utilizes the three-level valuation hierarchy for the recognition and disclosure of fair value measurements. The categorization of assets and liabilities within this hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. The three levels of the hierarchy consist of the following:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 Inputs to the valuation methodology are quoted prices for similar assets and liabilities in active markets, quoted prices in markets that are not active or inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the instrument.

Level 3 Inputs to the valuation methodology are unobservable inputs based upon management's best estimate of inputs market participants could use in pricing the asset or liability at the measurement date, including assumptions about risk.

Long-lived non-financial assets are measured at fair value on a nonrecurring basis for purposes of calculating impairment using Level 2 and Level 3 inputs as defined in the fair value hierarchy. The fair value of long-lived assets using Level 2 inputs is determined by evaluating the current economic conditions in the geographic area for similar use assets. The fair value of long-lived assets using Level 3 inputs is determined by estimating the amount and timing of net future cash flows (which are unobservable inputs) and discounting them using a risk-adjusted rate of interest (which is Level 1). The Company estimates future cash flows based on its experience and knowledge of the market in which the store is located. Significant increases or decreases in actual cash flows may result in valuation changes.

The table below sets forth by level within the fair value hierarchy the long-lived assets as of the impairment measurement date for which an impairment assessment was performed and total losses as of March 4, 2017 and February 27, 2016:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Values as of Impairment Date	Total Charges March 4, 2017
Long-lived assets held and used	$	$ 924	$ 19,827	$ 20,751	$ (32,076)
Long-lived assets held for sale		1,260		1,260	(71)
Total	$	$ 2,184	$ 19,827	$ 22,011	$ (32,147)

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

5. Lease Termination and Impairment Charges (Continued)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Values as of Impairment Date	Total Charges February 27, 2016
Long-lived assets held and used	$	$ 3,641	$ 17,645	$ 21,286	$ (16,672)
Long-lived assets held for sale		3,283	189	3,472	(547)
Total	$	$ 6,924	$ 17,834	$ 24,758	$ (17,219)

Lease Termination Charges

Charges to close a store, which principally consist of continuing lease obligations, are recorded at the time the store is closed and all inventory is liquidated, pursuant to the guidance set forth in ASC 420, "Exit or Disposal Cost Obligations." The Company calculates the liability for closed stores on a store-by-store basis. The calculation includes the discounted effect of future minimum lease payments and related ancillary costs, from the date of closure to the end of the remaining lease term, net of estimated cost recoveries that may be achieved through subletting or favorable lease terminations. The Company evaluates these assumptions each quarter and adjusts the liability accordingly.

In fiscal 2017, 2016 and 2015, the Company recorded lease termination charges of $23,147, $31,204 and $27,507, respectively. These charges related to changes in future assumptions, interest accretion and provisions for 17 stores in fiscal 2017, 23 stores in fiscal 2016, and 10 stores in fiscal 2015.

As part of its ongoing business activities, the Company assesses stores and distribution centers for potential closure. Decisions to close or relocate stores or distribution centers in future periods would result in lease termination charges for lease exit costs and liquidation of inventory, as well as impairment of assets at these locations. The following table reflects the closed store and distribution center charges that relate to new closures, changes in assumptions and interest accretion:

	Year Ended		
	March 4, 2017 (53 Weeks)	February 27, 2016 (52 Weeks)	February 28, 2015 (52 Weeks)
Balance beginning of year	$ 208,421	$ 241,047	$ 284,270
Provision for present value of noncancellable lease payments of closed stores	6,503	9,709	1,661
Changes in assumptions about future sublease income, terminations and change in interest rates	2,633	5,655	7,560
Interest accretion	14,186	16,463	18,988
Cash payments, net of sublease income	(66,605)	(64,453)	(71,432)

Balance end of year	$	165,138	$	208,421	$	241,047

The Company's revenues and income before income taxes for fiscal 2017, 2016, and 2015 included results from stores that have been closed or are approved for closure as of March 4, 2017. The

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

5. Lease Termination and Impairment Charges (Continued)

revenue, operating expenses and income before income taxes of these stores for the periods are presented as follows:

	Year Ended		
	March 4, 2017	February 27, 2016	February 28, 2015
Revenues	$ 132,790	$ 143,339	$ 193,757
Operating expenses	151,978	159,967	212,753
Gain from sale of assets	(1,364)	(5,607)	(5,529)
Other expenses	2,544	1,676	2,889
Loss before income taxes	(20,368)	(12,697)	(16,356)
Included in these stores' loss before income taxes are:			
Depreciation and amortization	1,166	1,162	1,650
Inventory liquidation charges	346	295	222

The above results are not necessarily indicative of the impact that these closures will have on revenues and operating results of the Company in the future, as the Company often transfers the business of a closed store to another Company store, thereby retaining a portion of these revenues and operating expenses.

6. Fair Value Measurements

The Company utilizes the three-level valuation hierarchy as described in Note 5, *Lease Termination and Impairment Charges*, for the recognition and disclosure of fair value measurements.

As of March 4, 2017 and February 27, 2016, the Company did not have any financial assets measured on a recurring basis. Please see Note 5 for fair value measurements of non-financial assets measured on a non-recurring basis.

Other Financial Instruments

Financial instruments other than long-term indebtedness include cash and cash equivalents, accounts receivable and accounts payable. These instruments are recorded at book value, which we believe approximate their fair values due to their short term nature. In addition, as of March 4, 2017 and February 27, 2016, the Company has $6,874 and $6,069, respectively, of investments carried at amortized cost as these investments are being held to maturity. These investments are included as a component of prepaid expenses and other current assets as of March 4, 2017 and are included as a component of other assets as of February 27, 2016. The Company believes the carrying value of these investments approximates their fair value.

The fair value for LIBOR-based borrowings under the Company's senior secured credit facility and first and second lien term loans are estimated based on the quoted market price of the financial instrument which is considered Level 1 of the fair value hierarchy. The fair values of substantially all of the Company's other long-term indebtedness are estimated based on quoted market prices of the financial instruments which are considered Level 1 of the fair value hierarchy. The carrying amount and

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

6. Fair Value Measurements (Continued)

estimated fair value of the Company's total long-term indebtedness was $7,263,378 and $7,556,599, respectively, as of March 4, 2017. The carrying amount and estimated fair value of the Company's total long-term indebtedness was $6,914,483 and $7,235,916, respectively, as of February 27, 2016. There were no outstanding derivative financial instruments as of March 4, 2017 and February 27, 2016.

7. Income Taxes

The provision for income tax expense (benefit) was as follows:

		Year Ended	
	March 4, 2017 (53 Weeks)	**February 27, 2016 (52 Weeks)**	**February 28, 2015 (52 Weeks)**
Current tax:			
Federal	$	$ (52)	$
State	14,596	9,396	6,011
	14,596	9,344	6,011
Deferred tax and other:			
Federal	10,341	117,200	(1,544,344)
State	19,455	(13,605)	(144,020)
	29,796	103,595	(1,688,364)
Total income tax expense (benefit)	$ 44,392	$ 112,939	$ (1,682,353)

A reconciliation of the expected statutory federal tax and the total income tax expense (benefit) was as follows:

		Year Ended	
	March 4, 2017 (53 Weeks)	**February 27, 2016 (52 Weeks)**	**February 28, 2015 (52 Weeks)**
Federal statutory rate	$ 16,957	$ 97,441	$ 149,389
Nondeductible expenses	2,479	6,518	805
State income taxes, net	8,219	23,828	11,565
Decrease of previously recorded liabilities	(955)		(3,698)
Nondeductible compensation	1,157	6,057	5,136
Acquisition Costs	4,023	6,782	
Valuation allowance	14,703	(26,358)	(1,841,304)
Other	(2,191)	(1,329)	(4,246)
Total income tax expense (benefit)	$ 44,392	$ 112,939	(1,682,353)

Net income for fiscal 2017 included income tax expense of $44,392, which included an increase in valuation allowance of $14,703 primarily related to a reduction in estimated utilization of state NOLs and for expiring carryforwards.

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

7. Income Taxes (Continued)

Net income for fiscal 2016 included income tax expense of $112,939 based on the effective tax rate above, which included a benefit of $26,358 related to a reduction in valuation allowance primarily for an increase in estimated utilization of state NOLs and for expiring carryforwards.

The fiscal 2015 income tax benefit of $1,682,353 was primarily attributable to the reduction of the deferred tax valuation allowance. The reduction of the valuation allowance was based upon the Company's then achievement of cumulative profitability over a three year window, reported earnings for ten consecutive quarters, utilization of federal and state net operating losses against taxable income for the last three years and the Company's historical ability of predicting earnings. Based upon the Company's projections for future taxable income over the periods in which the deferred tax assets are recoverable, management believed that it was more likely than not that the Company would realize the benefits of substantially all the net deferred tax assets existing at February 28, 2015.

The tax effect of temporary differences that gave rise to significant components of deferred tax assets and liabilities consisted of the following at March 4, 2017 and February 27, 2016:

	2017	2016
Deferred tax assets:		
Accounts receivable	$ 68,320	$ 72,883
Accrued expenses	194,884	198,636
Liability for lease exit costs	68,411	81,704
Pension, retirement and other benefits	168,274	182,394
Long-lived assets	509,283	487,944
Other	1,630	6,203
Credits	65,971	64,382
Net operating losses	1,207,650	1,182,440
Total gross deferred tax assets	2,284,423	2,276,586
Valuation allowance	(226,726)	(212,023)
Total deferred tax assets	2,057,697	2,064,563
Deferred tax liabilities:		
Outside basis difference	112,509	108,860
Inventory	439,624	416,562
Total gross deferred tax liabilities	552,133	525,422
Net deferred tax assets	$ 1,505,564	$ 1,539,141

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

7. Income Taxes (Continued)

A reconciliation of the beginning and ending amount of unrecognized tax benefits was as follows:

	2017	2016	2015
Unrecognized tax benefits	$ 10,676	$ 9,514	$ 10,143
Increases to prior year tax positions	16	1,667	1,003
Decreases to tax positions in prior periods	(626)	(577)	(984)
Increases to current year tax positions	26	72	123
Settlements			(681)
Lapse of statute of limitations	(1,153)		(90)
Unrecognized tax benefits balance	$ 8,939	$ 10,676	$ 9,514

The amount of the above unrecognized tax benefits at March 4, 2017, February 27, 2016 and February 28, 2015 which would impact the Company's effective tax rate, if recognized, was $892, $2,084 and $440, respectively. Additionally, any impact on the effective rate may be mitigated by the valuation allowance that is remaining against the Company's net deferred tax assets.

While it is expected that the amount of unrecognized tax benefits will change in the next twelve months, management does not expect the change to have a significant impact on the results of operations or the financial position of the Company.

The Company recognizes interest and penalties related to tax contingencies as income tax expense. The Company recognized an expense/(benefit) for interest and penalties in connection with tax matters of $(276), $60 and ($5,250) for fiscal years 2017, 2016 and 2015, respectively. As of March 4, 2017 and February 27, 2016 the total amount of accrued income tax-related interest and penalties was $263 and $539, respectively.

The Company files U.S. federal income tax returns as well as income tax returns in those states where it does business. The consolidated federal income tax returns are closed for examination through fiscal year 2013. Prior year returns for acquired subsidiaries remain open for 2012 and 2013 due to IRS examination. However, any net operating losses that were generated in these prior closed years may be subject to examination by the IRS upon utilization. Tax examinations by various state taxing authorities could generally be conducted for a period of three to five years after filing of the respective return. However, as a result of filing amended returns, the Company has statutes open in some states from fiscal year 2005.

Net Operating Losses and Tax Credits

At March 4, 2017, the Company had federal net operating loss carryforwards of approximately $2,936,612. Of these, $1,658,482 will expire, if not utilized, between fiscal 2020 and 2028. An additional $1,278,130 will expire, if not utilized, between fiscal 2029 and 2037.

At March 4, 2017, the Company had state net operating loss carryforwards of approximately $5,093,651, the majority of which will expire between fiscal 2028 and 2037.

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

7. Income Taxes (Continued)

The Company's federal and state net operating loss carryforwards include federal deductions of $35,935 and state deductions of $88,614 for windfall tax benefits that have not yet been recognized in the financial statements at March 4, 2017. Previously, these tax benefits would be credited to additional paid-in capital when they reduce current taxable income consistent with the tax law ordering approach. However, due to the adoption of ASU 2016-09, they will be recognized in the first quarter of fiscal 2018.

At March 4, 2017, the Company had federal business tax credit carryforwards of $51,869, the majority of which will expire between 2019 and 2021. In addition to these credits, the Company had alternative minimum tax credit carryforwards of $3,234.

Valuation Allowances

The valuation allowances as of March 4, 2017 and February 27, 2016 apply to the net deferred tax assets of the Company. The Company maintained a valuation allowance of $226,726 and $212,023, which relates primarily to state deferred tax assets at March 4, 2017 and February 27, 2016, respectively.

8. Accounts Receivable

The Company maintains an allowance for doubtful accounts receivable based upon the expected collectability of accounts receivable. The allowance for uncollectible accounts at March 4, 2017 and February 27, 2016 was $30,891 and $32,820 respectively. The Company's accounts receivable are due primarily from third-party payors (e.g., pharmacy benefit management companies, insurance companies or governmental agencies) and are recorded net of any allowances provided for under the respective plans. Since payments due from third-party payors are sensitive to payment criteria changes and legislative actions, the allowance is reviewed continually and adjusted for accounts deemed uncollectible by management.

