OMEGA HEALTHCARE INVESTORS INC
Form 10-Q
August 08, 2008

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

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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 June 30, 2008

or

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

For the transition period from _______________ to _______________

Commission file number 1-11316

OMEGA HEALTHCARE
INVESTORS, INC.
(Exact name of Registrant as specified in its charter)

| Maryland | 38-3041398 |
|---|---|
| (State of incorporation) | (IRS Employer Identification No.) |

9690 Deereco Road, Suite 100, Timonium, MD 21093
(Address of principal executive offices)

(410) 427-1700
(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 o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o Small reporting company o

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of August 1, 2008.

| Common Stock, $.10 par value | 75,705,571 |
|---|---|
| (Class) | (Number of shares) |

OMEGA HEALTHCARE INVESTORS, INC.
FORM 10-Q
June 30, 2008

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PART I – FINANCIAL INFORMATION

Item 1 - Financial Statements

OMEGA HEALTHCARE INVESTORS, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands)

| | June 30, 2008 (Unaudited) | December 31, 2007 |
|---|---|---|
| ASSETS | | |
| Real estate properties | | |
| Land and buildings | $ 1,309,422 | $ 1,274,722 |
| Less accumulated depreciation | (232,625) | (221,366) |
| Real estate properties – net | 1,076,797 | 1,053,356 |
| Mortgage notes receivable – net | 101,343 | 31,689 |
| | 1,178,140 | 1,085,045 |
| Other investments – net | 20,843 | 13,683 |
| | 1,198,983 | 1,098,728 |
| Assets held for sale – net | 17,380 | 2,870 |
| Total investments | 1,216,363 | 1,101,598 |
| | | |
| Cash and cash equivalents | 2,165 | 1,979 |
| Restricted cash | 5,091 | 2,104 |
| Accounts receivable – net | 66,167 | 64,992 |
| Other assets | 16,956 | 11,614 |
| Total assets | $ 1,306,742 | $ 1,182,287 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Revolving line of credit | $ 102,000 | $ 48,000 |
| Unsecured borrowings – net | 484,706 | 484,714 |
| Other long–term borrowings | 1,995 | 40,995 |
| Accrued expenses and other liabilities | 25,100 | 22,378 |
| Income tax liabilities | 73 | 73 |
| Total liabilities | 613,874 | 596,160 |
| | | |
| Stockholders' equity: | | |
| Preferred stock issued and outstanding – 4,740 shares Class D with an aggregate liquidation preference of $118,488 | 118,488 | 118,488 |
| Common stock $.10 par value authorized – 100,000 shares: issued and outstanding – 75,498 shares as of June 30, 2008 and 68,114 as of December 31, 2007 | 7,550 | 6,811 |
| Common stock – additional paid-in-capital | 943,326 | 825,925 |
| Cumulative net earnings | 396,496 | 362,140 |
| Cumulative dividends paid | (772,992) | (727,237) |
| Total stockholders' equity | 692,868 | 586,127 |
| Total liabilities and stockholders' equity | $ 1,306,742 | $ 1,182,287 |

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
Unaudited
(in thousands, except per share amounts)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Revenues | | | | |
| Rental income | $ 39,774 | $ 36,147 | $ 77,787 | $ 76,979 |
| Mortgage interest income | 2,550 | 888 | 3,529 | 1,897 |
| Other investment income – net | 582 | 729 | 1,218 | 1,374 |
| Miscellaneous | 829 | 353 | 2,067 | 490 |
| Total operating revenues | 43,735 | 38,117 | 84,601 | 80,740 |
| | | | | |
| Expenses | | | | |
| Depreciation and amortization | 9,713 | 8,821 | 19,109 | 17,609 |
| General and administrative | 2,971 | 2,765 | 6,065 | 5,338 |
| Impairment loss on real estate properties | - | - | 1,514 | - |
| Provision for uncollectible accounts receivable | 4,268 | - | 4,268 | - |
| Total operating expenses | 16,952 | 11,586 | 30,956 | 22,947 |
| | | | | |
| Income before other income and expense | 26,783 | 26,531 | 53,645 | 57,793 |
| Other income (expense): | | | | |
| Interest income | 58 | 58 | 123 | 98 |
| Interest expense | (9,745) | (10,073) | (19,430) | (21,917) |
| Interest – amortization of deferred financing costs | (500) | (500) | (1,000) | (959) |
| Litigation settlements | 526 | - | 526 | - |
| Total other expense | (9,661) | (10,515) | (19,781) | (22,778) |
| | | | | |
| Income before gain on assets sold | 17,122 | 16,016 | 33,864 | 35,015 |
| Gain on assets sold – net | - | - | 46 | - |
| Income from continuing operations | 17,122 | 16,016 | 33,910 | 35,015 |
| Discontinued operations | - | 34 | 446 | 1,694 |
| Net income | 17,122 | 16,050 | 34,356 | 36,709 |
| Preferred stock dividends | (2,481) | (2,481) | (4,962) | (4,962) |
| Net income available to common | $ 14,641 | $ 13,569 | $ 29,394 | $ 31,747 |
| | | | | |
| Income per common share: | | | | |
| Basic: | | | | |
| Income from continuing operations | $ 0.20 | $ 0.20 | $ 0.41 | $ 0.47 |
| Net income | $ 0.20 | $ 0.20 | $ 0.42 | $ 0.50 |
| Diluted: | | | | |
| Income from continuing operations | $ 0.20 | $ 0.20 | $ 0.41 | $ 0.47 |
| Net income | $ 0.20 | $ 0.20 | $ 0.41 | $ 0.50 |
| | | | | |
| Dividends declared and paid per common share | $ 0.30 | $ 0.27 | $ 0.59 | $ 0.53 |