9. Medicare Part D

The Company offers Medicare Part D benefits through EIC, which has contracted with CMS to be a PDP and, pursuant to the Medicare Prescription Drug, Improvement and Modernization Act of 2003, must be a risk-bearing entity regulated under state insurance laws or similar statutes.

EIC is a licensed domestic insurance company under the applicable laws and regulations. Pursuant to these laws and regulations, EIC must file quarterly and annual reports with the National Association of Insurance Commissioners ("NAIC") and certain state regulators, must maintain certain minimum amounts of capital and surplus under formulas established by certain states and must, in certain circumstances, request and receive the approval of certain state regulators before making dividend payments or other capital distributions to the Company. The Company does not believe these limitations on dividends and distributions materially impact its financial position. EIC is subject to minimum capital and surplus requirements in certain states. The minimum amount of capital and surplus required to satisfy regulatory requirements in these states is $18,962 as of December 31, 2016. EIC was in excess of the minimum required amounts in these states as of March 4, 2017.

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

9. Medicare Part D (Continued)

The Company has recorded estimates of various assets and liabilities arising from its participation in the Medicare Part D program based on information in its claims management and enrollment systems. Significant estimates arising from its participation in this program include: (i) estimates of low-income cost subsidies, reinsurance amounts, and coverage gap discount amounts ultimately payable to CMS based on a detailed claims reconciliation that will occur in the following year; (ii) an estimate of amounts receivable from CMS under a risk-sharing feature of the Medicare Part D program design, referred to as the risk corridor and (iii) estimates for claims that have been reported and are in the process of being paid or contested and for our estimate of claims that have been incurred but have not yet been reported.

As of March 4, 2017, accounts receivable, net included $245,766 due from CMS and accrued salaries, wages and other current liabilities included $145,903 of EIC liabilities under certain reinsurance contracts. As of February 27, 2016, accounts receivable, net included $275,032 due from CMS and accrued salaries, wages and other current liabilities included $166,238 of EIC liabilities under certain reinsurance contracts. EIC limits its exposure to loss and recovers a portion of benefits paid by utilizing quota-share reinsurance with a commercial reinsurance company.

10. Inventory

At March 4, 2017 and February 27, 2016, inventories were $999,776 and $1,006,396, respectively, lower than the amounts that would have been reported using the first-in, first-out ("FIFO") cost flow assumption. The Company calculates its FIFO inventory valuation using the retail method for store inventories and the cost method for distribution facility inventories. The Company recorded a LIFO credit for fiscal year 2017 of $6,620, compared to a LIFO charge of $11,163 for fiscal year 2016 and a LIFO credit of $18,857 for fiscal year 2015. During fiscal 2017, a reduction in non-pharmacy inventories resulted in the liquidation of applicable LIFO inventory quantities carried at lower costs in prior years. During fiscal 2016 and 2015, a reduction in inventories related to working capital initiatives resulted in similar LIFO liquidation. This LIFO liquidation resulted in a $4,225, $60,653 and $38,867 cost of revenues decrease, with a corresponding reduction to the adjustment to LIFO for fiscal 2017, fiscal 2016 and fiscal 2015, respectively.

11. Property, Plant and Equipment

Following is a summary of property, plant and equipment, including capital lease assets, at March 4, 2017 and February 27, 2016:

	2017	2016
Land	$ 217,112	$ 221,409
Buildings	754,289	764,497
Leasehold improvements	2,353,066	2,245,307
Equipment	2,512,748	2,416,316
Software	16,316	6,111
Construction in progress	71,954	153,236
	5,925,485	5,806,876
Accumulated depreciation	(3,673,793)	(3,551,478)
Property, plant and equipment, net	$ 2,251,692	$ 2,255,398

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11. Property, Plant and Equipment (Continued)

Depreciation expense, which included the depreciation of assets recorded under capital leases, was $346,081, $322,396 and $298,523 in fiscal 2017, 2016 and 2015, respectively.

Included in property, plant and equipment was the carrying amount, which approximates fair value, of assets to be disposed of totaling $1,057 and $3,256 at March 4, 2017 and February 27, 2016, respectively.

12. Goodwill and Other Intangibles

Goodwill and indefinitely-lived assets, such as certain trademarks acquired in connection with acquisition transactions, are not amortized, but is instead evaluated for impairment on an annual basis at the end of the fiscal year, or more frequently if events or circumstances indicate that impairment may be more likely. When evaluating goodwill for possible impairment, the Company typically performs a qualitative assessment in the fourth quarter of the fiscal year to determine if it is more likely than not that the carrying value of the goodwill exceeds the fair value of the goodwill. However, as part of this qualitative assessment, a quantitative assessment is performed at least once every three years to re-establish a baseline fair value that can be used in current and future qualitative assessments. During the Company's qualitative assessment it makes significant estimates, assumptions, and judgments, including, but not limited to, the overall economy, industry and market conditions, financial performance of the Company, changes in the Company's share price, and forecasts of revenue, profit, working capital requirements, and cash flows. The Company considers its two reporting units', the Retail Pharmacy segment and the Pharmacy Services segment, historical results and operating trends when determining these assumptions. If the Company determines that it is more likely than not that the carrying value of the goodwill exceeds the fair value of the goodwill, it performs the first step of the impairment process, which compares the fair value of a reporting unit to its carrying amount, including the goodwill. The Company estimates the fair value of its reporting units using a combination of a future discounted cash flow valuation model and a comparable market transaction models. If the carrying value of a reporting unit exceeds the fair value, the second step of the impairment process is performed and the implied fair value of a reporting unit is compared to the carrying amount of the goodwill. The implied fair value of the goodwill is determined the same way as the goodwill recognized in a business combination. The Company assigns the fair value of a reporting unit to all of the assets and liabilities of that unit (including unrecognized intangible assets) and any excess goes to the goodwill (its implied fair value). Any excess carrying amount of the goodwill over the implied fair value of the goodwill, is the amount of the impairment loss recognized.

In the fiscal fourth quarter the Company completed a qualitative goodwill impairment assessment, which included a quantitative assessment to re-establish baseline fair value where necessary, and after evaluating the results, events and circumstances of the reporting units, the Company concluded that sufficient evidence existed to assert qualitatively that it is more likely than not that the fair values of the reporting units exceeded their carrying values. Therefore, a two- step impairment assessment was not necessary and no goodwill impairment charge was assessed for the fiscal years ended March 4, 2017 and February 27, 2016.

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12. Goodwill and Other Intangibles (Continued)

Below is a summary of the changes in the carrying amount of goodwill by segment for the fiscal years ended March 4, 2017 and February 27, 2016:

	Retail Pharmacy	Pharmacy Services	Total
Balance, February 28, 2015	$ 76,124	$	$ 76,124
Acquisition (see Note 2. Acquisition)		1,637,351	1,637,351
Balance, February 27, 2016	$ 76,124	$ 1,637,351	$ 1,713,475
Acquisition (see Note 2. Acquisition)			
Change in goodwill resulting from changes to the final purchase price allocation		2,004	2,004
Balance, March 4, 2017	$ 76,124	$ 1,639,355	$ 1,715,479

The Company's intangible assets are finite-lived and amortized over their useful lives. Following is a summary of the Company's finite-lived and indefinite-lived intangible assets as of March 4, 2017 and February 27, 2016.

	2017				2016			
	Gross Carrying Amount	Accumulated Amortization	Net	Remaining Weighted Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net	Remaining Weighted Average Amortization Period
Favorable leases and other	$ 664,670	$ (531,022)	$ 133,648	7 years	$ 665,197	$ (507,776)	$ 157,421	8 years
Prescription files	1,584,240	(1,390,139)	194,101	3 years	1,541,518	(1,285,633)	255,885	3 years
Customer relationships(a)	465,000	(110,653)	354,347	16 years	465,000	(44,203)	420,797	17 years
CMS license	57,500	(3,872)	53,628	24 years	57,500	(1,572)	55,928	25 years
Claims adjudication and other developed software	58,995	(14,188)	44,807	6 years	59,000	(5,760)	53,240	7 years
Trademarks	20,100	(3,383)	16,717	9 years	20,100	(1,373)	18,727	10 years
Backlog	11,500	(6,453)	5,047	2 years	11,500	(2,619)	8,881	3 years
Total finite	$ 2,862,005	$ (2,059,710)	$ 802,295		$ 2,819,815	$ (1,848,936)	$ 970,879	
Trademarks	33,500		33,500	Indefinite	33,500		33,500	Indefinite
Total	$ 2,895,505	$ (2,059,710)	$ 835,795		$ 2,853,315	$ (1,848,936)	$ 1,004,379	

(a) Amortized on an accelerated basis which is determined based on the remaining useful economic lives of the customer relationships that are expected to contribute directly or indirectly to future cash flows.

Also included in other non-current liabilities as of March 4, 2017 and February 27, 2016 are unfavorable lease intangibles with a net carrying amount of $38,242 and $46,947, respectively. These intangible liabilities are amortized over their remaining lease terms at time of acquisition.

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12. Goodwill and Other Intangibles (Continued)

Amortization expense for these intangible assets and liabilities was $222,150, $186,816 and $118,105 for fiscal 2017, 2016 and 2015, respectively. The anticipated annual amortization expense for these intangible assets and liabilities is 2018 $180,560; 2019 $143,150; 2020 $113,607; 2021 $80,891 and 2022 $51,883.

13. Accrued Salaries, Wages and Other Current Liabilities

Accrued salaries, wages and other current liabilities consisted of the following at March 4, 2017 and February 27, 2016:

	2017	2016
Accrued wages, benefits and other personnel costs	$ 426,097	$ 457,135
Accrued interest	66,352	65,729
Accrued sales and other taxes payable	141,420	155,999
Accrued store expense	202,599	231,900
Accrued reinsurance	145,904	166,238
Other	387,632	350,249
	$ 1,370,004	$ 1,427,250

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

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14. Indebtedness and Credit Agreement

Following is a summary of indebtedness and lease financing obligations at March 4, 2017 and February 27, 2016:

	2017	2016
Secured Debt:		
Senior secured revolving credit facility due January 2020 ($2,430,000 and $2,100,000 face value less unamortized debt issuance costs of $24,918 and $33,903)	$ 2,405,082	$ 2,066,097
Tranche 1 Term Loan (second lien) due August 2020 ($470,000 face value less unamortized debt issuance costs of $4,167 and $5,414)	465,833	464,586
Tranche 2 Term Loan (second lien) due June 2021 ($500,000 face value less unamortized debt issuance costs of $2,431 and $3,007)	497,569	496,993
Other secured	90	90
	3,368,574	3,027,766
Guaranteed Unsecured Debt:		
9.25% senior notes due March 2020 ($902,000 face value plus unamortized premium of $2,071 and $2,743 and less unamortized debt issuance costs of $7,527 and $10,180)	896,544	894,563
6.75% senior notes due June 2021 ($810,000 face value less unamortized debt issuance costs of $6,360 and $7,872)	803,640	802,128
6.125% senior notes due April 2023 ($1,800,000 face value less unamortized debt issuance costs of $25,984 and $30,343)	1,774,016	1,769,657
	3,474,200	3,466,348
Unguaranteed Unsecured Debt:		
7.7% notes due February 2027 ($295,000 face value less unamortized debt issuance costs of $1,625 and $1,794)	293,375	293,206
6.875% fixed-rate senior notes due December 2028 ($128,000 face value less unamortized debt issuance costs of $771 and $837)	127,229	127,163
	420,604	420,369
Lease financing obligations	65,315	79,653
Total debt	7,328,693	6,994,136
Current maturities of long-term debt and lease financing obligations	(21,335)	(26,848)
Long-term debt and lease financing obligations, less current maturities	$ 7,307,358	$ 6,967,288

Credit Facility

The Company's Amended and Restated Senior Secured Credit Facility has a borrowing capacity of $3,700,000 and matures in January 2020. Borrowings under the revolver bear interest at a rate per annum between (i) LIBOR plus 1.50% and LIBOR plus 2.00% with respect to Eurodollar borrowings and (ii) the alternate base rate plus 0.50% and the alternate base rate plus 1.00% with respect to ABR borrowings, in each case, based upon the average revolver availability (as defined in the Amended and Restated Senior Secured Credit Facility). The Company is

required to pay fees between 0.250% and 0.375% per annum on the daily unused amount of the revolver, depending on the Average Revolver

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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14. Indebtedness and Credit Agreement (Continued)

Availability (as defined in the Amended and Restated Senior Secured Credit Facility). Amounts drawn under the revolver become due and payable on January 13, 2020.

The Company's ability to borrow under the revolver is based upon a specified borrowing base consisting of accounts receivable, inventory and prescription files. At March 4, 2017, the Company had $2,430,000 of borrowings outstanding under the revolver and had letters of credit outstanding against the revolver of $62,272 which resulted in additional borrowing capacity of $1,207,728. The Merger Agreement contains a requirement that the Company's borrowings under the revolver not exceed $3,000,000 in the aggregate immediately prior to the closing of the Merger.

The Amended and Restated Senior Secured Credit Facility restricts the Company and the Subsidiary Guarantors (as defined herein) from accumulating cash on hand, and under certain circumstances, requires the funds in the Company's deposit accounts to be applied first to the repayment of outstanding revolving loans under the Amended and Restated Senior Secured Credit Facility and then to be held as collateral for the senior obligations.

The Amended and Restated Senior Secured Credit Facility allows the Company to have outstanding, at any time, up to $1,500,000 in secured second priority debt, split-priority term loan debt, unsecured debt and disqualified preferred stock in addition to borrowings under the Amended and Restated Senior Secured Credit Facility and existing indebtedness, provided that not in excess of $750,000 of such secured second priority debt, split-priority term loan debt, unsecured debt and disqualified preferred stock shall mature or require scheduled payments of principal prior to 90 days after the latest of (a) the fifth anniversary of the effectiveness of the Amended and Restated Senior Secured Credit Facility and (b) the latest maturity date of any Term Loan or Other Revolving Loan (each as defined in the Amended and Restated Senior Secured Credit Facility) (excluding bridge facilities allowing extensions on customary terms to at least the date that is 90 days after such date and, with respect to any escrow notes issued by Rite Aid, excluding any special mandatory redemption of the type described in clause (iii) of the definition of "Escrow Notes" in the Amended and Restated Senior Secured Credit Facility). Subject to the limitations described in clauses (a) and (b) of the immediately preceding sentence, the Amended and Restated Senior Secured Credit Facility additionally allows the Company to issue or incur an unlimited amount of unsecured debt and disqualified preferred stock so long as a Financial Covenant Effectiveness Period (as defined in the Amended and Restated Senior Secured Credit Facility) is not in effect; provided, however, that certain of the Company's other outstanding indebtedness limits the amount of unsecured debt that can be incurred if certain interest coverage levels are not met at the time of incurrence or other exemptions are not available. The Amended and Restated Senior Secured Credit Facility also contains certain restrictions on the amount of secured first priority debt the Company is able to incur. The Amended and Restated Senior Secured Credit Facility also allows for the voluntary repurchase of any debt or other convertible debt, so long as the Amended and Restated Senior Secured Credit Facility is not in default and the Company maintains availability under its revolver of more than $365,000.

The Amended and Restated Senior Secured Credit Facility has a financial covenant that requires the Company to maintain a minimum fixed charge coverage ratio of 1.00 to 1.00 (a) on any date on which availability under the revolver is less than $200,000 or (b) on the third consecutive business day

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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14. Indebtedness and Credit Agreement (Continued)

on which availability under the revolver is less than $250,000 and, in each case, ending on and excluding the first day thereafter, if any, which is the 30th consecutive calendar day on which availability under the revolver is equal to or greater than $250,000. As of March 4, 2017, the Company had availability under its revolver of $1,207,728, its fixed charge coverage ratio was greater than 1.00 to 1.00, and the Company was in compliance with the senior secured credit facility's financial covenant. The Amended and Restated Senior Secured Credit Facility also contains covenants which place restrictions on the incurrence of debt, the payments of dividends, sale of assets, mergers and acquisitions and the granting of liens.

The Amended and Restated Senior Secured Credit Facility also provides for customary events of default.

The Company also has two second priority secured term loan facilities, the Tranche 1 Term Loan and the Tranche 2 Term Loan. The Tranche 1 Term Loan matures on August 21, 2020 and currently bears interest at a rate per annum equal to LIBOR plus 4.75% with a LIBOR floor of 1.00%, if the Company chooses to make LIBOR borrowings, or at Citibank's base rate plus 3.75%. The Tranche 2 Term Loan matures on June 21, 2021 and currently bears interest at a rate per annum equal to LIBOR plus 3.875% with a LIBOR floor of 1.00%, if the Company chooses to make LIBOR borrowings, or at Citibank's base rate plus 2.875%.

With the exception of EIC, substantially all of Rite Aid Corporation's 100 percent owned subsidiaries guarantee the obligations under the Amended and Restated Senior Secured Credit Facility, second priority secured term loan facilities, and unsecured guaranteed notes. The Amended and Restated Senior Secured Credit Facility and second priority secured term loan facilities are secured, on a senior or second priority basis, as applicable, by a lien on, among other things, accounts receivable, inventory and prescription files of the Subsidiary Guarantors. The subsidiary guarantees related to the Company's Amended and Restated Senior Secured Credit Facility and second priority secured term loan facilities and, on an unsecured basis, the unsecured guaranteed notes, are full and unconditional and joint and several, and there are no restrictions on the ability of the Company to obtain funds from its subsidiaries. The Company has no independent assets or operations. Additionally, prior to the Acquisition, the subsidiaries, including joint ventures, that did not guarantee the Amended and Restated Senior Secured Credit Facility, the credit facility, second priority secured term loan facilities and applicable notes, were minor. Accordingly, condensed consolidating financial information for the Company and subsidiaries is not presented for those periods. Subsequent to the Acquisition, other than EIC, the subsidiaries, including joint ventures, that do not guarantee the credit facility, second priority secured term loan facilities and applicable notes, are minor. As such, condensed consolidating financial information for the Company, its guaranteeing subsidiaries and non-guaranteeing subsidiaries is presented for those periods subsequent to the Acquisition. See Note 24 "Guarantor and Non-Guarantor Condensed Consolidating Financial Information" for additional disclosure.

2016 Transactions

On April 2, 2015, the Company issued $1,800,000 aggregate principal amount of its 6.125% Notes, the net proceeds of which, along with other available cash and borrowings under its Amended and

RITE AID CORPORATION AND SUBSIDIARIES

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14. Indebtedness and Credit Agreement (Continued)

Restated Senior Secured Credit Facility, were used to finance the cash portion of the Acquisition, which closed on June 24, 2015. The Company's obligations under the notes are fully and unconditionally guaranteed, jointly and severally, on an unsubordinated basis, by all of its subsidiaries that guarantee the Company's obligations under the Amended and Restated Senior Secured Credit Facility, second priority secured term loan facilities, the 9.25% senior notes due 2020 (the "9.25% Notes") and the 6.75% senior notes due 2021 (the "6.75% Notes") (the "Rite Aid Subsidiary Guarantors"), including EnvisionRx and certain of its domestic subsidiaries other than, among others, EIC (the "EnvisionRx Subsidiary Guarantors" and, together with the Rite Aid Subsidiary Guarantors, the "Subsidiary Guarantors"). The guarantees are unsecured. The 6.125% Notes are unsecured, unsubordinated obligations of Rite Aid Corporation and rank equally in right of payment with all of its other unsecured, unsubordinated indebtedness.

During May 2015, $64,089 of the Company's 8.5% convertible notes due 2015 were converted into 24,762 shares of common stock, pursuant to their terms. The remaining $79 of the Company's 8.5% convertible notes due 2015 were repaid by the Company upon maturity.

On August 15, 2015, the Company completed the redemption of all of its outstanding $650,000 aggregate principal amount of its 8.00% Notes. In connection with the redemption, the Company recorded a loss on debt retirement, including call premium and unamortized debt issue costs, of $33,205 during the second quarter of fiscal 2016.

2015 Transactions

On October 15, 2014, the Company completed the redemption of all of its outstanding $270,000 aggregate principal amount of its 10.25% senior notes due October 2019 at their contractually determined early redemption price of 105.125% of the principal amount, plus accrued interest. The Company funded this redemption with borrowings under its revolver. The Company recorded a loss on debt retirement of $18,512 related to this transaction.

Interest Rates and Maturities

The annual weighted average interest rate on the Company's indebtedness was 5.4%, 5.4%, and 5.8% for fiscal 2017, 2016, and 2015, respectively.

The aggregate annual principal payments of long-term debt for the five succeeding fiscal years are as follows: 2018 $90; 2019 $0; 2020 $2,430,000; 2021 $1,372,000 and $3,533,000 in 2022 and thereafter.

15. Leases

The Company leases most of its retail stores and certain distribution facilities under noncancellable operating and capital leases, most of which have initial lease terms ranging from 5 to 22 years. The Company also leases certain of its equipment and other assets under noncancellable operating leases with initial terms ranging from 3 to 10 years. In addition to minimum rental payments, certain store leases require additional payments based on sales volume, as well as reimbursements for taxes,

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15. Leases (Continued)

maintenance and insurance. Most leases contain renewal options, certain of which involve rent increases. Total rental expense, net of sublease income of $7,310, $8,995, and $8,559, was $1,017,316, $973,347, and $964,484 in fiscal 2017, 2016, and 2015, respectively. These amounts include contingent rentals of $15,522, $17,755 and $18,919 in fiscal 2017, 2016, and 2015, respectively.

During fiscal 2017, the Company did not enter into any sale-leaseback transactions whereby the Company sold owned operating stores to independent third parties and concurrent with the sale, entered into an agreement to lease the store back from the purchasers.

During fiscal 2016, the Company sold 10 owned operating stores to independent third parties. Net proceeds from the sale were $36,732. Concurrent with these sales, the Company entered into agreements to lease the stores back from the purchasers over minimum lease terms of 20 years. Eight leases were accounted for as operating leases and the remaining two were accounted for as capital leases. The transactions resulted in a gain for certain stores of $670 which is deferred over the life of the leases. In addition, the transaction resulted in a loss for certain stores of $546 which is included in the loss on sale of assets, net for the fifty-two weeks ended February 27, 2016.

During fiscal 2015, the Company did not enter into any sale-leaseback transactions whereby the Company sold owned operating stores to independent third parties and concurrent with the sale, entered into an agreement to lease the store back from the purchasers.

The net book values of assets under capital leases and sale-leasebacks accounted for under the financing method at March 4, 2017 and February 27, 2016 are summarized as follows:

	2017	2016
Land	$ 5,063	$ 5,063
Buildings	135,434	136,416
Leasehold improvements	1,470	1,612
Equipment	31,219	33,919
Accumulated depreciation	(132,105)	(128,168)
	$ 41,081	$ 48,842

Following is a summary of lease finance obligations at March 4, 2017 and February 27, 2016:

	2017	2016
Obligations under financing leases	$ 60,575	$ 74,913
Sale-leaseback obligations	4,740	4,740
Less current obligation	(21,245)	(26,758)
Long-term lease finance obligations	$ 44,070	$ 52,895

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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15. Leases (Continued)

Following are the minimum lease payments for all properties under a lease agreement that will have to be made in each of the years indicated based on non-cancelable leases in effect as of March 4, 2017:

Fiscal year	Lease Financing Obligations	Operating Leases
2018	$ 26,184	$ 1,050,834
2019	15,448	988,754
2020	10,668	868,907
2021	6,800	743,598
2022	5,037	640,073
Later years	25,743	3,054,697
Total minimum lease payments	89,880	$ 7,346,863
Amount representing interest	(24,565)	
Present value of minimum lease payments	$ 65,315	

16. Stock Option and Stock Award Plans

The Company recognizes share-based compensation expense in accordance with ASC 718, "Compensation Stock Compensation." Expense is recognized over the requisite service period of the award, net of an estimate for the impact of forfeitures. Operating results for fiscal 2017, 2016 and 2015 include $23,482, $37,948 and $23,390 of compensation costs related to the Company's stock-based compensation arrangements.

In December 2000, the Company adopted the 2000 Omnibus Equity Plan (the 2000 Plan) under which 22,000 shares of common stock are reserved for granting of restricted stock, stock options, phantom stock, stock bonus awards and other stock awards at the discretion of the Board of Directors.

In February 2001, the Company adopted the 2001 Stock Option Plan (the 2001 Plan) which was approved by the shareholders under which 20,000 shares of common stock are authorized for granting of stock options at the discretion of the Board of Directors.

In April 2004, the Board of Directors adopted the 2004 Omnibus Equity Plan, which was approved by the shareholders. Under the plan, 20,000 shares of common stock are authorized for granting of restricted stock, stock options, phantom stock, stock bonus awards and other equity based awards at the discretion of the Board of Directors.

In January 2007, the stockholders of Rite Aid Corporation approved the adoption of the Rite Aid Corporation 2006 Omnibus Equity Plan. Under the plan, 50,000 shares of Rite Aid common stock are available for granting of restricted stock, stock options, phantom stock, stock bonus awards and other equity based awards at the discretion of the Board of Directors.

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16. Stock Option and Stock Award Plans (Continued)

In June 2010, the stockholders of Rite Aid Corporation approved the adoption of the Rite Aid Corporation 2010 Omnibus Equity Plan. Under the plan, 35,000 shares of Rite Aid common stock are available for granting of restricted stock, stock options, phantom stock, stock bonus awards and other equity based awards at the discretion of the Board of Directors. The adoption of the 2010 Omnibus Equity Plan became effective on June 23, 2010.

In June 2012, the stockholders of Rite Aid Corporation approved the adoption of the Rite Aid Corporation 2012 Omnibus Equity Plan. Under the plan, 28,500 shares of Rite Aid common stock are available for granting of restricted stock, stock options, phantom stock, stock bonus awards and other equity based awards at the discretion of the Board of Directors. The adoption of the 2012 Omnibus Equity Plan became effective on June 21, 2012.