| | | | | |
|---|---|---|---|---|
| Weighted-average shares outstanding, basic | 72,942 | 67,237 | 70,811 | 63,666 |
| Weighted-average shares outstanding, diluted | 73,038 | 67,261 | 70,893 | 63,690 |
| | | | | |
| Components of other comprehensive income: | | | | |
| Net income | $ 17,122 | $ 16,050 | $ 34,356 | $ 36,709 |
| Total comprehensive income | $ 17,122 | $ 16,050 | $ 34,356 | $ 36,709 |

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Unaudited (in thousands)

| | Six Months Ended June 30, | |
|---|---|---|
| | 2008 | 2007 |
| Operating activities | | |
| Net income | $ 34,356 | $ 36,709 |
| Adjustment to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization (including amounts in discontinued operations) | 19,109 | 17,630 |
| Impairment loss on real estate properties | 1,514 | — |
| Uncollectible accounts receivable | 4,268 | — |
| Amortization of deferred financing costs | 1,000 | 959 |
| Gains on assets sold and equity securities – net | (477) | (1,596) |
| Restricted stock amortization expense | 1,051 | 334 |
| Income from accretion of marketable securities to redemption value | (103) | (103) |
| Other | (94) | (242) |
| Change in operating assets and liabilities: | | |
| Accounts receivable | (2,129) | 17 |
| Straight-line rent | (4,413) | (9,448) |
| Lease inducement | 1,636 | 1,230 |
| Other assets | (882) | (547) |
| Other assets and liabilities | (201) | (2,213) |
| Net cash provided by operating activities | 54,635 | 42,730 |
| | | |
| Cash flows from investing activities | | |
| Acquisition of real estate | (53,235) | — |
| Placement of mortgage loans | (74,928) | (345) |
| Proceeds from sale of real estate investments | 3,027 | 6,254 |
| Capital improvements and funding of other investments | (8,994) | (4,019) |
| Proceeds from other investments | 9,467 | 1,957 |
| Investments in other investments | (16,505) | (5,678) |
| Collection of mortgage principal – net | 448 | 369 |
| Net cash used in investing activities | (140,720) | (1,462) |
| | | |
| Cash flows from financing activities | | |
| Proceeds from credit facility borrowings | 240,800 | 45,400 |
| Payments on credit facility borrowings | (186,800) | (165,400) |
| Payments of other long-term borrowings | (39,000) | — |
| Prepayment of re-financing penalty | — | (692) |
| Receipts/(payments) from dividend reinvestment plan | 20,285 | 7,822 |
| Receipts/(payments) from exercised options and taxes on restricted stock – net | (2,087) | (780) |
| Dividends paid | (45,755) | (38,741) |
| Net proceeds from common stock offering | 98,828 | 112,878 |
| Net cash provided by (used in) financing activities | 86,271 | (39,513) |
| | | |
| Increase in cash and cash equivalents | 186 | 1,755 |
| Cash and cash equivalents at beginning of period | 1,979 | 729 |
| Cash and cash equivalents at end of period | $ 2,165 | $ 2,484 |
| Interest paid during the period, net of amounts capitalized | $ 19,579 | $ 20,566 |

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Unaudited
June 30, 2008

## NOTE 1 – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Business Overview:

We have one reportable segment consisting of investments in real estate (see Note 11- Subsequent Event). Our business is to provide financing and capital to the long-term healthcare industry with a particular focus on skilled nursing facilities located in the United States. Our core portfolio consists of long-term lease and mortgage agreements. All of our leases are "triple-net" leases, which require the tenants to pay all property-related expenses. Our mortgage revenue derives from fixed-rate mortgage loans, which are secured by first mortgage liens on the underlying real estate and personal property of the mortgagor. Substantially all depreciation expenses reflected in the consolidated statements of operations relate to the ownership of our investment in real estate.