In June 2014, the stockholders of Rite Aid Corporation approved the adoption of the Rite Aid Corporation 2014 Omnibus Equity Plan. Under the plan, 58,000 shares of Rite Aid common stock plus any shares of common stock remaining available for grant under the Rite Aid Corporation 2010 Omnibus Equity Plan and the Rite Aid Corporation 2012 Omnibus Equity Plan as of the effective date of the 2014 Plan (provided that no more than 25,000 shares may be granted as incentive stock options) are available for granting of restricted stock, stock options, phantom stock, stock bonus awards and other equity based awards at the discretion of the Board of Directors. The adoption of the 2014 Omnibus Equity Plan became effective on June 19, 2014.

All of the plans provide for the Board of Directors (or at its election, the Compensation Committee) to determine both when and in what manner options may be exercised; however, it may not be more than 10 years from the date of grant. All of the plans provide that stock options may be granted at prices that are not less than the fair market value of a share of common stock on the date of grant. The aggregate number of shares authorized for issuance for all plans is 54,337 as of March 4, 2017.

Stock Options

The Company determines the fair value of stock options issued on the date of grant using the Black-Scholes-Merton option-pricing model. The following weighted average assumptions were used for options granted in fiscal 2017, 2016 and 2015:

	2017	2016	2015
Expected stock price volatility(1)	N/A	56%	74%
Expected dividend yield(2)	N/A	0.00%	0.00%
Risk-free interest rate(3)	N/A	1.70%	1.70%
Expected option life(4)	N/A	5.5 years	5.5 years

(1) The expected volatility is based on the historical volatility of the stock price over the most recent period equal to expected life of the option.

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16. Stock Option and Stock Award Plans (Continued)

(2) The dividend rate that will be paid out on the underlying shares during the expected term of the options. The Company does not currently pay dividends on its common stock, as such, the dividend rate is assumed to be zero percent.

(3) The risk free interest rate is equal to the rate available on United States Treasury zero-coupon issues as of the grant date of the option with a remaining term equal to the expected term.

(4) The period of time for which the option is expected to be outstanding. The Company analyzed historical exercise behavior to estimate the life.

The weighted average fair value of options granted during fiscal 2017, 2016 and 2015 was $0.00, $4.45 and $4.43, respectively. Following is a summary of stock option transactions for the fiscal years ended March 4, 2017, February 27, 2016 and February 28, 2015:

	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at March 1, 2014	55,966	$ 1.65		
Granted	3,097	7.04		
Exercised	(16,485)	1.46		
Cancelled	(910)	3.16		
Outstanding at February 28, 2015	41,668	$ 2.09		
Granted	3,579	8.68		
Exercised	(6,400)	1.78		
Cancelled	(722)	4.20		
Outstanding at February 27, 2016	38,125	$ 2.73		
Granted		N/A		
Exercised	(3,556)	1.95		
Cancelled	(679)	5.60		
Outstanding at March 4, 2017	33,890	$ 2.75	4.76	$ 107,125
Vested or expected to vest at March 4, 2017	32,960	$ 2.66	4.69	$ 106,158

Exercisable at March 4, 2017	29,198	$ 2.08	4.31	$ 104,365

As of March 4, 2017, there was $12,376 of total unrecognized pre-tax compensation costs related to unvested stock options, net of forfeitures. These costs are expected to be recognized over a weighted average period of 1.87 years.

Cash received from stock option exercises for fiscal 2017, 2016 and 2015 was $6,951, $11,376 and $24,117, respectively. The income tax benefit from stock options for fiscal 2017, 2016 and 2015 was

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

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16. Stock Option and Stock Award Plans (Continued)

$421, $11,764 and $30,099, respectively. The total intrinsic value of stock options exercised for fiscal 2017, 2016 and 2015 was $20,475, $42,207 and $92,355, respectively.

Typically, stock options granted vest, and are subsequently exercisable in equal annual installments over a four-year period for employees.

Restricted Stock

The Company provides restricted stock grants to associates under plans approved by the stockholders. Shares awarded under the plans typically vest in equal annual installments over a three-year period. Unvested shares are forfeited upon termination of employment. Following is a summary of restricted stock transactions for the fiscal years ended March 4, 2017, February 27, 2016 and February 28, 2015:

	Shares	Weighted Average Grant Date Fair Value
Balance at March 1, 2014	10,056	$ 1.66
Granted	3,303	7.01
Vested	(5,239)	1.54
Cancelled	(454)	5.00
Balance at February 28, 2015	7,666	$ 3.84
Granted	2,752	8.60
Vested	(5,140)	2.94
Cancelled	(420)	6.89
Balance at February 27, 2016	4,858	$ 7.23
Granted	3,613	7.73
Vested	(2,222)	6.28
Cancelled	(426)	7.84
Balance at March 4, 2017	5,823	$ 7.87

At March 4, 2017, there was $31,605 of total unrecognized pre-tax compensation costs related to unvested restricted stock grants, net of forfeitures. These costs are expected to be recognized over a weighted average period of 1.95 years.

The total fair value of restricted stock vested during fiscal years 2017, 2016 and 2015 was $13,951, $15,104 and $8,090, respectively.

Performance Based Incentive Plan

Beginning in fiscal 2015, the Company provided certain of its associates with performance based incentive plans under which the associates will receive a certain number of shares of the Company's common stock based on the Company meeting certain financial and performance goals.

If such goals

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

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16. Stock Option and Stock Award Plans (Continued)

are not met, no stock-based compensation expense is recognized and any recognized stock-based compensation expense is reversed. The Company incurred $(6,070), $12,634 and $1,769 related to these performance based incentive plans for fiscal 2017, 2016 and 2015, respectively, which is recorded as a component of stock-based compensation expense.

17. Reclassifications from Accumulated Other Comprehensive Loss

The following table summarizes the components of accumulated other comprehensive loss and the changes in balances of each component of accumulated other comprehensive loss, net of tax as applicable, for the fiscal years ended March 4, 2017, February 27, 2016 and February 28, 2015:

	March 4, 2017 (53 Weeks)		February 27, 2016 (52 Weeks)		February 28, 2015 (52 Weeks)	
	Defined benefit pension plans	Accumulated other comprehensive loss	Defined benefit pension plans	Accumulated other comprehensive loss	Defined benefit pension plans	Accumulated other comprehensive loss
Accumulated other comprehensive loss						
Balance beginning of period	$ (47,781)	$ (47,781)	$ (45,850)	$ (45,850)	$ (37,334)	$ (37,334)
Other comprehensive (loss) income before reclassifications, net of $1,553, $(3,162), and $(7,506) tax expense (benefit)	2,356	2,356	(3,633)	(3,633)	(10,578)	(10,578)
Amounts reclassified from accumulated other comprehensive loss to net income, net of $2,047, $1,481, and $1,464 tax expense	3,108	3,108	1,702	1,702	2,062	2,062
Balance end of period	$ (42,317)	$ (42,317)	$ (47,781)	$ (47,781)	$ (45,850)	$ (45,850)

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17. Reclassifications from Accumulated Other Comprehensive Loss (Continued)

The following table summarizes the effects on net income of significant amounts classified out of each component of accumulated other comprehensive loss for the fiscal years ended March 4, 2017, February 27, 2016 and February 28, 2015:

	Fiscal Years Ended March 4, 2017, February 27, 2016 and February 28, 2015 Amount reclassified from accumulated other comprehensive loss			
Details about accumulated other comprehensive loss components	**March 4, 2017 (53 Weeks)**	**February 27, 2016 (52 Weeks)**	**February 28, 2015 (52 Weeks)**	**Affected line item in the consolidated statements of operations**
Defined benefit pension plans				
Amortization of unrecognized prior service cost(a)	$	$ (67)	$ (240)	Selling, general and administrative expenses
Amortization of unrecognized net loss(a)	(5,155)	(3,116)	(3,286)	Selling, general and administrative expenses
	(5,155)	(3,183)	(3,526)	Total before income tax expense
	2,047	1,481	1,464	Income tax expense
	$ (3,108)	$ (1,702)	$ (2,062)	Net of income tax expense

(a) See Note 18, Retirement Plans for additional details.

18. Retirement Plans

Defined Contribution Plans

The Company and its subsidiaries sponsor several retirement plans that are primarily 401(k) defined contribution plans covering nonunion associates and certain union associates. The Company does not contribute to all of the plans. In accordance with those plan provisions, the Company matches 100% of a participant's pretax payroll contributions, up to a maximum of 3% of such participant's pretax annual compensation. Thereafter, the Company will match 50% of the participant's additional pretax payroll contributions, up to a maximum of 2% of such participant's additional pretax annual compensation. Total expense recognized for the above plans was $68,393 in fiscal 2017, $65,118 in fiscal 2016 and $60,552 in fiscal 2015.

The Company sponsors a Supplemental Executive Retirement Plan ("SERP") for its officers, which is a defined contribution plan that is subject to a five year graduated vesting schedule. The expense recognized for the SERP was $16,921 in fiscal 2017, $1,377 in fiscal 2016 and $8,748 in fiscal 2015.

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For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

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18. Retirement Plans (Continued)

Defined Benefit Plans

The Company and its subsidiaries also sponsor a qualified defined benefit pension plan that requires benefits to be paid to eligible associates based upon years of service and, in some cases, eligible compensation. The Company's funding policy for The Rite Aid Pension Plan (The "Defined Benefit Pension Plan") is to contribute the minimum amount required by the Employee Retirement Income Security Act of 1974. However, the Company may, at its sole discretion, contribute additional funds to the plan. The Company made contributions of $0 in fiscal 2017, $0 in fiscal 2016 and $1,159 in fiscal 2015.

The Company also maintains a nonqualified executive retirement plan for certain former employees who, pursuant to their employment agreements, did not participate in the SERP. The Company no longer enrolls new participants into this plan. These participants generally receive an annual benefit payable monthly over fifteen years. This nonqualified defined benefit plan is unfunded.

Net periodic pension expense and other changes recognized in other comprehensive income for the defined benefit pension plans and the nonqualified executive retirement plan included the following components:

	Defined Benefit Pension Plan			Nonqualified Executive Retirement Plan		
	2017	2016	2015	2017	2016	2015
Service cost	$ 1,291	$ 1,498	$ 2,543	$	$	$
Interest cost	6,634	6,398	6,474	436	475	542
Expected return on plan assets	(4,512)	(6,330)	(7,339)			
Amortization of unrecognized prior service cost		67	240			
Amortization of unrecognized net loss (gain)	5,085	3,690	2,392	70	(574)	894
Net pension expense	$ 8,498	$ 5,323	$ 4,310	$ 506	$ (99)	$ 1,436
Other changes recognized in other comprehensive loss:						
Unrecognized net (gain) loss arising during period	$ (3,979)	$ 7,369	$ 17,190	$ 70	$ (574)	$ 894
Prior service cost arising during period						
Amortization of unrecognized prior service costs		(67)	(240)			
Amortization of unrecognized net (loss) gain	(5,085)	(3,690)	(2,392)	(70)	574	(894)
Net amount recognized in other comprehensive loss	(9,064)	3,612	14,558			
Net amount recognized in pension expense and other comprehensive loss	$ (566)	$ 8,935	$ 18,868	$ 506	$ (99)	$ 1,436

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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18. Retirement Plans (Continued)

The table below sets forth reconciliation from the beginning of the year for both the benefit obligation and plan assets of the Company's defined benefit plans, as well as the funded status and amounts recognized in the Company's balance sheet as of March 4, 2017 and February 27, 2016:

	Defined Benefit Pension Plan		Nonqualified Executive Retirement Plan	
	2017	**2016**	**2017**	**2016**
Change in benefit obligations:				
Benefit obligation at end of prior year	$ 156,474	$ 167,256	$ 11,046	$ 12,685
Service cost	1,291	1,498		
Interest cost	6,634	6,398	436	475
Distributions	(7,449)	(7,408)	(1,504)	(1,540)
Change due to change in assumptions				
Actuarial loss (gain)	7,399	(11,270)	70	(574)
Benefit obligation at end of year	$ 164,349	$ 156,474	$ 10,048	$ 11,046
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 110,217	$ 129,934	$	$
Employer contributions			1,504	1,540
Actual return on plan assets	15,890	(12,309)		
Distributions (including expenses paid by the plan)	(7,449)	(7,408)	(1,504)	(1,540)
Fair value of plan assets at end of year	$ 118,658	$ 110,217	$	$
Funded status	$ (45,691)	$ (46,257)	$ (10,048)	$ (11,046)
Net amount recognized	$ (45,691)	$ (46,257)	$ (10,048)	$ (11,046)
Amounts recognized in consolidated balance sheets consisted of:				
Prepaid pension cost	$	$	$	$
Accrued pension liability	(45,691)	(46,257)	(10,048)	(11,046)
Net amount recognized	$ (45,691)	$ (46,257)	$ (10,048)	$ (11,046)
Amounts recognized in accumulated other comprehensive loss consist of:				
Net actuarial loss	$ (44,761)	$ (53,825)	$	$
Prior service cost				

Amount recognized	$	(44,761)	$	(53,825)	$		$

The estimated net actuarial loss and prior service cost amounts that will be amortized from accumulated other comprehensive loss into net periodic pension expense in fiscal 2018 are $3,425 and $0, respectively.

The accumulated benefit obligation for the defined benefit pension plan was $164,349 and $156,474 as of March 4, 2017 and February 27, 2016, respectively. The accumulated benefit obligation

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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18. Retirement Plans (Continued)

for the nonqualified executive retirement plan was $10,048 and $11,046 as of March 4, 2017 and February 27, 2016, respectively.

The significant actuarial assumptions used for all defined benefit plans to determine the benefit obligation as of March 4, 2017, February 27, 2016 and February 28, 2015 were as follows:

	Defined Benefit Pension Plan			Nonqualified Executive Retirement Plan		
	2017	2016	2015	2017	2016	2015
Discount rate	4.00%	4.25%	4.00%	4.00%	4.25%	4.00%
Rate of increase in future compensation levels	N/A	N/A	N/A	N/A	N/A	N/A
Expected long-term rate of return on plan assets	6.50%	6.50%	6.50%	N/A	N/A	N/A

Weighted average assumptions used to determine net cost for the fiscal years ended March 4, 2017, February 27, 2016 and February 28, 2015 were:

	Defined Benefit Pension Plan			Nonqualified Executive Retirement Plan		
	2017	2016	2015	2017	2016	2015
Discount rate	4.25%	4.00%	4.50%	4.25%	4.00%	4.50%
Rate of increase in future compensation levels	N/A	N/A	N/A	N/A	N/A	N/A
Expected long-term rate of return on plan assets	6.50%	6.50%	7.75%	N/A	N/A	N/A

To develop the expected long-term rate of return on assets assumption, the Company considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio. This resulted in the selection of the 6.50% long-term rate of return on plan assets assumption for fiscal 2017, 2016 and 2015.

The Company's pension plan asset allocations at March 4, 2017 and February 27, 2016 by asset category were as follows:

	March 4, 2017	February 27, 2016
Equity securities	52%	49%
Fixed income securities	48%	51%
Total	100%	100%

The investment objectives of the Defined Benefit Pension Plan, the only defined benefit plan with assets, are to:

Achieve a rate of return on investments that exceeds inflation over a full market cycle and is consistent with actuarial assumptions;

Balance the correlation between assets and liabilities by diversifying the portfolio among various asset classes to address return risk and interest rate risk;

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RITE AID CORPORATION AND SUBSIDIARIES

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18. Retirement Plans (Continued)

Balance the allocation of assets between the investment managers to minimize concentration risk;

Maintain liquidity in the portfolio sufficient to meet plan obligations as they come due; and

Control administrative and management costs.

The asset allocation established for the pension investment program reflects the risk tolerance of the Company, as determined by:

the current and anticipated financial strength of the Company;

the funded status of the plan; and

plan liabilities.

Investments in both the equity and fixed income markets will be maintained, recognizing that historical results indicate that equities (primarily common stocks) have higher expected returns than fixed income investments. It is also recognized that the correlation between assets and liabilities must be balanced to address higher volatility of equity investments (return risk) and interest rate risk.

The following targets are to be applied to the allocation of plan assets.

Category	Target Allocation
U.S. equities	39%
International equities	13%
U.S. fixed income	48%
Total	100%

The Company expects to contribute $4,900 to the Defined Benefit Pension Plan and make payments of $1,241 to participants of the Nonqualified Executive Retirement Plan during fiscal 2018.

Common and Collective Trusts

Common collective trust funds are stated at fair value as determined by the issuer of the common collective trust funds based on the net asset value ("NAV") of the underlying investments in accordance with ASC 820. There are generally no restrictions on redemptions from these funds and no unfunded commitments to invest. In accordance with ASC subtopic 820-10, certain investments that were measured at NAV per shared (or its equivalent) have not been classified in the fair value hierarchy. The underlying investments mainly consist of equity and fixed

income securities funds that are valued based on the daily closing price as reported by the fund.

The proceeding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different

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18. Retirement Plans (Continued)

methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at March 4, 2017.

The following table sets forth by level within the fair value hierarchy a summary of the plan's investments measured at fair value on a recurring basis as of March 4, 2017 and February 27, 2016:

	Fair Value Measurements at March 4, 2017			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Equity Securities				
International equity	$	$	$	$ 15,348
Large Cap				32,413
Small-Mid Cap				14,083
Fixed Income				
Long Term Credit Bond Index				47,694
20+ Year Treasury STRIPS				7,563
Intermediate Fixed Income				639
Other types of investments				
Short Term Investments				918
Total	$	$	$	$ 118,658

	Fair Value Measurements at February 27, 2016			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Equity Securities				
International equity	$	$	$	$ 14,414
Large Cap				28,188
Small-Mid Cap				11,684
Fixed Income				
Long Term Credit Bond Index				43,130
20+ Year Treasury STRIPS				10,929
Intermediate Fixed Income				41
Other types of investments				
Short Term Investments				1,831
Total	$	$	$	$ 110,217

The following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

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18. Retirement Plans (Continued)

Following are the future benefit payments expected to be paid for the Defined Benefit Pension Plan and the nonqualified executive retirement plan during the years indicated:

Fiscal Year	Defined Benefit Pension Plan	Nonqualified Executive Retirement Plan
2018	$ 8,091	$ 1,241
2019	8,190	1,217
2020	8,408	1,137
2021	8,587	969
2022	8,785	874
2023 - 2027	45,960	3,550
Total	$ 88,021	$ 8,988

Other Plans

The Company participates in various multi-employer union pension plans that are not sponsored by the Company. Total expenses recognized for the multi-employer plans were $26,104 in fiscal 2017, $25,966 in fiscal 2016 and $24,261 in fiscal 2015.

19. Multiemployer Plans that Provide Pension Benefits

The Company contributes to a number of multiemployer defined benefit pension plans under the terms of collective-bargaining agreements that cover certain of its union-represented employees. The risks of participating in these multiemployer plans are different from single-employer plans. Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers. Additionally, if the Company chooses to stop participating in some of its multiemployer plans, the Company may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

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19. Multiemployer Plans that Provide Pension Benefits (Continued)

The Company's participation in these plans for the annual period ended March 4, 2017 is outlined in the table below. The "EIN/Pension Plan Number" column provides the Employer Identification Number (EIN) and the three- digit plan number, if applicable. The most recent Pension Protection Act (PPA) zone status available for fiscal 2017 and fiscal 2016 is for the plan year- ends as indicated below. The zone status is based on information that the Company received from the plan and is certified by the plan's actuary. Among other factors, plans in the red zone are generally less than 65 percent funded, plans in the yellow zone are less than 80 percent funded, and plans in the green zone are at least 80 percent funded. The "FIP/RP Status Pending/Implemented" column indicates plans for which a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented. In addition to regular plan contributions, the Company may be subject to a surcharge if the plan is in the red zone. The "Surcharge Imposed" column indicates whether a surcharge has been imposed on contributions to the plan. The last two columns list the expiration date(s) of the collective-bargaining agreement(s) to which the plans are subject and any minimum funding requirements. There have been no significant changes that affect the comparability of total employer contributions of fiscal years 2017, 2016, and 2015.

Pension	EIN/Pension Plan Number	Pension Protection Act Zone Status		FIP/ RP Status Pending/ Implemented	Contributions of the Company			Surcharge Imposed	Expiration Date of Collective-Bargaining Agreement	Minimum Funding Requirements
		2017	2016		2017	2016	2015			
1199 SEIU Health Care Employees Pension Fund	13-3604862-001	Green 12/31/2015	Green 12/31/2014	No	$ 11,920	$ 12,959	$ 11,568	No	4/18/2015	Contribution rate of 10.76% of gross wages earned per associate beginning 01/01/2016. Contribution rate of 10.22% of gross wages earned per associate from 01/01/2015 through 12/31/2015. Contribution rate of 11.25% of gross wages earned per associate through 12/31/2014.
Southern California United Food and Commercial Workers Unions and Drug Employers Pension Fund	51-6029925-001	Red 12/31/2016	Red 12/31/2015	Implemented	8,021	7,552	7,002	No	7/14/2018	Subsequent to 01/01/2016 contributions of $1.41 per hour worked. From 01/01/2015 through 12/31/2015

contributions of $1.328 per hour worked for pharmacists and $0.602 per hour worked for non pharmacists.

Prior to 01/01/2015 contributions of $1.242 per hour worked for pharmacists and $0.563 per hour worked for non pharmacists.

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19. Multiemployer Plans that Provide Pension Benefits (Continued)

Pension	EIN/Pension Plan Number	Pension Protection Act Zone Status 2017	Pension Protection Act Zone Status 2016	FIP/ RP Status Pending/ Implemented	Contributions of the Company 2017	Contributions of the Company 2016	Contributions of the Company 2015	Surcharge Imposed	Expiration Date of Collective-Bargaining Agreement	Minimum Funding Requirements
UFCW Pharmacists, Clerks and Drug Employers Pension Trust	94-2518312-001	Green 12/31/2016	Green 12/31/2015	No	2,970	3,006	2,938	No	7/13/2019	Effective 09/01/2014, contribution rate frozen at $0.55 per hour worked for associates. Prior to 9/01/2014, contribution rate of $0.57 per hour worked for associates.
United Food and Commercial Workers Union-Employer Pension Fund	34-6665155-001	Red 9/30/2016	Red 9/30/2015	Implemented	827	732	667	No	12/31/2017	Effective 02/05/207 contribution rate of $1.89 per hour worked. Effective 02/07/2016 through 02/04/2017 contribution rate of $1.76 per hour worked. Effective 02/02/2015 through 02/06/2016 contribution rate of $1.62 per hour worked. Contribution rate of $1.49 per hour worked prior to 02/02/2015.
United Food and Commercial Workers Union Local 880 Mercantile Employers Joint Pension Fund	51-6031766-001	Yellow 9/30/2016	Yellow 9/30/2015	Implemented	504	454	480	No	12/31/2017	Effective 01/01/2017 contribution rate $1.88 per hour worked. Effective 01/01/2016 through

				12/31/2016 contribution rate of $1.79 per hour worked. Effective 10/01/2015 through 12/31/2015 contribution rate of $1.70 per hour worked. Effective 01/01/2015 through 09/30/2015 contribution rate of $1.61 per hour worked. Effective 10/01/2014 through 12/31/2014 contribution rate of $1.73 per hour worked. Contribution of $1.52 per hour worked prior to 10/01/2014.
Other Funds	1,862	1,263	1,606	
	$ 26,104	$ 25,966	$ 24,261	

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19. Multiemployer Plans that Provide Pension Benefits (Continued)

The Company was listed in these plans Forms 5500 as providing more than 5 percent of the total contributions for the following plans and plan years:

Pension Fund	Year Contributions to Plan Exceeded More Than 5 Percent of Total Contributions (as of the Plan's Year-End)
UFCW Pharmacists, Clerks and Drug Employers Pension Trust	12/31/2015 and 12/31/2014
Southern California United Food and Commercial Workers Unions and Drug Employers Pension Fund	12/31/2015 and 12/31/2014
United Food & Commercial Workers Union- Employer Pension Fund	9/30/2015 and 9/30/2014
United Food & Commercial Workers Union Local 880 Mercantile Employers Joint Pension Fund	9/30/2015 and 9/30/2014

At the date the Company's financial statements were issued, certain Forms 5500 were not available.

During fiscal 2017, 2016 and 2015, the Company did not withdraw from any plans or incur any additional withdrawal liabilities.

20. Segment Reporting

Prior to June 24, 2015, the Company's operations were within one reportable segment. As a result of the completion of the Acquisition, the Company has realigned its internal management reporting to reflect two reportable segments, its retail drug stores ("Retail Pharmacy"), and its pharmacy services ("Pharmacy Services") segments.

The Retail Pharmacy segment's primary business is the sale of prescription drugs and related consultation to its customers. Additionally, the Retail Pharmacy segment sells a full selection of health and beauty aids and personal care products, seasonal merchandise and a large private brand product line. The Pharmacy Services segment offers a full range of pharmacy benefit management services including plan design and administration, on both a transparent pass-through model and traditional model, formulary management and claims processing. Additionally, the Pharmacy Services segment offers specialty and mail order services, infertility treatment, and drug benefits to eligible beneficiaries under the federal government's Medicare Part D program.

The Parent Company's chief operating decision makers are its Parent Company Chief Executive Officer, Parent Company President and CEO Retail Pharmacy, CEO Pharmacy Services, Chief Financial Officer and its Senior Executive Vice Presidents (collectively the "CODM"). The CODM has ultimate responsibility for enterprise decisions. The CODM determines, in particular, resource allocation for, and monitors performance of, the consolidated enterprise, the Retail Pharmacy segment and the Pharmacy Services segment. The Retail Pharmacy and Pharmacy Services segment managers have responsibility for operating decisions, allocating resources and assessing performance within their respective segments. The CODM relies on internal management reporting that analyzes enterprise results on certain key performance indicators, namely, revenues, gross profit, and Adjusted EBITDA.

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(In thousands, except per share amounts)

20. Segment Reporting (Continued)

The following table is a reconciliation of the Company's business segments to the consolidated financial statements for the fiscal years ended March 4, 2017, February 27, 2016 and February 28, 2015:

	Retail Pharmacy	Pharmacy Services	Intersegment Eliminations(1)	Consolidated
March 4, 2017:				
Revenues	$ 26,816,669	$ 6,393,884	$ (365,480)	$ 32,845,073
Gross Profit	7,381,333	392,732		7,774,065
Adjusted EBITDA(2)	948,906	188,235		1,137,141
February 27, 2016:				
Revenues	$ 26,865,931	$ 4,103,513	$ (232,787)	$ 30,736,657
Gross Profit	7,595,429	230,826		7,826,255
Adjusted EBITDA(2)	1,300,905	101,357		1,402,262
February 28, 2015:				
Revenues	$ 26,528,377	$	$	$ 26,528,377
Gross Profit	7,576,732			7,576,732
Adjusted EBITDA(2)	1,322,843			1,322,843

(1) Intersegment eliminations include intersegment revenues and corresponding cost of revenues that occur when Pharmacy Services segment customers use Retail Pharmacy segment stores to purchase covered products. When this occurs, both the Retail Pharmacy and Pharmacy Services segments record the revenue on a stand-alone basis.