Basis of Presentation:

The accompanying unaudited consolidated financial statements for Omega Healthcare Investors, Inc. ("Omega" or the "Company") have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles ("GAAP") in the United States for complete financial statements. In our opinion, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These unaudited consolidated financial statements should be read in conjunction with the financial statements and the footnotes thereto included in our latest Annual Report on Form 10-K.

Our consolidated financial statements include the accounts of Omega, all direct and indirect wholly owned subsidiaries and one variable interest entity ("VIE") for which we are the primary beneficiary. All inter-company accounts and transactions have been eliminated in consolidation of the financial statements.

Reclassifications:

Certain amounts in the prior year have been reclassified to conform to the current year presentation and to reflect the results of discontinued operations. See Note 9 – Discontinued Operations for a discussion of discontinued operations. Such reclassifications have no effect on previously reported earnings or equity.

Accounts Receivables:

Accounts receivable includes: contractual receivables, straight-line rent receivables, lease inducements, net of an estimated provision for losses related to uncollectible and disputed accounts. Contractual receivables relate to the amounts currently owed to us under the terms of the lease agreement. Straight-line receivables relates to the difference between the rental revenue recognized on a straight-line basis and the amounts due to us contractually. Lease inducements result from value provided by us to the lessee at the inception of the lease and will be amortized as a reduction of rental revenue over the lease term. On a quarterly basis, we review the collection of our contractual payments and determine the appropriateness of our allowance for uncollectible contractual rents. In the case of a lease recognized on a straight-line basis, we generally provide an allowance for straight-line accounts receivable when certain conditions or indicators of adverse collectibility are present.

A summary of our net receivables by type is as follows:

| | June 30, 2008 | December 31, 2007 |
|---|---|---|
| | (in thousands) | |
| Contractual receivables | $ 5,771 | $ 5,517 |
| Straight-line receivables | 36,242 | 34,537 |
| Lease inducements | 26,328 | 27,965 |
| Allowance | (2,174) | (3,027) |
| Accounts receivable – net | $ 66,167 | $ 64,992 |

During the three months ended June 30, 2008, we recorded a $4.3 million provision for uncollectible accounts receivable associated with Haven Eldercare, LLC ("Haven") receivables. The $4.3 million charge consisted of $3.3 million to write off straight-line receivables and $1.0 million to establish an allowance for pre-petition contractual receivables associated with one of our tenants.

We continuously evaluate the payment history and financial strength of our operators and have historically established allowance reserves for straight-line rent adjustments for operators that do not meet our requirements. We consider factors such as payment history, the operator's financial condition as well as current and future anticipated operating trends when evaluating whether to establish allowance reserves.

Implementation of New Accounting Pronouncement:

FAS 157 Evaluation

On January 1, 2008, we adopted Financial Accounting Standards Board, ("FASB"), Statement No. 157, Fair Value Measurements ("FAS No. 157"). This standard defines fair value, establishes a methodology for measuring fair value and expands the required disclosure for fair value measurements. FAS No. 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. This statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those pronouncements that fair value is the relevant measurement attribute. Accordingly, this statement does not require any new fair value measurements. The standard applies prospectively to new fair value measurements performed after the required effective dates, which are as follows: (i) on January 1, 2008, the standard applied to our measurements of the fair values of financial instruments and recurring fair value measurements of non-financial assets and liabilities; and (ii) on January 1, 2009, the standard will apply to all remaining fair value measurements, including non-recurring measurements of non-financial assets and liabilities such as measurement of potential impairments of goodwill, other intangible assets and other long-lived assets. It also will apply to fair value measurements of non-financial assets acquired and liabilities assumed in business combinations. On January 18, 2008, the FASB issued proposed FASB Staff Position ("FSP") FAS No. 157-c, Measuring Liabilities under Statement 157, which will modify the definition of fair value by requiring estimation of the proceeds that would be received if the entity were to issue the liability at the measurement date. We evaluated FAS No. 157 and determined that the adoption of the provisions FAS No. 157 effective on January 1, 2008 had no impact on our financial statements. We are currently evaluating the impact, if any, that the provisions of FAS No. 157 that apply on January 1, 2009 will have on our financial statements.