(2) See "Adjusted EBITDA, Adjusted Net Income, Adjusted Net Income per Diluted Share and Other Non-GAAP Measures" in MD&A for additional details.

The following is a reconciliation of net income to Adjusted EBITDA for fiscal 2017, 2016 and 2015:

	March 4, 2017 (53 weeks)	February 27, 2016 (52 weeks)	February 28, 2015 (52 weeks)
Net income	$ 4,053	$ 165,465	$ 2,109,173
Interest expense	431,991	449,574	397,612
Income tax expense	29,689	139,297	158,951
Income tax valuation allowance increase/ (release)	14,703	(26,358)	(1,841,304)
Depreciation and amortization expense	568,231	509,212	416,628
LIFO (credit) charge	(6,620)	11,163	(18,857)
Lease termination and impairment charges	55,294	48,423	41,945
Loss on debt retirements, net		33,205	18,512
Other	39,800	72,281	40,183
Adjusted EBITDA	$ 1,137,141	$ 1,402,262	$ 1,322,843

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

20. Segment Reporting (Continued)

The following is balance sheet information for the Company's reportable segments:

	Retail Pharmacy	Pharmacy Services	Eliminations(2)	Consolidated
March 4, 2017:				
Total Assets	$ 8,664,216	$ 3,087,143	$ (157,607)	$ 11,593,752
Goodwill	76,124	1,639,355		1,715,479
Additions to property and equipment and intangible assets	468,386	12,725		481,111
February 27, 2016:				
Total Assets	$ 8,468,186	$ 2,948,548	$ (139,724)	$ 11,277,010
Goodwill	76,124	1,637,351		1,713,475
Additions to property and equipment and intangible assets	667,719	2,276		669,995

(2) As of March 4, 2017 and February 27, 2016, intersegment eliminations include netting of the Pharmacy Services segment long-term deferred tax liability of $140,865 and $116,027, respectively, against the Retail Pharmacy segment long-term deferred tax asset for consolidation purposes in accordance with ASC 740, and intersegment accounts receivable of $16,742 and $23,697, respectively, that represents amounts owed from the Pharmacy Services segment to the Retail Pharmacy segment that are created when Pharmacy Services segment customers use Retail Pharmacy segment stores to purchase covered products.

21. Commitments, Contingencies and Guarantees

Legal Matters

The Company is a party to legal proceedings, investigations and claims in the ordinary course of its business, including the matters described below. The Company records accruals for outstanding legal matters when it believes it is probable that a loss will be incurred and the amount can be reasonably estimated. The Company evaluates, on a quarterly basis, developments in legal matters that could affect the amount of any accrual and developments that would make a loss contingency both probable and reasonably estimable. If a loss contingency is not both probable and estimable, the Company does not establish an accrued liability.

The Company's contingencies are subject to significant uncertainties, including, among other factors: (i) proceedings are in early stages; (ii) whether class or collective action status is sought and the likelihood of a class being certified; (iii) the outcome of pending appeals or motions; (iv) the extent of potential damages, fines or penalties, which are often unspecified or indeterminate; (v) the impact of discovery on the matter; (vi) whether novel or unsettled legal theories are at issue; (vii) there are significant factual issues to be resolved; and/or (viii) in the case of certain government agency investigations, whether a sealed qui tam lawsuit ("whistleblower" action) has been filed and whether the government agency makes a decision to intervene in the lawsuit following investigation.

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

21. Commitments, Contingencies and Guarantees (Continued)

After the announcement of the proposed Merger between the Company and Walgreens Boots Alliance, Inc. (WBA), ten (10) putative class action lawsuits were filed by purported Company stockholders against the Company, its directors (the Individual Defendants, together with the Company, the Rite Aid Defendants), WBA and Victoria Merger Sub Inc. (Victoria) challenging the transactions contemplated by the Merger agreement. Eight (8) of these actions were filed in the Court of Chancery of the State of Delaware (*Smukler v. Rite Aid Corp., et al.*, *Hirschler v. Standley, et al.*, *Catelli v. Rite Aid Corp., et al.*, *Orr v. Rite Aid Corp., et al.*, *DePietro v. Standley, et al.*, *Abadi v. Rite Aid Corp., et al.*, *Mortman v. Rite Aid Corp., et al., Sachs Investment Grp., et al v. Standley, et al.*). One (1) action was filed in Pennsylvania in the Court of Common Pleas of Cumberland County (*Wilson v. Rite Aid Corp., et al.*). The complaints in these nine (9) actions alleged primarily that the Individual Defendants breached their fiduciary duties by, among other things, agreeing to an allegedly unfair and inadequate price, agreeing to deal protection devices that allegedly prevented the directors from obtaining higher offers from other interested buyers for the Company and allegedly failing to protect against certain purported conflicts of interest in connection with the Merger. The complaints further alleged that the Company, WBA and/or Victoria aided and abetted these alleged breaches of fiduciary duty. The complaints sought, among other things, to enjoin the closing of the Merger as well as money damages and attorneys' and experts' fees.

On December 23, 2015, the eight (8) Delaware actions were consolidated in an action captioned *In re Rite Aid Corporation Stockholders Litigation,* Consol. C.A. No. 11663-CB (the Consolidated Action). In addition to the claims asserted in the nine (9) complaints discussed above, the operative pleading in the Consolidated Action also included allegations that the preliminary proxy statement contained material omissions, including with respect to the process that resulted in the Merger agreement and the fairness opinion rendered by the Company's banker. On December 28, 2015, the plaintiffs in the Consolidated Action filed a motion for expedited proceedings, which the Court orally denied at a hearing held on January 5, 2016. On March 11, 2016, the Court granted the plaintiffs' notice and proposed order voluntarily dismissing the Consolidated Action as moot, while retaining jurisdiction solely for the purpose of adjudicating plaintiffs' counsel's anticipated application for an award of attorneys' fees and reimbursement of expenses. On April 15, 2016, the Company reached a settlement in principle related to this matter for an immaterial amount. On May 11, 2016, the Court entered a stipulated order regarding notice of payment thereof and final dismissal of this matter.

A tenth action was filed in the United States District Court for the Middle District of Pennsylvania (the Pennsylvania District Court), asserting a claim for violations of Section 14(a) of the Exchange Act and SEC Rule 14a-9 against the Rite Aid Defendants, WBA and Victoria and a claim for violations of Section 20(a) of the Exchange Act against the Individual Defendants and WBA (*Herring v. Rite Aid Corp., et al.*). The complaint in the *Herring* action alleges, among other things, that the Company and the Individual Defendants disseminated an allegedly false and materially misleading proxy. The complaint sought to enjoin the shareholder vote on the proposed Merger, a declaration that the proxy was materially false and misleading in violation of federal securities laws and an award of money damages and attorneys' and experts' fees. On January 14 and 16, 2016, respectively, the plaintiff in the *Herring* action filed a motion for preliminary injunction and a motion for expedited discovery. On January 21, 2016, the Rite Aid Defendants filed a motion to dismiss the *Herring* complaint. At a

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

21. Commitments, Contingencies and Guarantees (Continued)

hearing held on January 25, 2016, the Pennsylvania District Court orally denied the plaintiff's motion for expedited discovery and subsequently denied the plaintiff's motion for preliminary injunction on January 28, 2016. On March 14, 2016, the Pennsylvania District Court appointed Jerry Herring, Don Michael Hussey and Joanna Pauli Hussey as lead plaintiffs for the putative class and approved their selection of Robbins Geller Rudman & Dowd LLP as lead counsel. On April 14, 2016, the Pennsylvania District Court granted the lead plaintiffs' unopposed motion to stay the *Herring* action for all purposes pending consummation of the Merger.

The Company has been named in a collective and class action lawsuit, *Indergit v. Rite Aid Corporation, et al.*, pending in the United States District Court for the Southern District of New York, filed purportedly on behalf of current and former store managers working in the Company's stores at various locations around the country. The lawsuit alleges that the Company failed to pay overtime to store managers as required under the FLSA and under certain New York state statutes. The lawsuit also seeks other relief, including liquidated damages, attorneys' fees, costs and injunctive relief arising out of state and federal claims for overtime pay. On April 2, 2010, the Court conditionally certified a nationwide collective group of individuals who worked for the Company as store managers since March 31, 2007. The Court ordered that Notice of the *Indergit* action be sent to the purported members of the collective group (approximately 7,000 current and former store managers) and approximately 1,550 joined the *Indergit* action. Discovery as to certification issues has been completed. On September 26, 2013, the Court granted Rule 23 class certification of the New York store manager claims as to liability only, but denied it as to damages, and denied the Company's motion for decertification of the nationwide collective action claims. The Company filed a motion seeking reconsideration of the Court's September 26, 2013 decision which motion was denied in June 2014. The Company subsequently filed a petition for an interlocutory appeal of the Court's September 26, 2013 ruling with the U. S. Court of Appeals for the Second Circuit which petition was denied in September 2014. Notice of the Rule 23 class certification as to liability only has been sent to approximately 1,750 current and former store managers in the state of New York. Discovery related to the merits of the claims is ongoing. On January 12, 2017, the parties reached a settlement in principle of this matter, for an immaterial amount of money, which is subject to preliminary and final approval by the court. On January 19, 2017, the court entered an order staying the case indefinitely pending preliminary and final court approval. In the event the settlement does not receive preliminary and/or final approval by the court, the litigation will resume. If such occurs, the Company presently is not able to either predict the outcome of this lawsuit or estimate a potential range of loss with respect to the lawsuit. The Company's management believes, however, that this lawsuit is without merit and is vigorously defending this lawsuit.

The Company is currently a defendant in several lawsuits filed in state courts in California alleging violations of California wage-and-hour laws, rules and regulations pertaining primarily to failure to pay overtime, failure to pay for missed meals and rest periods, failure to reimburse business expenses and failure to provide employee seating (the "California Cases"). The class actions pertaining to failure to reimburse business expenses and provide employee seating purport to be class actions and seek substantial damages. The single-plaintiff and multi-plaintiff lawsuits regarding failure to pay overtime and failure to pay for missed meals and rest periods, in the aggregate, seek substantial damages. The

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

21. Commitments, Contingencies and Guarantees (Continued)

Company has aggressively challenged the merits of the lawsuits and, where applicable, the allegations that the cases should be certified as class or representative actions.

In the business expense class action (*Fenley v. Rite Aid Corporation, Santa Clara Superior Court*), the parties reached a settlement pursuant to which the Company will pay an immaterial amount to settle the class claims. The court granted final approval of the settlement on February 3, 2017.

In the employee seating case (*Hall v. Rite Aid Corporation, San Diego County Superior Court*), the Court, in October 2011, granted the plaintiff's motion for class certification. The Company filed its motion for decertification, which motion was granted in November 2012. Plaintiff subsequently appealed the Court's order which appeal was granted in May 2014. The Company filed a petition for review of the appellate court's decision with the California Supreme Court, which petition was denied in August 2014. Proceedings in the *Hall* case were stayed pending a decision by the California Supreme Court in two similar cases. That decision was rendered on April 4, 2016. A status conference in the case was held on November 18, 2016, at which time the court lifted the stay and scheduled the case for trial on January 26, 2018.

With respect to the California Cases, the Company, at this time, is not able to predict either the outcome of these lawsuits or estimate a potential range of loss with respect to said lawsuits and is vigorously defending them.

The Company was served with a Civil Investigative Demand Subpoena Duces Tecum dated August 26, 2011 by the United States Attorney's Office for the Eastern District of Michigan. The subpoena requests records regarding the relationship of Rite Aid's Rx Savings Program to the reporting of usual and customary charges to publicly funded health programs. In connection with the same investigation, the Company was served with a Civil Subpoena Duces Tecum dated February 22, 2013 by the State of Indiana Office of the Attorney General requesting additional information regarding both Rite Aid's Rx Savings Program and usual and customary charges. The Company responded to both of the subpoenas. To enable the parties to discuss a possible resolution, the Medicaid Fraud Control Units of the several states, commonwealths, and the District of Columbia and the Company entered into an agreement tolling the statute of limitations until October 7, 2015. The parties agreed to extend the tolling agreement and continue to exchange pertinent claims data in the near future. On January 19, 2017, the District Court for the Eastern District of Michigan unsealed Relator's Second Amended Complaint against the Company. In its Complaint, Relator alleges that the Company failed to report Rx Savings prices as its usual and customary charges under the Medicare Part D program and to federal and state Medicaid programs in 18 (eighteen) states and the District of Columbia; and that the Company is thus liable under the federal False Claims Act and similar False Claims Act statutes operative in the states named in the Complaint. The federal government and the 18 (eighteen) states and the District of Columbia named in the lawsuit have elected not to intervene in this action. At this stage of the proceedings, the Company is not able to either predict the outcome of this lawsuit or estimate a potential range of loss with respect to the lawsuit and is vigorously defending this lawsuit.