FAS 159 Evaluation

In February 2007, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure certain financial assets and liabilities at fair value, with the change in unrealized gains and losses on items for which the fair value option has been elected and reported in earnings. We adopted SFAS No. 159 on January 1, 2008. We evaluated SFAS No. 159 and did not elect the fair value accounting option for any of our eligible assets; therefore, the adoption of SFAS No. 159 had no impact on our financial statements.

Recent Accounting Pronouncement:

FAS 141(R) Evaluation

On December 4, 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), Business Combinations ("FAS 141(R)"). The new standard will significantly change the accounting for and reporting of business combination transactions. FAS 141(R) requires companies to recognize, with certain exception, 100 percent of the fair value of the assets acquired, liabilities assumed and non-controlling interest in acquisitions of less than a 100 percent controlling interest when the acquisition constitutes a change in control; measure acquirer shares issued as consideration for a business combination at fair value on the date of the acquisition; recognize contingent consideration arrangements at their acquisition date fair value, with subsequent change in fair value generally reflected in earnings; recognition of reacquisition loss and gain contingencies at their acquisition date fair value; capitalize in process research and development assets acquired; expense as incurred, acquisition related transaction costs; capitalize acquisition-related restructuring costs only if the criteria in Financial Accounting Standards Board No. 146, Accounting for Costs associated with Exit or Disposal Activities are met as of the date of the acquisition; and recognizing changes that result from a business combination transaction in an acquirer's existing income tax valuation allowance and tax uncertainty accruals as adjustment to income tax expense. FAS 141(R) is effective for fiscal years beginning after December 15, 2008 and early adoption is prohibited. We intend to adopt the standard on January 1, 2009. We are currently evaluating the impact, if any, FAS 141(R) will have on our financial statements.

NOTE 2 –PROPERTIES

In the ordinary course of our business activities, we periodically evaluate investment opportunities and extend credit to customers. We also regularly engage in lease and loan extensions and modifications. Additionally, we actively monitor and manage our investment portfolio with the objectives of improving credit quality and increasing investment returns. In connection with portfolio management, we may engage in various collection and foreclosure activities.

If we acquire real estate pursuant to a foreclosure, lease termination or bankruptcy proceeding and do not immediately re-lease or sell the properties to new operators, the assets will be included on the balance sheet as "foreclosed real estate properties," and the value of such assets is reported at the lower of cost or estimated fair value.

Leased Property

Our leased real estate properties, represented by 232 long-term care facilities and four rehabilitation hospitals at June 30, 2008, are leased under provisions of single leases and master leases with initial terms typically ranging from 5 to 15 years, plus renewal options. Substantially all of our leases contain provisions for specified annual increases over the rents of the prior year and are generally computed in one of three methods depending on specific provisions of each lease as follows: (i) a specific annual percentage increase over the prior year's rent, generally 2.5%; (ii) an increase based on the change in pre-determined formulas from year to year (i.e., such as increases in the Consumer Price Index ("CPI")); or (iii) specific dollar increases over prior years. Under the terms of the leases, the lessee is

responsible for all maintenance, repairs, taxes and insurance on the leased properties.

During the second quarter of 2008, we purchased nine skilled nursing facilities ("SNFs") for $47.4 million from an unrelated third party and leased the facilities to an existing tenant of ours. The facilities were added to the tenant's existing master lease and will increase cash rent by $4.7 million annually. The $47.4 million acquisition price was allocated $6.6 million to land, $38.9 million to building and $1.9 million to personal property.

During the first quarter of 2008, we purchased one SNF for $5.2 million from an unrelated third party and leased the facility to an existing tenant of ours. The facility was added to the tenant's existing master lease and will increase cash rent by $0.5 million annually. The $5.2 million acquisition price was allocated $0.4 million to land, $4.5 million to building and $0.3 million to personal property.

During the second quarter of 2008, we amended our master lease with an existing operator primarily to: i) extend the lease term of the agreement through December 2019; and ii) allow for the additional capital investment of up to $5 million; and iii) allow the operator the ability to exit or lease three facilities to another operator during the lease term.

During the second quarter of 2008, we amended our single facility lease agreement with an existing operator primarily to: i) to extend the lease term from August 2013 to June 2018; and ii) to increase the rent from $0.8 million to $1.0 million annually beginning July 1, 2008.

During the first quarter of 2008, we amended our master lease with an existing operator to allow for the construction of a new facility to replace an existing facility currently operated by the operator. Upon completion (estimated to be in mid-2009), annual cash rent will increase by approximately $0.7 million. As a result of our plan to replace the existing facility, we recorded a $1.5 million impairment loss on the existing facility during the first quarter of 2008 to record it at its estimated fair value.

On February 1, 2008, we amended our master lease with an existing operator and certain of its affiliates primarily to: i) consolidate three existing master leases into one master lease; ii) extend the lease term of the agreement through September 2017 for facilities acquired in August 2006; and iii) allow for the sale of two rehabilitation hospitals currently operated by the operator.

Since November 2007, affiliates of one of our operators/lessees/mortgagors (collectively, "Haven"), have operated under Chapter 11 bankruptcy protection. Commencing in February 2008, the assets of Haven were marketed for sale via an auction process to be conducted through proceedings established by the bankruptcy court. The auction process failed to produce a qualified buyer. In 2007, Haven represented approximately 8% of our operating revenue. As of June 30, 2008, our investment in Land and buildings for the Haven properties was approximately $103.3 million. See Note 11 for information regarding subsequent events regarding our Haven portfolio.

In January 2008, Haven entered into a debtors-in-possession ("DIP") financing agreement with us and one other financial institution (collectively, the "DIP Lenders"), in which our initial participation was approximately $5.0 million of a $50 million total commitment. The agreement was originally scheduled to mature in June 2008 and yield an interest rate of prime plus 3%. On June 4, 2008, the DIP Lenders and Haven amended the DIP agreement (the "Amended DIP") which, among other things, extended the term to allow Haven additional time to sell its assets. As collateral for the Amended DIP, we received the right to use all facility accounts receivable generated from the Omega facilities from June 4, 2008 to satisfy any of our post-June 3, 2008 advances. As of June 30, 2008, we had $0.6 million outstanding on the original DIP agreement and $8.7 million related to the Amended DIP.

Assets Sold or Held for Sale

Assets Sold

- On January 31, 2008, we sold one SNF in California for approximately $1.5 million resulting in a gain of approximately $0.4 million, which was included in our gain/loss from discontinued operations. For additional information, see Note 9 – Discontinued Operations.

- On February 1, 2008, we sold a SNF in California for approximately $1.5 million resulting in a gain of approximately $46 thousand.

Held for Sale

At June 30, 2008, we had two SNFs and two rehabilitation hospitals classified as held-for-sale with a net book value of approximately $17.4 million.

Mortgage Notes Receivable

On April 18, 2008, and simultaneous with the amendment and extension of the master lease with CommuniCare Health Services ("CommuniCare"), we entered into a first mortgage loan with CommuniCare in the amount of $74.9 million. This mortgage loan matures on April 30, 2018 and carries an interest rate of 11% per year. CommuniCare used the proceeds of the mortgage loan to acquire seven (7) SNFs located in Maryland, totaling 965 beds from several unrelated third parties. The mortgage loan is secured by a lien on the seven (7) facilities. At the closing, $4.9 million of loan proceeds were escrowed pending CommuniCare's acquisition of an additional 90 bed SNF, also located in Maryland. The loan proceeds held in escrow are included in Other assets as of June 30, 2008. We anticipate that CommuniCare will acquire this facility within eight months upon the satisfaction of certain contingencies, including the granting of a lien on such facility to secure the mortgage loan. If the additional facility is not acquired, CommuniCare will be obligated to re-pay the $4.9 million of escrowed loan proceeds.

Mortgage notes receivable relate to 16 long-term care facilities. The mortgage notes are secured by first mortgage liens on the borrowers' underlying real estate and personal property. The mortgage notes receivable relate to facilities located in five (5) states, operated by five (5) independent healthcare operating companies. We monitor compliance with mortgages and when necessary have initiated collection, foreclosure and other proceedings with respect to certain outstanding loans. As of June 30, 2008, we had no foreclosed property, and none of our mortgages were in foreclosure proceedings. The mortgage properties are cross-collateralized with the master lease agreement.

Mortgage interest income is recognized as earned over the terms of the related mortgage notes. Allowances are provided against earned revenues from mortgage interest when collection of amounts due becomes questionable or when negotiations for restructurings of troubled operators lead to lower expectations regarding ultimate collection. When collection is uncertain, mortgage interest income on impaired mortgage loans is recognized as received after taking into account application of security deposits.