On April 26, 2012, the Company received an administrative subpoena from the U.S. Drug Enforcement Administration ("DEA"), Albany, New York District Office, requesting information regarding the Company's sale of products containing pseudoephedrine ("PSE"). In April 2012, it also

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(In thousands, except per share amounts)

21. Commitments, Contingencies and Guarantees (Continued)

received a communication from the U.S. Attorney's Office ("USAO") for the Northern District of New York concerning an investigation of possible civil violations of the Combat Methamphetamine Epidemic Act of 2005 ("CMEA"). Additional subpoenas were issued in 2013, 2014, and 2015 seeking broader documentation regarding PSE sales and recordkeeping requirements. Assistant U.S. Attorneys from the Northern and Eastern Districts of New York and the Southern District of West Virginia are currently investigating, but no lawsuits or charges have been filed. Between September 2015 and January 2017, the Company received several grand jury subpoenas from the U.S. District Court for the Southern District of West Virginia seeking additional information in connection with the investigation of violations of the CMEA and/or the Controlled Substances Act ("CSA"). Violations of the CMEA or the CSA could result in the imposition of administrative, civil and/or criminal penalties against the Company. The Company is cooperating with the government and continues to provide information responsive to the subpoenas. The Company has entered into a tolling agreement with the USAOs in the Northern and Eastern Districts of New York and entered into a separate tolling agreement with the USAO in the Southern District of West Virginia. Discussions are underway to attempt to resolve these matters with those USAOs and the Department of Justice, but whether an agreement can be reached and on what terms is uncertain. While the Company's management cannot predict the outcome of these matters, it is possible that the Company's results of operations or cash flows could be materially affected by an unfavorable resolution. At this stage of the investigation, Rite Aid is not able to predict the outcome of the investigation.

In January 2013, the DEA, Los Angeles District Office, served an administrative subpoena on the Company seeking documents related to prescriptions by a certain prescriber. The USAO, Central District of California, also contacted the Company about a related investigation into allegations that Rite Aid pharmacies filled certain controlled substance prescriptions for a number of prescribers after their DEA registrations had expired or otherwise become invalid in violation of the federal Controlled Substances Act and DEA regulations. The Company responded to the administrative subpoena and subsequent informal requests for information from the USAO. The Company met with the USAO and DEA in January 2014 regarding this matter. The Company entered into a tolling agreement with the USAO. The Company recorded a legal accrual during the period ended March 1, 2014, which was revised during the period ending August 29, 2015. On February 28, 2017, the USAO, Central District of California, and the Company entered into a settlement agreement resolving this matter for an immaterial amount. The settlement agreement is not an admission of liability by the Company.

In June 2013, the Company was served with a Civil Investigative Demand ("CID") by the United States Attorney's Office for the Eastern District of California (the "USAO"). The CID requested records and responses to interrogatories regarding the Company's Drug Utilization Review and prescription dispensing protocol and the dispensing of drugs designated as "Code 1" by the State of California. The Company researched the government's allegations and refuted the government's position in writing and on conference calls. Subsequently, the USAO's office, along with the State of California, Department of Justice, Bureau of Medical Fraud and Elder Abuse (the "Bureau"), requested the Company to produce certain prescription files related to Code 1 drugs. There has been a series of four document productions in which the Company has produced prescription and associated documentation concerning Code 1 drugs: (i) on May 15, 2014, the government requested that the

RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

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21. Commitments, Contingencies and Guarantees (Continued)

Company produce 60 prescriptions; (ii) on July 30, 2014, the government requested that the Company produce 30 prescriptions; (iii) on June 15, 2015, the government requested that the Company produce 80 prescriptions; and (iv) on September 30, 2016, the Company agreed to produce an additional 242 prescriptions. The Company is continuing discussions with the government.

Relator, Matthew Omlansky, filed a *qui tam* action, State of California ex rel. Matthew Omlansky v. Rite Aid Corporation, on behalf of the State of California against Rite Aid in the Superior Court of the State of California. In his Complaint, Relator alleges that Rite Aid violated the California False Claims Act by (i) failing to comply with California rules governing the Company's reporting of its usual and customary prices; (ii) failing to dispense the least expensive equivalent generic drug in certain circumstances, in violation of applicable regulations; and (iii) dispensing, and seeking reimbursement for, restricted brand name drugs without prior approval. Relator filed his Second Amended Complaint on April 19, 2016 and Rite Aid filed its demurrer on July 29, 2016. On October 5, 2016, Rite Aid's demurrer was granted and plaintiff's complaint was dismissed with leave for plaintiff to file an amended complaint. Plaintiff filed a Third Amended Complaint to which Rite Aid filed a second demurrer, which is pending. At this stage of the proceedings, Rite Aid is unable to predict the outcome of its demurrer and Relator's suit.

In addition to the above described matters, the Company is subject from time to time to various claims and lawsuits and governmental investigations arising in the ordinary course of business. While the Company's management cannot predict the outcome of any of the claims, the Company's management does not believe that the outcome of any of these legal matters will be material to the Company's consolidated financial position. It is possible, however, that the Company's results of operations or cash flows could be materially affected by an unfavorable resolution of pending litigation or contingencies.

22. Supplementary Cash Flow Data

		Year Ended	
	March 4, 2017	**February 27, 2016**	**February 28, 2015**
Cash paid for interest (net of capitalized amounts of $195, $196 and $145)	$ 409,692	$ 403,727	$ 384,329
Cash payments for income taxes, net	$ 17,081	$ 4,856	$ 6,665
Equipment financed under capital leases	$ 7,551	$ 9,614	$ 6,157
Equipment received for noncash consideration	$ 746	$ 3,011	$ 1,600
Accrued capital expenditures	$ 37,325	$ 69,417	$ 87,916

Gross borrowings from revolver	$	3,608,000	$	4,729,000	$	6,078,000
Gross repayments to revolver	$	3,278,000	$	4,354,000	$	4,753,000

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

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23. Related Party Transactions

There were receivables from related parties of $34 and $48 at March 4, 2017 and February 27, 2016, respectively.

As contemplated by the pending Merger with WBA, on December 31, 2015, the Board of Directors of the Company approved the adoption of a retention and severance program upon the recommendation of the Compensation Committee of the Board (the "Committee"), which was advised by the Committee's independent compensation consultant, to enhance employee retention and corporate performance through the closing of the Merger, and authorized the Company to enter into individual retention award agreements with certain of its executive officers. The individual retention award agreements provide for the lump-sum payment of the retention award on the one hundred twentieth day following the closing of the Merger (the "retention date"), subject to continued employment through such retention date or upon the earlier termination of the recipient's employment by the Company without "cause" or by the recipient for "good reason" (as such terms are defined in the Company's 2014 Omnibus Equity Plan) (each referred to as a "qualifying termination"). The Company executed retention award agreements on December 31, 2015 with certain Company executive officers, which provided for the grant of retention awards under the terms described above and, for tax planning purposes, provide for the accelerated payment of the executive's fiscal year 2016 bonus in 2015, the accelerated lapse of restrictions on certain time-based restricted stock awards in 2015 and, to the extent necessary for one executive officer, the accelerated payment of the retention award in 2015, in each case subject to repayment requirements on the part of the executive if the executive would not have otherwise become entitled to such payments. During fiscal 2016, the Company made advance payments to certain executives of $500 for retention bonuses and $1,778 of fiscal 2016 performance bonuses for tax planning purposes.

24. Guarantor and Non-Guarantor Condensed Consolidating Financial Information

Rite Aid Corporation conducts the majority of its business through its subsidiaries. With the exception of EIC, substantially all of Rite Aid Corporation's 100 percent owned subsidiaries guarantee the obligations under the Amended and Restated Senior Secured Credit Facility, second priority secured term loan facilities, secured guaranteed notes and unsecured guaranteed notes (the "Subsidiary Guarantors"). Additionally, prior to the Acquisition, the subsidiaries, including joint ventures, that did not guarantee the Amended and Restated Senior Secured Credit Facility, second priority secured term loan facilities, secured guaranteed notes and unsecured guaranteed notes, were minor. Accordingly, condensed consolidating financial information for the Company and subsidiaries is not presented for those periods. Condensed consolidating financial information for the Company, its Subsidiary Guarantors and non-guarantor subsidiaries, is presented for periods subsequent to the Acquisition.

For the purposes of preparing the information below, Rite Aid Corporation uses the equity method to account for its investment in subsidiaries. The equity method has been used by Subsidiary Guarantors with respect to investments in the non-guarantor subsidiaries. The subsidiary guarantees related to the Company's Amended and Restated Senior Secured Credit Facility, second priority secured term loan facilities and secured guaranteed notes and, on an unsecured basis, the unsecured guaranteed notes, are full and unconditional and joint and several. Presented below is condensed consolidating financial information for Rite Aid Corporation, the Subsidiary Guarantors, and the

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RITE AID CORPORATION AND SUBSIDIARIES

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24. Guarantor and Non-Guarantor Condensed Consolidating Financial Information (Continued)

non-guarantor subsidiaries at March 4, 2017, February 27, 2016 and for the fiscal years ended March 4, 2017 and February 27, 2016. Separate financial statements for Subsidiary Guarantors are not presented.

	Rite Aid Corporation Condensed Consolidating Balance Sheet March 4, 2017				
	Rite Aid Corporation (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
ASSETS					
Current assets:					
Cash and cash equivalents	$	$ 213,104	$ 32,306	$	$ 245,410
Accounts receivable, net		1,506,288	264,838		1,771,126
Intercompany receivable		215,862		(215,862)(a)	
Inventories, net of LIFO reserve of $0, $999,776, $0, $0, and $999,776		2,837,211			2,837,211
Prepaid expenses and other current assets		203,033	8,508		211,541
Total current assets		4,975,498	305,652	(215,862)	5,065,288
Property, plant and equipment, net		2,251,692			2,251,692
Goodwill		1,715,479			1,715,479
Other intangibles, net		782,167	53,628		835,795
Deferred tax assets		1,505,564			1,505,564
Investment in subsidiaries	15,275,488	50,004		(15,325,492)(b)	
Intercompany receivable		7,331,675		(7,331,675)(a)	
Other assets		219,934			219,934
Total assets	$ 15,275,488	$ 18,832,013	$ 359,280	$ (22,873,029)	$ 11,593,752
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Current maturities of long-term debt and lease financing obligations	$ 90	$ 21,245	$	$	$ 21,335
Accounts payable		1,609,025	4,884		1,613,909
Intercompany payable			215,862	(215,862)(a)	
Accrued salaries, wages and other current liabilities	66,365	1,236,297	67,342		1,370,004
Total current liabilities	66,455	2,866,567	288,088	(215,862)	3,005,248
Long-term debt, less current maturities	7,263,288				7,263,288
Lease financing obligations, less current maturities		44,070			44,070
Intercompany payable	7,331,675			(7,331,675)(a)	
Other noncurrent liabilities		645,888	21,188		667,076

Total liabilities	14,661,418	3,556,525	309,276	(7,547,537)	10,979,682
Commitments and contingencies					
Total stockholders' equity	614,070	15,275,488	50,004	(15,325,492)(b)	614,070
Total liabilities and stockholders' equity	$ 15,275,488	$ 18,832,013	$ 359,280	$ (22,873,029)	$ 11,593,752

(a) Elimination of intercompany accounts receivable and accounts payable amounts.

(b) Elimination of investments in consolidated subsidiaries.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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(In thousands, except per share amounts)

24. Guarantor and Non-Guarantor Condensed Consolidating Financial Information (Continued)

Rite Aid Corporation
Condensed Consolidating Balance Sheet
February 27, 2016

	Rite Aid Corporation (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
ASSETS					
Current assets:					
Cash and cash equivalents	$	$ 90,569	$ 33,902	$	$ 124,471
Accounts receivable, net		1,316,797	284,211		1,601,008
Intercompany receivable		224,220		(224,220)(a)	
Inventories, net of LIFO reserve of $0, $1,006,396, $0, $0, and $1,006,396		2,697,104			2,697,104
Prepaid expenses and other current assets		121,684	6,460		128,144
Total current assets		4,450,374	324,573	(224,220)	4,550,727
Property, plant and equipment, net		2,255,398			2,255,398
Goodwill		1,713,475			1,713,475
Other intangibles, net		948,451	55,928		1,004,379
Deferred tax assets		1,539,141			1,539,141
Investment in subsidiaries	14,832,523	57,167		(14,889,690)(b)	
Intercompany receivable		7,270,869		(7,270,869)(a)	
Other assets		207,821	6,069		213,890
Total assets	$ 14,832,523	$ 18,442,696	$ 386,570	$ (22,384,779)	$ 11,277,010
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Current maturities of long-term debt and lease financing obligations	$ 90	$ 26,758	$	$	$ 26,848
Accounts payable		1,541,984	813		1,542,797
Intercompany payable			224,220	(224,220)(a)	
Accrued salaries, wages and other current liabilities	65,743	1,274,074	87,433		1,427,250
Total current liabilities	65,833	2,842,816	312,466	(224,220)	2,996,895
Long-term debt, less current maturities	6,914,393				6,914,393
Lease financing obligations, less current maturities		52,895			52,895
Intercompany payable	7,270,869			(7,270,869)(a)	
Other noncurrent liabilities		714,462	16,937		731,399
Total liabilities	14,251,095	3,610,173	329,403	(7,495,089)	10,695,582

Commitments and contingencies					
Total stockholders' equity	581,428	14,832,523	57,167	(14,889,690)(b)	581,428
Total liabilities and stockholders' equity	$ 14,832,523	$ 18,442,696	$ 386,570	$ (22,384,779)	$ 11,277,010

(a) Elimination of intercompany accounts receivable and accounts payable amounts.