NOTE 3 – CONCENTRATION OF RISK

As of June 30, 2008, our portfolio of investments consisted of 252 healthcare facilities, located in 29 states and operated by 26 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately $1.4 billion at June 30, 2008, with approximately 98% of our real estate investments related to long-term care facilities. This portfolio is made up of 230 long-term healthcare facilities, two

rehabilitation hospitals owned and leased to third parties, fixed rate mortgages on 16 long-term healthcare facilities, and two rehabilitation hospitals and two long-term healthcare facility that are currently held for sale. At June 30, 2008, we also held miscellaneous investments of approximately $21 million, consisting primarily of secured loans to third-party operators of our facilities.

At June 30, 2008, approximately 26% of our real estate investments were operated by two public companies: Sun Healthcare Group ("Sun") (16%) and Advocat Inc. ("Advocat") (10%). Our largest private company operators (by investment) were CommuniCare (22%), Signature Holding II, LLC (10%). No other operator represents more than 9% of our investments. The three states in which we had our highest concentration of investments were Ohio (23%), Florida (12%) and Pennsylvania (8%) at June 30, 2008.

For the three-month period ended June 30, 2008, our revenues from operations totaled $43.7 million, of which approximately $8.4 million were from CommuniCare (19%), $8.2 million from Sun (19%) and $5.1 million from Advocat (12%). No other operator generated more than 10% of our revenues from operations for the three-month period ended June 30, 2008.

For the six-month period ended June 30, 2008, our revenues from operations totaled $84.6 million, of which approximately $16.3 million were from Sun (19%), $13.7 million from CommuniCare (16%) and $10.2 million from Advocat (12%). No other operator generated more than 10% of our revenues from operations for the six- month period ended June 30, 2008.

Sun and Advocat are subject to the reporting requirements of the Security Exchange Commission ("SEC") and are required to file with the SEC annual reports containing audited financial information and quarterly reports containing unaudited interim financial information. Sun and Advocat's filings with the SEC can be found at the SEC's website at www.sec.gov. We are providing this data for information purposes only, and you are encouraged to obtain Sun's and Advocat's publicly available filings from the SEC.

NOTE 4 –DIVIDENDS

Common Dividends

On July 16, 2008, the Board of Directors declared a common stock dividend of $0.30 per share, to be paid August 15, 2008 to common stockholders of record on July 31, 2008.

On April 16, 2008, the Board of Directors declared a common stock dividend of $0.30 per share, an increase of $0.01 per common share compared to the prior quarter. The common dividend was paid May 15, 2008 to common stockholders of record on April 30, 2008.

On January 17, 2008, the Board of Directors declared a common stock dividend of $0.29 per share, an increase of $0.01 per common share compared to the prior quarter. The common dividend was paid February 15, 2008 to common stockholders of record on January 31, 2008.

Series D Preferred Dividends

On July 16, 2008, the Board of Directors declared the regular quarterly dividends for the 8.375% Series D Cumulative Redeemable Preferred Stock ("Series D Preferred Stock") to stockholders of record on July 31, 2008. The stockholders of record of the Series D Preferred Stock on July 31, 2008 will be paid dividends in the amount of $0.52344 per preferred share on August 15, 2008. The liquidation preference for our Series D Preferred Stock is $25.00 per share. Regular quarterly preferred dividends for the Series D Preferred Stock represent dividends for the period May 1, 2008 through July 31, 2008.

On April 16, 2008, the Board of Directors declared regular quarterly dividends of approximately $0.52344 per preferred share on the Series D Preferred Stock that were paid May 15, 2008 to preferred stockholders of record on April 30, 2008.

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On January 17, 2008, the Board of Directors declared regular quarterly dividends of approximately $0.52344 per preferred share on the Series D Preferred Stock that were paid February 15, 2008 to preferred stockholders of record on January 31, 2008.

NOTE 5 – TAXES

So long as we qualify as a real estate investment trust (“REIT”) under the Internal Revenue Code (the “Code”), we generally will not be subject to federal income taxes on the REIT taxable income that we distribute to stockholders, subject to certain exceptions. On a quarterly and annual basis we test our compliance within the REIT taxation rules to ensure that we were in compliance with the rules.

Subject to the limitation under the REIT asset test rules, we are permitted to own up to 100% of the stock of one or more taxable REIT subsidiary (“TRSs”). Currently, we have one TRS that is taxable as a corporation and that pays federal, state and local income tax on its net income at the applicable corporate rates. The TRS had a net operating loss carry-forward as of June 30, 2008 of $1.1 million. The loss carry-forward was fully reserved with a valuation allowance due to uncertainties regarding realization.

NOTE 6 – STOCK-BASED COMPENSATION

The following is a summary of our stock based compensation expense for the three- and six- month periods ended June 30, 2008 and 2007, respectively:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| | (in thousands) | | | |
| Stock based compensation cost | $ 525 | $ 309 | $ 1,051 | $ 335 |

2007 Stock Awards

In May 2007, we granted 286,908 shares of restricted stock and 247,992 performance restricted stock units (“PRSU”) to five executive officers under the 2004 Plan Stock Incentive Plan (the “2004 Plan”).

Restricted Stock Award

The restricted stock award vests one-seventh on December 31, 2007 and two-sevenths on December 31, 2008, December 31, 2009, and December 31, 2010, respectively, subject to continued employment on the vesting date (as defined in the agreements filed with the SEC on May 8, 2007). As of June 30, 2008, 40,987 shares of restricted stock have vested under the restricted stock award.

Performance Restricted Stock Units

We awarded two types of PRSUs (annual and cliff vesting awards) to the five executives. One half of the PRSU awards vest annually in equal increments on December 31, 2008, December 31, 2009, and December 31, 2010, respectively. The other half of the PRSU awards cliff vest on December 31, 2010. Vesting on both types of awards requires achievement of total shareholder return (as defined in the agreements filed with the SEC on May 8, 2007).

The following table summarizes our total unrecognized compensation cost associated with the restricted stock awards and PRSUs awarded in May 2007 as of June 30, 2008:

| | Shares/ Units | Grant Date Fair Value Per Unit/ Share | Total Compensation Cost | Weighted Average Period of Expense Recognition (in months) | Unrecognized Compensation Cost |
|---|---|---|---|---|---|
| | (in thousands, except share and per share amounts) | | | | |
| Restricted stock | 286,908 | $ 17.06 | $ 4,895 | 44 | $ 3,337 |
| 2008 Annual performance restricted stock units | 41,332 | 8.78 | 363 | 20 | 109 |
| 2009 Annual performance restricted stock units | 41,332 | 8.25 | 341 | 32 | 192 |
| 2010 Annual performance restricted stock units | 41,332 | 8.14 | 336 | 44 | 229 |
| 3 year cliff vest performance restricted stock units | 123,996 | 6.17 | 765 | 44 | 522 |
| Total | 534,900 | | $ 6,700 | | $ 4,389 |

As of June 30, 2008, we had 27,664 stock options and 16,495 shares of restricted stock outstanding to directors. The stock options were fully vested as of January 1, 2007 and the restricted shares are scheduled to vest over the next three years. As of June 30, 2008, the unrecognized compensation cost associated with the directors' restricted stock is $0.2 million.

NOTE 7 – FINANCING ACTIVITIES AND BORROWING ARRANGEMENTS

Bank Credit Agreements

At June 30, 2008, we had $102.0 million outstanding under our $255 million revolving senior secured credit facility (the "Credit Facility") and $2.1 million was utilized for the issuance of letters of credit, leaving availability of $150.9 million. The $102.0 million of outstanding borrowings had a blended interest rate of 3.55% at June 30, 2008.

Pursuant to Section 2.01 of the Credit Agreement, dated as of March 31, 2006 (the "Credit Agreement"), that governs our Credit Facility, we were permitted under certain circumstances to increase our available borrowing base under the Credit Agreement from $200 million up to an aggregate of $300 million. Effective February 22, 2007, we exercised our right to increase the available revolving commitment under Section 2.01 of the Credit Agreement from $200 million to $255 million and we consented to add additional properties to the borrowing base assets under the Credit Agreement.

Our long-term borrowings require us to meet certain property level financial covenants and corporate financial covenants, including prescribed leverage, fixed charge coverage, minimum net worth, limitations on additional indebtedness and limitations on dividend payouts. As of June 30, 2008, we were in compliance with all property level and corporate financial covenants.