(b) Elimination of investments in consolidated subsidiaries.

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

24. Guarantor and Non-Guarantor Condensed Consolidating Financial Information (Continued)

	Rite Aid Corporation Condensed Consolidating Statement of Operations For the Year Ended March 4, 2017				
	Rite Aid Corporation (Parent Company Only)	**Subsidiary Guarantors**	**Non-Guarantor Subsidiaries**	**Eliminations**	**Consolidated**
			(in thousands)		
Revenues	$	$ 32,739,473	$ 223,077	$ (117,477)(a)	$ 32,845,073
Costs and expenses:					
Cost of revenues		24,975,538	213,225	(117,755)(a)	25,071,008
Selling, general and administrative expenses		7,228,540	13,541	278(a)	7,242,359
Lease termination and impairment expenses		55,294			55,294
Interest expense	414,208	17,796	(13)		431,991
Gain on sale of assets, net		(4,024)			(4,024)
Equity in earnings of subsidiaries, net of tax	(418,261)	5,101		413,160(b)	
	(4,053)	32,278,245	226,753	295,683	32,796,628
Income (loss) before income taxes	4,053	461,228	(3,676)	(413,160)	48,445
Income tax expense		42,967	1,425		44,392
Net income (loss)	$ 4,053	$ 418,261	$ (5,101)	$ (413,160)(b)	$ 4,053
Total other comprehensive income (loss)	5,464	5,464		(5,464)	5,464
Comprehensive income (loss)	$ 9,517	$ 423,725	$ (5,101)	$ (418,624)	$ 9,517

(a) Elimination of intercompany revenues and expenses.

(b) Elimination of equity in earnings of subsidiaries.

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

24. Guarantor and Non-Guarantor Condensed Consolidating Financial Information (Continued)

	Rite Aid Corporation Condensed Consolidating Statement of Operations For the Year Ended February 27, 2016				
	Rite Aid Corporation (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Revenues	$	$ 30,731,771	$ 162,620	$ (157,734)(a)	$ 30,736,657
Costs and expenses:					
Cost of revenues		22,910,402	154,838	(154,838)(a)	22,910,402
Selling, general and administrative expenses		7,004,321	11,921	(2,896)(a)	7,013,346
Lease termination and impairment expenses		48,423			48,423
Interest expense	415,304	34,268	2		449,574
Loss on debt retirement, net	33,205				33,205
Loss on sale of assets, net		3,303			3,303
Equity in earnings of subsidiaries, net of tax	(613,974)	3,972		610,002(b)	
	(165,465)	30,004,689	166,761	452,268	30,458,253
Income (loss) before income taxes	165,465	727,082	(4,141)	(610,002)	278,404
Income tax expense (benefit)		113,108	(169)		112,939
Net income (loss)	$ 165,465	$ 613,974	$ (3,972)	$ (610,002)(b)	$ 165,465
Total other comprehensive (loss) income	(1,931)	(1,931)		1,931	(1,931)
Comprehensive income (loss)	$ 163,534	$ 612,043	$ (3,972)	$ (608,071)	$ 163,534

(a) Elimination of intercompany revenues and expenses.

(b) Elimination of equity in earnings of subsidiaries.

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

24. Guarantor and Non-Guarantor Condensed Consolidating Financial Information (Continued)

	Rite Aid Corporation Condensed Consolidating Statement of Cash Flows For the Year Ended March 4, 2017				
	Rite Aid Corporation (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Operating activities:					
Net cash (used in) provided by operating activities	$ (394,768)	$ 622,227	$ (1,596)	$	$ 225,863
Investing activities:					
Payments for property, plant and equipment		(424,289)			(424,289)
Intangible assets acquired		(56,822)			(56,822)
Intercompany activity		(57,817)		57,817	
Proceeds from dispositions of assets and investments		16,852			16,852
Net cash (used in) provided by investing activities		(522,076)		57,817	(464,259)
Financing activities:					
Net proceeds from revolver	330,000				330,000
Principal payments on long-term debt		(21,239)			(21,239)
Change in zero balance cash accounts		43,080			43,080
Net proceeds from issuance of common stock	6,951				6,951
Excess tax benefit on stock options and restricted stock		543			543
Intercompany activity	57,817			(57,817)	
Net cash provided by (used in) financing activities	394,768	22,384		(57,817)	359,335
Increase (decrease) in cash and cash equivalents		122,535	(1,596)		120,939
Cash and cash equivalents, beginning of period		90,569	33,902		124,471
Cash and cash equivalents, end of period	$	$ 213,104	$ 32,306	$	$ 245,410

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

24. Guarantor and Non-Guarantor Condensed Consolidating Financial Information (Continued)

	Rite Aid Corporation Condensed Consolidating Statement of Cash Flows For the Year Ended February 27, 2016				
	Rite Aid Corporation (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Operating activities:					
Net cash (used in) provided by operating activities	$ (387,871)	$ 1,391,759	$ (6,486)	$	$ 997,402
Investing activities:					
Payments for property, plant and equipment		(541,347)			(541,347)
Intangible assets acquired		(128,648)			(128,648)
Acquisition of businesses, net of cash acquired	(1,778,377)				(1,778,377)
Intercompany activity	(103,834)	(794,422)		898,256	
Proceeds from sale-leaseback transaction		36,732			36,732
Proceeds from dispositions of assets and investments		9,782			9,782
Net cash (used in) provided by investing activities	(1,882,211)	(1,417,903)		898,256	(2,401,858)
Financing activities:					
Proceeds from issuance of long-term debt	1,800,000				1,800,000
Net proceeds from revolver	375,000				375,000
Principal payments on long-term debt	(650,079)	(22,638)			(672,717)
Change in zero balance cash accounts		(62,878)			(62,878)
Net proceeds from issuance of common stock	11,376				11,376
Financing fees paid for early debt redemption	(26,003)				(26,003)
Excess tax benefit on stock options and restricted stock		22,884			22,884
Deferred financing costs paid	(34,634)				(34,634)
Intercompany activity	794,422	63,446	40,388	(898,256)	
Net cash provided by (used in) financing activities	2,270,082	814	40,388	(898,256)	1,413,028
(Decrease) increase in cash and cash equivalents		(25,330)	33,902		8,572
		115,899			115,899

Cash and cash equivalents, beginning of period					
Cash and cash equivalents, end of period	$	$ 90,569	$ 33,902	$	$ 124,471

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

25. Interim Financial Results (Unaudited)

	Fiscal Year 2017				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter(2)	Year
Revenues	$ 8,184,181	$ 8,029,806	$ 8,089,726	$ 8,541,360	$ 32,845,073
Cost of revenues	6,289,881	6,113,063	6,194,866	6,473,198	25,071,008
Selling, general and administrative expenses	1,793,247	1,778,247	1,773,862	1,897,003	7,242,359
Lease termination and impairment charges	5,781	7,233	7,265	35,015	55,294
Interest expense	105,113	105,388	106,309	115,181	431,991
Loss (gain) on sale of assets, net	1,056	174	501	(5,755)	(4,024)
	8,195,078	8,004,105	8,082,803	8,514,642	32,796,628
(Loss) income before income taxes	(10,897)	25,701	6,923	26,718	48,445
Income tax (benefit) expense	(6,309)	10,928	(8,087)	47,860	44,392
Net (loss) income	$ (4,588)	$ 14,773	$ 15,010	$ (21,142)	$ 4,053
Basic and diluted (loss) income per share(1)	$ (0.00)	$ 0.01	$ 0.01	$ (0.02)	$ 0.00

	Fiscal Year 2016				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Revenues	$ 6,647,561	$ 7,664,776	$ 8,154,184	$ 8,270,136	$ 30,736,657
Cost of revenues	4,788,031	5,742,485	6,151,305	6,228,581	22,910,402
Selling, general and administrative expenses	1,699,585	1,725,826	1,777,647	1,810,288	7,013,346
Lease termination and impairment charges	5,022	9,637	7,011	26,753	48,423
Interest expense	123,607	115,410	106,879	103,678	449,574
Loss on debt retirements, net		33,205			33,205
Loss (gain) on sale of assets, net	39	281	3,331	(348)	3,303
	6,616,284	7,626,844	8,046,173	8,168,952	30,458,253
Income before income taxes	31,277	37,932	108,011	101,184	278,404
Income tax expense	12,441	16,463	48,468	35,567	112,939

Net income	$	18,836	$	21,469	$	59,543	$	65,617	$	165,465
Basic income per share(1)	$	0.02	$	0.02	$	0.06	$	0.06	$	0.16
Diluted income per share(1)	$	0.02	$	0.02	$	0.06	$	0.06	$	0.16

(1) Income per share amounts for each quarter may not necessarily total to the yearly income per share due to the weighting of shares outstanding on a quarterly and year-to-date basis.

(2) The interim financial results for the fourth quarter of fiscal 2017 includes 14 weeks.

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RITE AID CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the Years Ended March 4, 2017, February 27, 2016 and February 28, 2015

(In thousands, except per share amounts)

25. Interim Financial Results (Unaudited) (Continued)

During the fourth quarter of fiscal 2017, the Company recorded facilities impairment charges of $30,493 and a LIFO credit of $47,881 due to lower deflation on pharmacy generics as compared to a lower LIFO credit recognized at prior year end due to lower deflation on pharmacy generics.

During the second quarter of 2016, the Company recorded a loss on debt retirement related to the August 2015 redemption of the outstanding 8.00% Notes as discussed in Note 14. During the fourth quarter of fiscal 2016, the Company recorded facilities impairment charges of $16,401 and a LIFO credit of $6,796 due to lower deflation on pharmacy generics as compared to a larger LIFO credit recognized at prior year end caused by lower pharmacy inventory due to its Purchasing and Delivery Arrangement.

26. Financial Instruments

The carrying amounts and fair values of financial instruments at March 4, 2017 and February 27, 2016 are listed as follows:

	2017		2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Variable rate indebtedness	$ 3,368,484	$ 3,404,225	$ 3,027,675	$ 3,025,500
Fixed rate indebtedness	$ 3,894,894	$ 4,152,374	$ 3,886,808	$ 4,210,416

Cash, trade receivables and trade payables are carried at market value, which approximates their fair values due to the short-term maturity of these instruments. In addition, as of March 4, 2017 and February 27, 2016, the Company had $6,874 and $6,069, respectively, of investments carried at amortized cost, as these investments are being held to maturity. As of March 4, 2017, these investments are included as a component of prepaid expenses and other current assets. As of February 27, 2016, these investments are included as a component of other assets. The Company believes the carrying value of these investments approximates their fair value.

The following methods and assumptions were used in estimating fair value disclosures for financial instruments:

LIBOR-based borrowings under credit facilities:

The carrying amounts for LIBOR-based borrowings under the credit facilities, term loans and term notes are estimated based on the quoted market price of the financial instruments.

Long-term indebtedness:

The fair values of long-term indebtedness are estimated based on the quoted market prices of the financial instruments. If quoted market prices were not available, the Company estimated the fair value based on the quoted market price of a financial instrument with similar characteristics.

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RITE AID CORPORATION AND SUBSIDIARIES

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS
For the Years Ended March 4, 2017, February 27, 2016, and February 28, 2015
(dollars in thousands)

Allowances deducted from accounts receivable for estimated uncollectible amounts:	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Deductions	Balance at End of Period
Year ended March 4, 2017	$ 32,820	$ 72,876	$ 74,805	$ 30,891
Year ended February 27, 2016	$ 31,247	$ 71,984	$ 70,411	$ 32,820
Year ended February 28, 2015	$ 26,873	$ 66,319	$ 61,945	$ 31,247

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

RITE AID CORPORATION
By: /s/ JOHN T. STANDLEY

John T. Standley
Chairman and Chief Executive Officer

Dated: May 3, 2017

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in their respective capacities on May 3, 2017.

Signature	Title
/s/ JOHN T. STANDLEY John T. Standley	Chairman, Chief Executive Officer and Director (principal executive officer)
/s/ DARREN W. KARST Darren W. Karst	Chief Financial Officer, Chief Administrative Officer and Senior Executive Vice President (principal financial officer)
/s/ DOUGLAS E. DONLEY Douglas E. Donley	Chief Accounting Officer and Senior Vice President (principal accounting officer)
/s/ JOSEPH B. ANDERSON, JR Joseph B. Anderson, Jr	Director
/s/ BRUCE G. BODAKEN Bruce G. Bodaken	Director
/s/ DAVID R. JESSICK David R. Jessick	Director
/s/ KEVIN E. LOFTON Kevin E. Lofton	Director

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Signature	Title
/s/ MYRTLE S. POTTER Myrtle S. Potter	Director
/s/ MICHAEL N. REGAN Michael N. Regan	Director
/s/ FRANK A. SAVAGE Frank A. Savage	Director
/s/ MARCY SYMS Marcy Syms	Director