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Other Long-Term Borrowings

In January 2008, we purchased from General Electric Capital Corporation ("GE Capital") a $39.0 million mortgage loan on seven facilities operated by Haven Eldercare, LLC ("Haven") due October 2012. Prior to the acquisition of this mortgage, we had a $22.8 million second mortgage on these facilities. At June 30, 2008, we held a combined $61.8 million mortgage on these facilities and an option to purchase these facilities. Exercising the purchase option would have resulted in the seven facilities being combined with an eight facility master lease agreement with Haven. In conjunction with the above–noted mortgage and purchase option and the application of Financial Accounting Standards Board Interpretation No. 46R, Consolidation of Variable Interest Entities, ("FIN 46R"), we have historically and continue to consolidate the financial statements and real estate of this Haven entity into our financial statements. The impact of consolidating this Haven entity resulted in the following adjustments to our consolidated balance sheet as of June 30, 2008: (i) an increase in Land and buildings of $61.8 million; (ii) an increase in accumulated depreciation of $3.9 million; (iii) a decrease in Mortgage notes receivable – net of $61.8 million; and (iv) a reduction of $3.9 million in Cumulative net earnings due to increased depreciation expense. The impact of consolidating the Haven entity resulted in the following adjustments to our consolidated balance sheet as of December 31, 2007: (i) an increase in total gross investments of $39.0 million; (ii) an increase in accumulated depreciation of $3.1 million; (iii) an increase in Accounts receivable – net of $0.4 million; (iv) an increase in Other long-term borrowings of $39.0 million; and (v) a reduction of $2.7 million in Cumulative net earnings primarily due to increased depreciation expense. Our results of operation reflect the impact of the consolidation of this Haven entity for the three- and six- month periods ended June 30, 2008 and 2007, respectively. See Note 2 – Leased Properties for information regarding subsequent events related to Haven.

5.9 Million Share Common Stock Offering

On May 6, 2008, we issued 5.9 million shares of our common stock in a registered direct placement to a number of institutional investors. The net proceeds from the offering were approximately $98.8 million, after deducting the placement agent's fee and other estimated offering expense. Cohen & Steers Capital Advisors, LLC acted as Placement Agent for the offering. The net proceeds were used to repay indebtedness under our senior credit facility.

Dividend Reinvestment and Common Stock Purchase Plan

We have a Dividend Reinvestment and Common Stock Purchase Plan (the "DRSPP") that allows for the reinvestment of dividends and the optional purchase of our common stock. We currently offer shares under the DRSPP at a 1% discount to market. For the six month period ended June 30, 2008, we issued 1,232,966 shares of common stock for approximately $20.3 million in net proceeds.

NOTE 8 – LITIGATION

We are subject to various legal proceedings, claims and other actions arising out of the normal course of business. While any legal proceeding or claim has an element of uncertainty, management believes that the outcome of each lawsuit, claim or legal proceeding that is pending or threatened, or all of them combined, will not have a material adverse effect on our consolidated financial position or results of operations.

NOTE 9 – DISCONTINUED OPERATIONS

Statement of Financial Accounting Standards ("SFAS") No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, requires the presentation of the net operating results of facilities classified as discontinued operations for all periods presented.

The following table summarizes the results of operations of facilities sold or held-for-sale during the three- and six-month periods ended June 30, 2008 and 2007, respectively.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| | (in thousands) | | | |
| Revenues | | | | |
| Rental income | $ — | $ 45 | $ 15 | $ 122 |
| Expenses | | | | |
| Depreciation and amortization | — | 10 | — | 21 |
| General and administrative | — | — | — | 3 |
| Provision for impairment | — | — | — | — |
| Subtotal expenses | — | 10 | — | 24 |
| Income before gain (loss) on sale of assets | — | 35 | 15 | 98 |
| (Loss) gain on assets sold – net | — | (1) | 431 | 1,596 |
| Discontinued operations | $ — | $ 34 | $ 446 | $ 1,694 |

During the second quarter of 2008, no revenue or expense was generated from discontinued operations. The second quarter 2007 discontinued operations revenue and expense includes revenue and expense from one SNF sold during the first quarter of 2008.

For the six months ended June 30, 2008, discontinued operations includes revenue of $15 thousand for one SNF located in California that was sold during the first quarter of 2008, generating a gain of $0.4 million. For the six months ended June 30, 2007, discontinued operations include revenue and expense from three facilities that have been sold, including revenue from the SNF sold during the first quarter of 2008. In 2007, we recorded a gain of $1.6 million for the sale of six facilities.

NOTE 10 – EARNINGS PER SHARE

We calculate basic and diluted earnings per common share (“EPS”) in accordance with FAS No. 128, Earnings Per Share. The computation of basic EPS is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding during the relevant period. Diluted EPS is computed using the treasury stock method, which is net income divided by the total weighted-average number of common outstanding shares plus the effect of dilutive common equivalent shares during the respective period. Dilutive common shares reflect the assumed issuance of additional common shares pursuant to certain of our share-based compensation plans, including stock options, restricted stock and performance restricted stock units.

The following tables set forth the computation of basic and diluted earnings per share:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| | (in thousands, except per share amounts) | | | |
| Numerator: | | | | |
| Income from continuing operations | $ 17,122 | $ 16,016 | $ 33,910 | $ 35,015 |
| Preferred stock dividends | (2,481) | (2,481) | | |